APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

HARRY C. CALCUTT III, *Petitioner* *v.* FEDERAL DEPOSIT INSURANCE CORPORATION, *Respondent*	No. 20-4303

On Petition for Review of an Order of the Federal Deposit Insurance Corporation;
Nos. FDIC-12-568e; FDIC-13-115k.

Argued: October 20, 2021

Decided and Filed: June 10, 2022

Before: BOGGS, GRIFFIN, and MURPHY, Circuit Judges.

COUNSEL

ARGUED: Sarah M. Harris, WILLIAMS & CONNOLLY LLP, Washington, D.C., for Petitioner. Michelle Ognibene, FEDERAL DEPOSIT INSURANCE CORPORATION, Arlington, Virginia, for Respondent. **ON BRIEF:** Sarah M. Harris, Ryan T. Scarborough, William B. Snyderwine, Helen E. White, WILLIAMS & CONNOLLY LLP, Washington, D.C., Barry D. Hovis, MUSICK, PEELER & GARRETT LLP, San Francisco, California, for Petitioner. Michelle Ognibene, John Guarisco, FEDERAL DEPOSIT INSURANCE CORPORATION, Arlington, Virginia, for Respondent. John M. Masslon II, WASHINGTON LEGAL FOUNDATION, Washington, D.C., Ilya Shapiro, CATO INSTITUTE, Washington, D.C., Michael Pepson, AMERICANS FOR PROSPERITY FOUNDATION, Arlington, Virginia, Andrew J. Pincus, MAYER BROWN LLP, Washington, D.C., Robert D. Nachman, BARACK FERRAZZANO KIRSCHBAUM & NAGELBERG LLP, Chicago, Illinois, for Amici Curiae.

BOGGS, J., delivered the opinion of the court in which GRIFFIN, J., joined. MURPHY, J.(pp. 54–91), delivered a separate dissenting opinion.

OPINION

BOGGS, Circuit Judge. Harry C. Calcutt III, a bank executive and director, petitions for review of an order issued by the Federal Deposit Insurance Corporation ("FDIC") that removes him from his position, prohibits him from participating in the conduct of the affairs of any insured depository institution, and imposes civil money penalties. In addition to attacking the conduct and findings in his individual proceedings, he also brings several constitutional challenges to the appointments and removal restrictions of FDIC officials.

His first hearing in these proceedings occurred before an FDIC administrative law judge ("ALJ") in 2015. Before the ALJ released his recommended decision, the

Supreme Court decided *Lucia v. SEC*, 138 S. Ct. 2044 (2018), which invalidated the appointments of similar ALJs in the Securities and Exchange Commission ("SEC"). The FDIC Board of Directors then appointed its ALJs anew, and in 2019 a different FDIC ALJ held another hearing in Calcutt's matter and ultimately recommended penalties.

Broadly, Calcutt's claims fall into two categories. First, he brings structural constitutional challenges, contending that: The FDIC Board of Directors is unconstitutionally shielded from removal by the President; the FDIC ALJs who oversee enforcement proceedings are also unconstitutionally insulated from removal; and the second hearing before a different ALJ failed to afford him a "new hearing," as mandated by *Lucia*. In his second group of challenges, Calcutt attacks the procedure used and results reached in his post-*Lucia* adjudication. He begins by contending that the ALJ abused his discretion by curtailing cross-examination about bias of the witnesses. He then argues that the FDIC Board failed to find that he had committed misconduct that caused "effects" for Northwestern Bank, as the governing statute, 12 U.S.C. § 1818(e)(1), requires. *See Dodge v. Comptroller of Currency*, 744 F.3d 148, 152 (D.C. Cir. 2014).

We deny his petition. Calcutt's challenges to the removal restrictions at the FDIC are unavailing, because even if he were to establish a constitutional violation, he has not shown that he is entitled to relief. *See Collins v. Yellen*, 141 S. Ct. 1761, 1789 (2021). We also conclude that his 2019 hearing satisfied *Lucia*'s mandate. As for the limits on cross-examination at that hearing, any error committed by the ALJ was harmless. Finally, there is substantial evidence in the record to support the FDIC Board's findings regarding the elements of § 1818(e)(1).

I. BACKGROUND

A. Overview of FDIC Enforcement Proceedings

Among other functions, the FDIC conducts examinations and investigations to ensure banks' safety, soundness, and compliance with statutes and regulations. *See* 12 U.S.C. § 1811. It has the authority to impose a range of enforcement remedies. *Id.* § 1818. These include removal and prohibition orders, in which the FDIC orders "an institution-affiliated party" to be removed from office or "prohibit[s] any further participation by such party, in any manner, in the conduct of the affairs of any insured depository institution." *Id.* § 1818(e)(1). An institution-affiliated party includes "any director, officer, employee, or controlling stockholder (other than a bank holding company or savings and loan holding company) of, or agent for, an insured depository institution." *Id.* § 1813(u)(1).

Section 8(e) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1818(e), as amended by the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA"), P.L. No. 101-73, § 903, 103 Stat. 183, 453–54 (1989), provides that FDIC may remove an institution-affiliated party from office or prohibit the party from participating in conducting the affairs of any insured institution upon establishing three elements: "(1) the banker committed an improper act; (2) the act had an impermissible effect, either an adverse effect on the bank or a benefit to the actor; and (3) the act was accompanied by a culpable state of mind." *De la Fuente v. FDIC*, 332 F.3d 1208, 1222 (9th Cir. 2003). First, the Board of Directors of the FDIC ("FDIC Board" or "Board") must find that the party has committed misconduct, including engaging in "any unsafe or unsound practice in connection with any insured depository institution" or committing "any act, omission, or practice which constitutes a breach of such party's fiduciary duty." 12 U.S.C. § 1818(e)(1)(A)(ii)–(iii). Second, the Board must find that at least one requisite effect has occurred, i.e., that "by reason of" the party's action, the insured depository institution "has suffered or will probably suffer financial loss or other damage," its depositors have been or could be prejudiced, or the party has received financial gain or other benefit. *Id.* § 1818(e)(1)(B). Finally, the party must have had a culpable state of mind: The violation must be one that "involves personal dishonesty" or "demonstrates willful or continuing disregard by such party for the safety or soundness of such insured depository institution." *Id.* § 1818(e)(1)(C).

The FDIC may also issue civil money penalties ("CMPs") under a similar test. *See* 12 U.S.C. § 1818(i)(2). As relevant here, the agency may impose a "second tier" penalty of $25,000 per day of violation when a party "recklessly engages in an unsafe or unsound practice in conducting the affairs of [an] insured depository institution" or "breaches any fiduciary duty," and that action "is part of a pattern of misconduct," causes more than minimal loss to the institution, or benefits the institution-affiliated party. *Id.* § 1818(i)(2)(B).

To commence these enforcement proceedings, the FDIC first serves the party with a notice of intention to remove the party from office and/or prohibit that party from participating in other insured depository institutions. *See id.* § 1818(e)(1); *see also id.* § 1818(i)(2)(E)(i) (requiring notice for civil money penalty). The notice must contain a statement of facts establishing grounds for the removal and indicate a time and place for a hearing. *Id.* § 1818(e)(4). The institution-affiliated party may then appear at the hearing to contest the notice; failure to appear constitutes consent to the order. *Ibid.*

An ALJ conducts the adversarial hearing in accordance with the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 551–559. *See* 12 U.S.C. § 1818(h)(1) (requiring hearings to be "conducted in accordance with the provisions of chapter 5 of Title 5"). Under the applicable regulations, an ALJ presiding over a removal proceeding has "all powers necessary to conduct a proceeding in a fair and impartial manner and to avoid unnecessary delay," 12 C.F.R. § 308.5(a), including the power to "receive relevant evidence and to rule upon the admission of evidence and offers of proof," *id.* § 308.5(b)(3); "[t]o consider and rule upon all procedural and other motions appropriate in an adjudicatory proceeding . . . ," *id.* § 308.5(b)(7); and "[t]o prepare and present to the Board of Directors a recommended decision," *id.* § 308.5(b)(8).

The regulations also provide that evidence that would be admissible under the Federal Rules of Evidence is admissible in adjudicatory proceedings, *id.* § 308.36(a)(2), and that except as otherwise provided, "relevant, material, and reliable evidence that is not unduly repetitive is admissible to the fullest extent authorized by the Administrative Procedure Act and other applicable law," *id.* § 308.36(a)(1). If evidence meets this latter standard but would be inadmissible under the Federal Rules of Evidence, the ALJ may not deem the evidence inadmissible. *Id.* § 308.36(a)(3).

After the hearing, the ALJ must file and certify a record of the proceeding, including a recommended decision, recommended findings of fact, recommended conclusions of law, and a proposed order. *Id.* § 308.38(a). A party then has thirty days to file written exceptions for the FDIC Board's review objecting to particular matters or omissions in the ALJ's recommendations, but a failure to file an exception on a particular matter is treated as a waiver of that objection, and the Board need not consider any such objections that were not initially raised before the ALJ. *Id.* § 303.39.

The Board then reviews the ALJ's recommendations and issues a final decision. *Id.* § 308.40. Its review is "based upon review of the entire record of the proceedings," although it may limit its review to those arguments and exceptions that were raised by the parties. *Id.* § 308.40(c)(1). After the Board's final decision, a party may petition for review in the United States Court of Appeals for the District of Columbia Circuit or the circuit in which the institution's home office is located. 12 U.S.C. § 1818(h)(2).

B. FDIC Composition and Structure

The FDIC Board consists of five members: the Comptroller of the Currency, the Director of the Consumer Financial Protection Bureau ("CFPB"), and three additional directors who are appointed by the President with the advice and consent of the Senate. 12 U.S.C. § 1812(a)(1). The Comptroller of the Currency and the CFPB Director are also appointed by the President with Senate advice and consent. *Id.* § 2 (Comptroller of the Currency); *id.* § 5491(b)(2) (CFPB Director). The Board also incorporates a measure of partisan balancing, with a maximum of three directors permitted to be members of the same political party. *Id.* § 1812(a)(2).

The three members of the Board not appointed by virtue of another office serve fixed terms, and the parties agree that they are not removable at will. During the proceedings before the ALJs in this case, the CFPB Director also enjoyed for-cause protection from removal under 12 U.S.C. § 5491(c)(3); however, before the Board issued its final order, the Supreme Court held this removal restriction to be unconstitutional. *Seila Law LLC v. Consumer Fin. Prot. Bureau*, 140 S. Ct. 2183 (2020). The Comptroller of the Currency's term lasts for five years "unless sooner removed by the President, upon reasons to be communicated by him to the Senate," and Calcutt concedes that this provision provides for at-will removal. 12 U.S.C. § 2. In practice, however, the FDIC Board has had several vacancies during the proceedings in Calcutt's case; additionally, at least one board member continued to serve after his term expired until a successor was appointed. *See* 12 U.S.C. § 1812(c)(3) (providing for continuation of service of appointed members after expiration of term before a successor is appointed).

The ALJs who hear FDIC removal and prohibition proceedings are part of a pool housed in the Office of Financial Institution Adjudication ("OFIA"), an interagency body established by FIRREA that presides over enforcement proceedings brought by the FDIC, the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), and the National Credit Union Administration ("NCUA"). *See* FIRREA § 916, 103 Stat. 183, 486–87 (codified at 12 U.S.C. §1818 note); 12 C.F.R. § 308.3 (defining OFIA as "the executive body charged with overseeing the administration of administrative enforcement proceedings" of OCC, FRB, FDIC, and NCUA).[1] These agencies signed an agreement that provides for cost-sharing and specifies that the FDIC is the "Host Agency," responsible for the employment of an office staff consisting of ALJs and administrative employees. *See* Ex. L to Emergency Motion for Stay Pending Review, at 1–6. The agreement also states: "Any change to the Office Staff personnel shall be subject to the prior written approval of all Agencies." *Id.* at 3. Two ALJs currently make up the pool in OFIA. *See Our Judges*, Office of Financial Institution Adjudication, https://www.ofia.gov/who-we-are/our-judges.html (last visited May 24, 2022).

Until *Lucia*, these ALJs were not appointed by the FDIC. After the Supreme Court held in *Lucia* that SEC ALJs were officers who must be appointed by the President, a court of law, or a head of department, *see* 138 S. Ct. at 2051–54, the FDIC Board then newly appointed the same ALJs without conceding that their previous appointments had been unconstitutional. The FDIC ALJs may only be removed "for good cause" determined by the Merit Systems Protection Board ("MSPB") on the record after an opportunity for a hearing. 5 U.S.C. § 7521(a). Members of the MSPB, in turn, may be removed by the President "only for inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d).

C. Calcutt's Actions at Northwestern Bank

With this background, we turn to the facts of the present case. Calcutt was the President, CEO, and Chairman

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[1] Initially, the Office of Thrift Supervision served as "host agency" for OFIA, but that agency's responsibilities were transferred to FRB, OCC, and FDIC in Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No 111-203, 124 Stat. 1376 (2010).

of the Board of Directors of Northwestern Bank (the "Bank"), which had its principal place of business in Traverse City, Michigan. He also served as a member of the Bank's senior loan committee and as CEO of the Bank's holding company, Northwestern Bancorp. The Bank was an insured state nonmember bank subject to the FDI Act, as well as associated regulations and Michigan state laws. Calcutt retired from his positions at the Bank in 2013 and now serves as the Chairman of State Savings Bank in Michigan and its holding company. Northwestern Bank was purchased by a competitor in 2014.

Under the Bank's management structure, twenty employees reported directly to Calcutt, including Richard Jackson, an Executive Vice President and board member. A commercial-loan officer named William Green also worked for the Bank.

By 2009, the Bank's largest loan relationship was with a group of nineteen limited liability companies controlled by the Nielson family (the "Nielson Entities"). These businesses' activities involved development of real estate, holding vacant and developed real estate, and holding oil and gas interests. At that time, the Bank's loans to the Nielson Entities (the "Nielson Loans") amounted to approximately $38 million. The value of the Nielson Entities' holdings during this time was approximately $112 million, with $7–9 million in cash or cash equivalents, and $80 million available in real estate or oil and gas assets that could be used for collateral or loan-payment purposes.

As early as 2008, FDIC examiners identified several of the Nielson Entities as a single borrower and identified the Bank's loans to these businesses as a "concentration of credit"—defined as a lending relationship that exceeds twenty-five percent of a bank's Tier 1 capital. Although in practice the Nielsons could use cash derived from one entity to pay the loans of another entity, the loans were not cross-collateralized, meaning that the collateral in one Nielson Entity did not secure loans to other Nielson Entities, despite the common control. Neither were the loans supported by personal guarantees: If a Nielson Entity failed, the Bank could not compel the Nielsons to personally satisfy the obligation. Loans lacking personal guarantees were considered to be an exception to the Bank's commercial-loan policy.

In April 2008, Calcutt and Green met Cori Nielson, one of the managers of the limited-liability company that managed the Nielson Entities, and Autumn Berden, the chief financial officer of that company. Calcutt and Green requested that the Nielsons stop reporting transfers between Nielson Entities as intercompany loans on their balance sheets; instead, the bankers recommended that when an entity needed funds, another entity should distribute funds to its members, who could then loan or give the funds to the cash-strapped entity. Such a payment mechanism would not be reported to regulators as an intercompany transfer and would conceal the Nielson Entities' "common use of funds." According to the FDIC, over the following months this strategy also masked the interrelationship of the Nielson Entities and hid loans to Entities that had no positive cash flow by routing funds through other actors in the Nielson group.

The relationship between the Bank and the Nielsons began to deteriorate during the Great Recession. Although in May 2009 several of the Nielson Entities wrote to Calcutt stating that they had sufficient cash flow for debt service, by August multiple loans were past due.

More were scheduled to mature on September 1. On August 10, Berden told the Bank that the Nielson Entities would need to restructure their loans, and on August 21, Cori Nielson made a similar communication. The Bank did not oblige, and the Nielson Entities stopped paying their loans on September 1.

Over the following months, the Nielsons and the Bank continued to negotiate, but their efforts were fruitless. The Nielsons sought measures such as debt forbearance, reduction of loan payments, or deeds in lieu of foreclosure,[2] because ongoing problems in the real-estate market had diminished their ability to repay existing debts. Calcutt, on the other hand, later testified that he thought that the Nielsons were "posturing" and possessed sufficient funds to pay their loans. The Bank attempted to convince the Nielsons to refinance and provide greater payments on their loans. Cori Nielson later testified that in response to her communications, Calcutt expressed concerns about raising "red flags" to regulators about the Bank's relationship with the Nielson Entities. By November 30, 2009, several of the loans to the Nielson entities were automatically placed on nonaccrual status by the Bank, meaning that they were ninety days past due.

Also on November 30, the Bank and the Nielson Entities finally reached an agreement that would bring all the loans current. First, the Bank extended a loan of $760,000 to Bedrock Holdings LLC, one of the Nielson Entities (the "Bedrock Loan"), which would be used for the companies'

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[2] Through a deed in lieu of foreclosure, "a mortgagee . . . take[s] a conveyance from the mortgagor in full or partial satisfaction and as a substitute for foreclosure." Restatement (Third) of Property (Mortgages) § 8.5 cmt. b (Am. Law Inst. 1997).

future required loan payments until April 2010. After receipt of the loan, Bedrock Holdings transferred the funds into accounts at the Bank for other Nielson Entities. Second, the Bank agreed to release $600,000 worth of collateral in investment-trading funds that had been granted to it by another Nielson Entity, Pillay Trading LLC (the "Pillay Collateral").[3] This collateral release allowed the Nielson Entities to bring their past-due loans current. Finally, the Bank renewed the Nielson Entities' matured loans, including a loan of $4,500,000 to Bedrock Holdings. The parties refer to this agreement, which took effect in December 2009, as the "Bedrock Transaction." Consequently, the Nielson Entities' loans were removed from the Bank's nonaccrual list on December 1.

The FDIC Board would later find that the actions surrounding the Bedrock Transaction violated the Bank's commercial-loan policy. That policy required 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," yet the Bank did not conduct these analyses or collateral appraisals prior to providing the Bedrock Loan and releasing the Pillay Collateral. At the 2019 hearing, however, Calcutt testified that he thought that the Bedrock Transaction was in the Bank's best interest, because it provided time for the Nielson Entities to pay off their debt and because he believed they had the resources to do so.

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[3] As discussed below, a year later Northwestern Bank also released $690,000 in collateral from Pillay Trading LLC. We refer to the $600,000 and $690,000 disbursements together as the "Pillay Collateral."

Moreover, the commercial-loan policy required approval by two-thirds of the board of directors for loans "where the total aggregate exposure is between 15 and 25 percent of the Bank's Regulatory Capital." *Ibid.* The loans to the Nielson Entities were approximately half of the Bank's Tier 1 capital, thereby qualifying for the voting requirement. According to the FDIC, however, the board did not approve the Bedrock Transaction until March 2010—approximately four months after the disbursements. The loan write-up for the Bedrock Transaction that was presented to the board in March 2010 also contained inaccurate information, including misstating the purpose of the Bedrock Loan as "working capital requirements" and omitting that the Bedrock Transaction had already occurred.

That loan write-up was prepared by a credit analyst based on information provided by Green, and Calcutt and Jackson both initialed the document. Before the FDIC, Calcutt argued that: (a) the write-up's errors and mischaracterization could not be attributed to him; (b) the board of directors was aware of the difficulties with the Nielson Entities in November 2009 because of materials it had received; and (c) the board of directors verbally approved the Bedrock Transaction in November and December 2009. The ALJ and FDIC Board, however, found against him on these points.

Calcutt's actions surrounding the FDIC's June 2010 examination of the Bank also attracted scrutiny. In May 2010, Calcutt signed an Officer's Questionnaire required by the agency. The first question required him to list the loans that the Bank had renewed or extended since the previous year's examination by accepting separate notes for the payment of interest or without fully collecting interest, as well as any loans made for the direct benefit of anyone other than the named recipients of the loans. On the questionnaire, Calcutt answered that he was not aware of any such loans. He later testified that these answers were incorrect in light of the Bank's activities with the Nielson Entities, but argued that the misstatements were "inadvertent and unintentional." (Brackets omitted.)

Additionally, Calcutt participated in a decision to sell several Nielson Entity loans to two of Northwestern Bank's affiliates in May 2010, shortly before the FDIC examiners were due to arrive. Green told Berden that he and Calcutt would continue to serve as the points of contact on those loans. In late September 2010, the Bank repurchased the loans, at which point the loans were delinquent and past maturity.

Despite these actions, by September 2010 the Nielson Entities' position remained precarious. Beginning on September 1, they again stopped making payments on their loans. Several additional months of negotiations ensued, and in December 2010 the parties agreed to an additional release of $690,000 of collateral from Pillay Trading LLC to fund the Nielson Entities' debt service from September 2010 to January 2011. The Bank's board of directors agreed to this arrangement. At the end of that period, however, the Nielson Entities yet again stopped making payments, and they have been in default since then.

D. The 2011 Examination

Shortly before the FDIC's 2011 regular examination of the Bank was set to begin on August 1, 2011, Cori Nielson sent the agency a binder with approximately 267 pages of correspondence between herself, Berden, Green, and Calcutt. The binder's contents went beyond the correspondence that FDIC examiners had found in the Bank's loan file. According to Calcutt, Nielson's move also began a series of actions in which she and Berden improperly influenced the FDIC's Case Manager, Anne Miessner, and Miessner became biased against Calcutt while participating in the examination.

During his September 14, 2011 meeting with examiners from the FDIC and the Michigan Office of Financial and Insurance Regulation,[4] Calcutt made several false statements about the Bedrock Transaction. First, in response to a question about his understanding as to the purpose of the Bedrock Loan, Calcutt said that the funds were meant to provide "working capital" in connection with an acquisition of another business, although their true purpose was to help pay off the loans to Nielson Entities. Second, when examiners asked him about the release of the Pillay Collateral, he responded, "I thought we still had them," although he had authorized releases of the collateral in 2009 and 2010. Third, when queried about how the Nielson Entities managed to bring their loans current in December 2010, he answered that they used their "vast resources between oil, gas, and rentals," although the December 2010 release of Pillay Collateral was in fact used to satisfy these obligations.

In its 2011 examination, the FDIC also noted that the Nielson relationship "should have been reported as non-accrual on quarterly Call Reports beginning no later than December 2009," and that its omission "has resulted in a material overstatement in earnings both in the form of

[4] This agency has been renamed the Michigan Department of Insurance and Financial Services.

falsely inflated interest income and of grossly understated provision expense." Calcutt signed the Call Reports, yet he later testified that he was not involved in their preparation.

Ultimately, the FDIC's 2011 examination report identified the Bank's failures in securing and analyzing the Bedrock Transaction, its reporting inaccuracies, and its misstatements during the examination. It ordered the Bank to charge off $6.443 million on the loans to Nielson Entities, which represented the amount that the Bank would be unlikely to collect.[5] On July 31, 2012, the Bank charged off an additional $30,000 specifically on the Bedrock Loan.

E. Administrative P*roceedings*

1. The 2015 Hearing

On April 13, 2012, the FDIC formally opened an investigation into the Bank's officers. Its investigation ended on August 20, 2013, and the agency issued a Notice of Intention to Remove from Office and Prohibit from Further Participation against Calcutt, Jackson, and Green, as well as a notice of assessment of civil money penalties (the "Notice"). In 2015, both Jackson and Green stipulated to orders prohibiting them from banking activity, and Jackson agreed to a $75,000 CMP. Calcutt proceeded to discovery and further administrative proceedings.

In September 2015, ALJ C. Richard Miserendino held an eight-day hearing on Calcutt's charges. Among the several witnesses who testified were Calcutt, Jackson,

[5] The parties disagree about whether a charge-off necessarily qualifies as a loss. *See infra* at 45.

Nielson, Berden, Miessner, and Dennis O'Neill (one of the FDIC examiners). ALJ Miserendino released a recommended decision on June 6, 2017. However, before the Board issued its final decision, it stayed the case pending the Supreme Court's decision in *Lucia*, because ALJ Miserendino had not been appointed by an agency head.

2. *The 2019 Hearing*

Following *Lucia*, the FDIC Board formally appointed Miserendino and its other ALJ, Christopher B. McNeil, then remanded and reassigned each ALJ's pending cases to the other ALJ "for a new hearing and a fresh reconsideration of all prior actions, including summary dispositions, taken before the hearing." *See* FDIC Resolution Seal No. 085172, Order in Pending Cases (July 19, 2018). The Board permitted each new ALJ to conduct a paper hearing on remand, but if a party objected to the paper hearing, the Board ordered that the ALJ "must conduct a new oral hearing in accordance with 12 C.F.R. § 308.35, except that the ALJ may accept the written transcript of prior testimony of any witnesses for which the parties agreed to accept such testimony."

Calcutt's case was reassigned to ALJ McNeil, who stated that he would conduct an oral hearing and requested that the parties submit objections to ALJ Miserendino's prehearing rulings. In response, Calcutt asserted that the prior proceedings were entirely void under *Lucia* because the prior ALJ had not been appointed by an agency head. ALJ McNeil rejected this argument, and proceeded to request that the parties submit specific examples where the prior proceeding's outcome turned on evidence that should have been included or excluded, or "elements, such as witness demeanor, that are not readily determined from a review of the written record."

Calcutt then reasserted his argument that "the original proceeding was void *ab initio*" and objected to the inclusion of the record from the 2015 proceedings because the case "turn[ed] entirely on credibility assessments." In an order dated March 19, 2019, ALJ McNeil rejected these arguments, concluding that the second hearing would not be de novo, and that "[t]he prior proceedings have not been deemed void *ab initio*, but instead serve as the primary source of the evidentiary record, subject to review and reconsideration by the new ALJ." ALJ McNeil went on to observe that although credibility assessments were material to the decision of the case, Calcutt had not established that a review of the 2015 hearing transcript would be hindered by an inability to view witnesses' demeanor. Finally, he rejected Calcutt's objections to the admission of several exhibits from the 2015 proceedings.

On March 20, 2019, ALJ McNeil released an additional prehearing order, which among other things specified that the parties should identify witnesses by May 15, 2019 and indicate each witness's expected testimony. The order specified that "during the evidentiary hearing, witness testimony will be limited to the descriptions provided in this summary." Calcutt sought an interlocutory appeal before the FDIC Board on ALJ McNeil's limitations on the oral hearing. The Board granted his request for a new oral hearing on all issues considered at the prior hearing, including live witness testimony, but it denied his request for an entirely new proceeding as untimely.

In the next prehearing order, ALJ McNeil granted enforcement counsel's motions to strike Calcutt's affirmative defenses of laches, entrapment, and examiners' violation of the agency's own procedural rules. Then, in response to the parties' motions in limine, he permitted introduction of Green and Jackson's testimony and the parties' stipulations at the 2015 hearing, among other evidentiary rulings.

The hearing lasted from October 29 to November 6, 2019. Calcutt was among twelve witnesses who testified. During the proceedings, Calcutt's counsel unsuccessfully attempted to cross-examine witnesses, including Berden, Miessner, and Nielson, about the theory that Miessner and the FDIC were biased against Calcutt due to their relationship with the Nielsons. In sustaining enforcement counsel's objections to this testimony, ALJ McNeil reasoned that these questions were outside the scope of direct examination, and that in accordance with his March 20, 2019 order, Calcutt could have identified these witnesses in a prehearing submission as subject to questioning about bias but failed to do so.

On April 3, 2020, ALJ McNeil issued the Findings of Fact, Conclusions of Law, and Recommended Decision on Remand (the "Recommended Decision"), finding that Calcutt's actions surrounding the Bedrock Transaction amounted to unsafe or unsound practices and breached his fiduciary duties of care and candor; that these actions caused the Bank to suffer damages and financially benefitted Calcutt; and that the actions involved personal dishonesty and willful and continuing disregard for the Bank's safety and soundness. *See* 12 U.S.C. § 1818(e)(1). Finding that Calcutt's actions satisfied the requirements for a removal and prohibition order and civil money penalties, ALJ McNeil recommended that Calcutt be prohibited from banking and assessed a $125,000 CMP.

Calcutt filed exceptions to the FDIC Board, challenging many of these findings and conclusions. He also argued that the proceedings were invalid because the restrictions on ALJ McNeil's removal were unconstitutional, and because the new hearing granted after *Lucia* did not remedy the Appointments Clause violation in the previous proceedings before ALJ Miserendino. He did not argue that the Board was also improperly shielded from removal.

Upon review, the FDIC Board accepted ALJ McNeil's findings and conclusions, and on December 15, 2020, it issued a final Decision and Order to Remove and Prohibit from Further Participation and Assessment of Civil Money Penalties (the "Removal and Prohibition Order"). The Board concluded that Calcutt's involvement with the Bank's loans to the Nielson Entities, as well as his misrepresentations to regulators and the board of directors, were both unsafe and unsound practices and breaches of his fiduciary duties. *See* 12 U.S.C. § 1818(e)(1)(A). It also found that sufficient effects had occurred by reason of Calcutt's malfeasance: loan charge-offs; the Bank's increased investigative, legal, and auditing expenses; and Calcutt's receipt of dividends from the Bank's holding company that reflected the Nielson portfolio's inflated value. *See* 12 U.S.C. § 1818(e)(1)(B). And it concluded that Calcutt acted with the requisite culpability. *See* 12 U.S.C. § 1818(e)(1)(C). The Board similarly upheld ALJ McNeil's conclusions regarding the appropriateness of the civil money penalty. *See* 12 U.S.C. § 1818(i). Finally, it rejected Calcutt's exceptions regarding the ALJ's insulation from removal, the adequacy of the new hearing after *Lucia*, the ALJ's evidentiary rulings, the statute of limitations, and the ALJ's bias.

Calcutt petitioned this court for review the following day. On December 21, 2020, he moved for an emergency stay. A panel of this court granted the stay on January 5, 2021. We have jurisdiction over Calcutt's petition for review of the FDIC's order under 12 U.S.C. § 1818(h)(2).

II. STANDARD OF REVIEW

The judicial-review provisions of the APA apply to FDIC removal and prohibition orders and orders assessing CMPs. 12 U.S.C. § 1818(h)(2). Accordingly, we must hold unlawful and set aside agency actions, findings, or conclusions that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"; "contrary to constitutional right, power, privilege, or immunity"; "in excess of statutory jurisdiction, authority, or limitations"; "without observance of procedure required by law"; or "unsupported by substantial evidence." 5 U.S.C. § 706(2). Furthermore, "due account shall be taken of the rule of prejudicial error." *Ibid.*; *see Nat'l Ass'n of Home Builders v. Defs. of Wildlife*, 551 U.S. 664, 659–60 (2007) (explaining that this statutory language refers to a harmless-error rule). Though a court does not "substitute its judgment for that of the agency" over decisions within the agency's delegated authority in applying the APA's arbitrary-and-capricious standard, the agency's conclusions must still be based on "reasoned decision making." *Wollschlager v. FDIC*, 992 F.3d 574, 581–82 (6th Cir. 2021).

We review other agency determinations differently. Questions of law are reviewed de novo, but we defer to an agency's interpretation of a provision in a statute that it is entrusted with administering, if (1) Congress has not "directly spoken to the precise question at issue," and (2) "the agency's answer is based on a permissible construction of the statute." *N. Fork Coal Corp. v. Fed. Mine Safety & Health Rev. Comm'n*, 691 F.3d 735, 739 (6th Cir. 2012) (quoting *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984)). And an agency's factual findings are reviewed for substantial evidence, which is "more than a scintilla of evidence but less than a preponderance; it is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Gen. Med., P.C. v. Azar*, 963 F.3d 516, 520 (6th Cir. 2020) (quoting *Cutlip v. Sec'y of Health & Hum. Servs.*, 25 F.3d 284, 286 (6th Cir. 1994)). "The substantiality of evidence must take into account whatever in the record fairly detracts from its weight." *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 488 (1951).

III. REMOVAL PROTECTIONS

Calcutt maintains that two features of the structure of the FDIC violate Article II and the separation of powers and thus compel invalidation of the agency's proceedings against him. First, relying principally on *Seila Law*, he argues that the members of the FDIC Board are unconstitutionally insulated from removal by the President. Second, he contends that the FDIC's ALJs are insulated by multiple levels of for-cause protection in contravention of the Supreme Court's holding in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477 (2010).

Neither alleged infirmity, however, compels invalidation of the FDIC proceedings against Calcutt. As the Court recently explained in *Collins v. Yellen*, even if an agency's structure unconstitutionally shields officers from removal, a party challenging the agency's action is not entitled to relief unless that unconstitutional provision "inflict[s] compensable harm." 141 S. Ct. at 1789. Calcutt has not demonstrated that the removal protections of the FDIC Board or the FDIC ALJs caused such harm to him.

A. FDIC Board Structure

We first address Calcutt's challenge to the FDIC Board's structure. To start, we conclude that Calcutt has not forfeited this claim. However, Calcutt has not demonstrated that the purported constitutional infirmity inflicted harm. *See Collins*, 141 S. Ct. at 1789. Thus, he is not entitled to invalidation of the proceedings on this basis.

1. *Issue Exhaustion*

At the outset, we disagree with the argument by the FDIC that Calcutt has forfeited his challenge to the Board's removal protections by not raising it in his exceptions to the recommended decision of ALJ McNeil. This is a question of "issue exhaustion," a rule in many administrative contexts that requires a party to present an issue to an agency before pursuing judicial review on that issue. *Carr v. Saul*, 141 S. Ct. 1352, 1358 (2021).

We have recognized three types of issue-exhaustion requirements. First, many "requirements of administrative issue exhaustion are largely creatures of statute." *Sims v. Apfel*, 530 U.S. 103, 107 (2000). Second, an agency's regulations may require exhaustion, *id.* at 108, so long as the regulations "comport with the statute" and are not applied arbitrarily, *Island Creek Coal Co. v. Bryan*, 937 F.3d 738, 747 (6th Cir. 2019). Third, a court may impose an issue-exhaustion requirement without either a statute or regulation. *Sims*, 530 U.S. at 108; *see Bryan*, 937 F.3d at 747–48 (describing "prudential exhaustion" and its unclear doctrinal source). In this last context, "[t]he desirability of a court imposing a requirement of issue exhaustion depends on the degree to which the analogy to normal adversarial litigation applies in a particular administrative proceeding." *Carr*, 141 S. Ct. at 1358 (quoting *Sims*, 530 U.S. at 109). This resemblance to an adversarial litigation in turn depends on "whether claimants bear the responsibility to develop issues for adjudicators' consideration." *Ibid.*

The FDIC argues that its regulations (namely 12 C.F.R. § 308.39(b)) compelled Calcutt to raise any Appointments Clause challenge to the Board's structure in his exceptions to the Recommended Decision before raising them before this court. Moreover, the agency adds, *Carr*'s limitation on imposing issue-exhaustion requirements in non-adversarial proceedings do not apply here, because Calcutt's adjudication was adversarial.

Calcutt responds that § 308.39(b) requires exhaustion only of issues over which the agency has jurisdiction, and that because agencies lack "authority to entertain a facial constitutional challenge to the validity of a law," he did not need to exhaust the removal issue before the ALJ or the Board. Reply Br. 2 (quoting *Jones Bros.*, 898 F.3d at 673); *see* 12 C.F.R. § 308.39(c)(1) (stating that exceptions "must be confined to the particular matters in, or omissions from, the administrative law judge's recommendations"). Relatedly, he argues that an agency proceeding is an inappropriate forum to consider a structural constitutional claim such as the Board's removability, because the Board has no special expertise in Appointments Clause jurisprudence and has previously disclaimed authority to entertain constitutional challenges to statutes, meaning that raising this issue before the Board would have been futile.

We think Calcutt has the better of the argument, and that in the "particular administrative scheme at issue" in this case, no statute, regulation, or prudential principle required him to raise his challenge to the FDIC Board during the administrative proceedings. *Joseph Forrester Trucking v. Dir., Off. of Workers' Comp. Programs*, 987 F.3d 581, 590 (6th Cir. 2021) (quoting *Weinberger v. Salfi*, 422 U.S. 749, 765 (1975)). To begin with, the judicial review provision of the FDI Act, 12 U.S.C. § 1818(h), says nothing bearing on exhaustion. We have explained that a statute must contain language "directing parties to raise issues" before the agency in order to create a statutory issue-exhaustion requirement. *See Bryan*, 937 F.3d at 749; *Jones Bros., Inc. v. Sec'y of Lab.*, 898 F.3d 669, 673–74 (6th Cir. 2018).

The applicable FDIC regulations hit closer to the mark. They provide that the "[f]ailure of a party to file exceptions . . . is deemed a waiver of objection thereto." 12 C.F.R. § 308.39(b)(1). This text might be read to create an issue-exhaustion requirement in light of our decision in *Bryan*, where we detected an issue-exhaustion requirement in a regulation requiring that a petition for review list "specific issues to be considered" for appeals from Black Lung Benefits Act adjudications to the Benefits Review Board. 937 F.3d at 749 (quoting 20 C.F.R. § 802.211(a)). However, there is an important difference between *Bryan* and this case. Calcutt raises a facial constitutional challenge to the FDI Act, and the FDIC has no power to invalidate its own organic statute; thus, it could never entertain Calcutt's separation-of-powers challenge to the FDIC Board in the first place. *See Jones Bros.*, 898 F.3d at 673–74 (reading statute not to impose issue-exhaustion requirement on facial constitutional challenges where agency could not "invalidate the statute from which it derives its existence and that it is charged with implementing"). True, we have explained that an agency may entertain certain facial constitutional challenges and therefore impose issue-exhaustion requirements where it has long asserted that authority. *See Joseph Forrester Trucking*, 987 F.3d at 588–89; *Bryan*, 937 F.3d at 753. But the FDIC Board has previously disclaimed the authority to determine the constitutionality of statutes. *See Matter of the Bank of Hartford*, No. FDIC-92-212kk, at A-2525 (FDIC Apr. 11, 1995), https://www.fdic.gov/bank/individual/enforcement/5223.html (last visited June 8, 2022)). Though the FDIC now offers a list of examples in which it has considered constitutional claims in adjudications, almost none of those decisions considered a constitutional challenge to the authority or structure of the FDIC, and the decision that did so—*Matter of* ***, No. FDIC-85-363e, 1986 WL 379631 (FDIC Apr. 21, 1986)—predates *Bank of Hartford*.[6] And even if we recognize that the FDIC has asserted authority to decide *some* constitutional issues, we cannot say that this constitutes an established practice for the type of separation-of-powers claim at issue here.

A further consideration counsels against imposing an

[6] This is not to say that the FDIC has disavowed authority to address *any* constitutional claim. As the FDIC notes, it has previously addressed Appointments Clause and separation-of-powers challenges to ALJs. *See Matter of Sapp*, Nos. FDIC-13-477(e), FDIC-13-478(k), 2019 WL 5823871, at *18–19 (FDIC Sept. 17, 2019); *Matter of Landry*, No. FDIC-95-65e, 1999 WL 440608, at *27–29 (FDIC May 25, 1999); *Matter of Leuthe*, Nos. FDIC-95-15Ee, FDIC-95-16k,1998 WL 438323, *10–11 (FDIC June 26, 1998). Those decisions, however, did not concern a separation-of-powers challenge to the FDIC Board.

issue-exhaustion requirement here: Calcutt's challenge to the removal protections of the FDIC Board is a structural constitutional challenge over which the FDIC Board has no special expertise. *See Carr*, 141 S. Ct. at 1360. And had Calcutt raised this challenge before the Board, his efforts would have been futile. *See id.* at 1361 ("[T]his Court has consistently recognized a futility exception to exhaustion requirements.").[7] To illustrate, consider what remedy the Board could have offered if Calcutt had raised the issue and the Board had agreed that it was unconstitutionally shielded from removal. The remedies granted by Article III courts, such as severing and striking the Board's for-cause protections from the FDIC's organic statute, would have been unavailable, because the Board, an agency of the Executive Branch, cannot edit its own organic statute. *Cf. Seila Law*, 140 S. Ct. at 2207–09. Similarly, the Board could hardly have told the President to treat it as if it had no protections from removal, since an agency cannot compel the President to act (let alone violate a statute). Another possibility would be for it to vacate Calcutt's penalty, but that would not resolve the constitutional issue, because the removal restrictions would persist. Requiring issue exhaustion in this situation would have been a pointless exercise.

In sum, Calcutt has not forfeited his claim that the FDIC Board is unconstitutionally insulated from removal.

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[7] While the Supreme Court has cautioned that courts should hesitate to apply exceptions to mandatory exhaustion requirements in a *statute*, *see Ross v. Blake*, 136 S. Ct. 1850, 1857–58 (2016), that concern does not apply here because, as we have explained, the FDI Act does not clearly mandate an issue-exhaustion requirement.

2. *FDIC Board Structure*

Calcutt would have us hold that the FDIC Board is unconstitutionally shielded from removal and therefore asks us to invalidate his entire proceeding. Under the framework set out by the Supreme Court's recent separation-of-powers decisions, however, he is not entitled to invalidation of his proceedings. *See Collins*, 141 S. Ct. at 1783–89; *Seila Law*, 140 S. Ct. at 2198–2204. In particular, *Collins* indicates that Calcutt is not entitled to the relief he seeks, because he has not specified the harm that occurred as a result of the allegedly unconstitutional removal restrictions. *See* 141 S. Ct. at 1788–89.

Article II of the Constitution states that "[t]he executive Power shall be vested in a President," U.S. Const. art. II, § 1, cl. 1, and requires the President to "take Care that the Laws be faithfully executed," *id.* art. II, § 3. This language establishes a core principle of constitutional separation of powers: "[T]he President's removal power is the rule, not the exception." *Seila Law*, 140 S. Ct. at 2206; *see also Myers v. United States*, 272 U.S. 52, 163–64 (1926).

In *Seila Law*, the Court provided the framework for analyzing the constitutionality of a restriction on the President's removal authority. 140 S. Ct. at 2198. At the first step, we ask whether an officer's tenure protection falls within an established exception to the general removal authority. *Id.* at 2198. As relevant here, one such exception, identified in *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), permits for-cause removal protections for "multimember expert agencies that do not wield substantial executive power." *Seila Law*, 140 S. Ct. at 2199–2200.[8] To determine whether an agency falls within this category, we consider whether (a) the agency is a "body of experts," *id.* at 2200 (quoting *Humphrey's Ex'r*, 295 U.S. at 624); (b) the agency is nonpartisan or balanced along partisan lines, *ibid.*; and (c) the agency is closer to "a mere legislative or judicial aid" that "was said not to exercise any enforcement power," *id.* at 2199–2200, or rather an enforcement body that may "promulgate binding rules," "unilaterally issue final decisions awarding legal and equitable relief in administrative adjudications," and "seek daunting monetary penalties against private parties on behalf of the United States in federal court," *id.* at 2200.

At the second step, if an agency structure does not fall within an established exception, we must determine "whether to extend those precedents to the 'new situation.'" *Seila Law*, 140 S. Ct. at 2201 (quoting *Free Enter. Fund*, 561 U.S. at 483). In concluding that the CFPB Director was unconstitutionally shielded from removal, the *Seila Law* Court emphasized two key features: the historical novelty of an agency headed by a single director removable only for cause, and the inconsistency of this design with constitutional structure. *Id.* at 2201–04.

As for the historical inquiry, the Court canvassed American history and found only "modern and contested"

[8] The *Seila Law* Court also recognized an exception for "inferior officers with limited duties and no policymaking or administrative authority" under *Morrison v. Olson*, 487 U.S. 654 (1988). *See Seila Law*, 140 S. Ct. at 2199–2200. However, this exception does not apply to the FDIC Board, which qualifies as the head of a department. *See Free Enter. Fund*, 561 U.S. at 512–13 (explaining that multimember commissions can qualify as head of a department).

examples of agencies headed by a single director who enjoyed good-cause tenure, such as the Federal Housing Finance Agency ("FHFA") Director, and a "one-year blip" during the Civil War in which the Comptroller of the Currency received for-cause protections. *Id.* at 2202; *see also Collins*, 141 S. Ct. at 1783 (holding that removal restriction for FHFA Director was unconstitutional, and that *Seila Law* was "all but dispositive" on the question).

As for the structural inquiry, the Court underscored that the constitutional scheme's combination of the separation of powers and democratic accountability foreclosed executive officers from exercising significant authority without direct presidential supervision. The Constitution emphasizes the division of power, but it also recognized the need for an "energetic executive" to respond quickly and flexibly to challenges. *Seila Law*, 140 S. Ct. at 2203 (discussing The Federalist No. 51 (James Madison) and The Federalist No. 70 (Alexander Hamilton)). To resolve these dueling priorities, the Constitution makes the President directly accountable to the American people through elections, allowing him to delegate authority to subordinate officials to complete the tasks of governance so long as that delegated authority "remains subject to the ongoing supervision and control of the elected President." *Ibid.* The CFPB Director's for-cause protections violated this structure because, by eliminating the President's ability to remove the CFPB Director at will, the CFPB concentrated power in a single officer while insulating him from presidential control. *Id.* at 2204. This infirmity was exacerbated by the CFPB Director's five-year term, which meant that "some Presidents may not have any opportunity to shape its leadership," and the agency's independence from the normal appropriations process.

Ibid.

We need not delve deeply into the *Seila Law* inquiry in this case, however, because *Collins* instructs that relief from agency proceedings is predicated on a showing of harm, a requirement that forecloses Calcutt from receiving the relief he seeks. *See* 141 S. Ct. at 1788–89. *Collins* concerned the Director of the Federal Housing Finance Agency, an agency with authority to regulate and act as the conservator or receiver of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). *Collins*, 141 S. Ct. at 1770. Acting as the companies' conservator, the FHFA amended stock purchasing agreements with the Treasury Department, which altered the dividends that Fannie Mae and Freddie Mac were required to pay to Treasury in exchange for capital. *See id.* at 1772–75. Shareholders of the companies brought suit against the FHFA and the FHFA Director as a result. *See id.* at 1775. As relevant here, the shareholders argued that the statutory for-cause removal protection of the FHFA Director violated the separation of powers, *see id.* at 1778, and that therefore the amendment to the FHFA-Treasury agreement "must be completely undone," *id.* at 1787.

The Supreme Court agreed that the for-cause removal provision was unconstitutional, as its decision in *Seila Law* was "all but dispositive." *Id.* at 1783. Just as the CFPB in that decision presented a "novel context of an independent agency led by a single Director" whose for-cause removal protections "lack[ed] a foundation in historical practice and clashe[d] with constitutional structure by concentrating power in a unilateral actor insulated from Presidential control," so too did the single-director structure and removal protections in the FHFA unconstitutionally limit the President's removal power. *Id.* at 1783–84 (quoting *Seila Law*, 140 S. Ct. at 2192).

Yet although the removal restriction was unconstitutional, the Court held that the shareholders were not entitled to relief absent further findings by the lower courts. The shareholders were not entitled to a prospective remedy, because a subsequent agreement between the FHFA and Treasury had deleted the dividend formula that caused the alleged injury. *Id.* at 1779–80. As to retrospective relief for the claimed injury during the years that the dividend formula was in effect, the Court observed that "[a]lthough the statute unconstitutionally limited the President's authority to *remove* the confirmed Directors, there was no constitutional defect in the statutorily prescribed method of appointment to that office." *Id.* at 1787. Thus, the Director "lawfully possess[ed]" the power to implement the provision. *Id.* at 1788.

The Court explained that the shareholders would be entitled to relief if the unconstitutional removal restriction "inflict[ed] compensable harm," and it remanded the case to the Court of Appeals to conduct this inquiry. *Id.* at 1789. To establish such harm, the shareholders would need to show that the removal restriction *specifically* impacted the agency actions of which they complained:

> Suppose, for example, that the President had attempted to remove a Director but was prevented from doing so by a lower court decision holding that he did not have "cause" for removal. Or suppose that the President had made a public statement expressing displeasure with actions taken by a Director and had asserted that he would remove the Director if the statute did not

> stand in the way. In those situations, the statutory provision would clearly cause harm.

Ibid. Several concurring Justices confirmed that a petitioner would have to establish that an unconstitutional removal protection specifically caused an agency action in order to be entitled to judicial invalidation of that action. *See id.* at 1789 (Thomas, J., concurring) (agreeing with majority's remedial analysis "that, to the extent a Government action violates the Constitution, the remedy should fit the injury"); *id.* at 1801 (Kagan, J., concurring in part and concurring in the judgment) ("I also agree that plaintiffs alleging a removal violation are entitled to injunctive relief—a rewinding of agency action—only when the President's inability to fire an agency head affected the complained-of decision."); *id.* at 1803 n.1 (Sotomayor, J., concurring in part and dissenting in part) (agreeing with majority's remedial discussion).

Calcutt attempts to distinguish *Collins* by observing that the decision concerned only retrospective relief, because the FHFA had already ended the challenged action, whereas Calcutt's Removal and Prohibition Order remains in effect and operates prospectively. That distinction does not matter here. The *Collins* inquiry focuses on whether a "harm" occurred that would create an entitlement to a remedy, rather than the nature of the remedy, and our determination as to whether an unconstitutional removal protection "inflicted harm" remains the same whether the petitioner seeks retrospective or prospective relief (particularly when we review an adjudication that has already ended). *Collins*, 141 S. Ct. at 1789. In other words, *Collins* instructs that we must ask whether the FDIC Board's for-cause protections "inflicted harm," such as by preventing superior officers from removing Board members when they attempted to do so, or possibly by altering the Board's behavior. *Ibid.* The Removal and Prohibition Order's prospective effect does not change a court's ability to conduct that inquiry.

Collins thus provides a clear instruction: To invalidate an agency action due to a removal violation, that constitutional infirmity must "cause harm" to the challenging party. *Ibid.* Our sister circuits that have considered the question agree that this is the key inquiry. *See Kaufmann v. Kijakazi*, 32 F.4th 843, 849 (9th Cir. 2022) (explaining that "[a] party challenging an agency's past actions must . . . show how the unconstitutional removal provision *actually harmed* the party"); *Bhatti v. Fed. Housing Fin. Agency*, 15 F.4th 848, 854 (8th Cir. 2021) (identifying issue under *Collins* as whether unconstitutional removal restriction "caused compensable harm");[9] *Decker Coal Co. v. Pehringer*, 8 F.4th 1123, 1137 (9th Cir. 2021) (stating that, under the "controlling" authority of *Collins,* "[a]bsent a showing of harm, we refuse to unwind the [agency] decisions below").

Calcutt has not demonstrated that the structure of the FDIC Board caused him harm. He first states that the FDIC Board's Removal and Prohibition Order "inflicts ongoing harm" by preventing him from participating in

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[9] In *Bhatti*, the Eighth Circuit also remanded to the district court "to determine if the shareholders suffered 'compensable harm' and are entitled to 'retrospective relief.'" *Bhatti*, 15 F.4th at 854 (quoting *Collins*, 141 S. Ct. at 1789). This language does not conflict with our conclusion that *Collins* does not rest on whether relief is prospective or retrospective, because *Bhatti* concerned the same agency actions as *Collins* did. *See id.* at 852. Because the *Collins* Court recognized that only retrospective relief was available to Fannie Mae and Freddie Mac shareholders, the *Bhatti* court followed that precedent. *See ibid.*

banking activities. Reply Br. 10. However, *Collins* does not say that *any* administrative penalty imposed by an unconstitutionally-structured agency must be vacated. Instead, the constitutional violation must have *caused* the harm. *See Collins*, 141 S. Ct. 1789 (identifying inquiry as whether "an unconstitutional provision . . . inflict[ed] compensable harm").

Calcutt also argues that the *possibility* that the FDIC would have taken different actions in his case, if the Board not been unconstitutionally shielded from removal, means that we should vacate and remand. Taken in isolation, some language in *Collins* might be read to support this view. *See, e.g.*, *ibid.* ("[T]he possibility that the unconstitutional restriction on the President's power to remove a Director of the FHFA could have such an effect [of inflicting compensable harm] cannot be ruled out."). But such a broad reading would effectively eliminate any need to show that unconstitutional removal protections caused harm, because a petitioner could always assert a possibility that an agency with different personnel might have acted differently. The *Collins* Court was not deterred from its holding by the very possibility that harm *might* occur; rather, it indicated that a more concrete showing was needed.

Calcutt also posits that if the FDIC Board had not been unconstitutionally insulated from removal, after *Lucia* it might have "altered [its] behavior," *ibid.*, and provided new proceedings as recommended by the Solicitor General, *see* Mem. from the Solicitor General to Agency General Counsels, Guidance on Administrative Law Judges after *Lucia v. SEC* (S. Ct.) 8–9, https://static.reuters.com/resources/media/editorial/20180723/ALJ--SGMEMO.pdf (last visited May 24, 2022). While failure to follow executive-branch policy could certainly help indicate that a removal restriction inflicted harm, that is not what happened here. As we explain further below, the FDIC provided a new hearing to Calcutt consistent with *Lucia*. *See infra* at 30–35. We also fail to see how the FDIC disregarded the Solicitor General's guidance. The Solicitor General told agencies that while "a full soup-to-nuts redo of the administrative proceeding" was "the safest course" after *Lucia*, it was not the only course available:

> While litigants may be expected to argue otherwise, however, we do not believe a complete do-over is constitutionally required. We believe that a 'new hearing' will be constitutionally adequate as long as the new ALJ is careful to avoid any taint from the prior ALJ's decision. Thus, we do not think it is necessarily fatal if the new ALJ starts with the existing record in the proceeding (including hearing transcripts), much of which there would be little purpose in generating anew.

Mem. from the Solicitor General to Agency General Counsels 8–9. Thus, we disagree with Calcutt's suggestion that the FDIC Board failed to follow executive-branch policy—let alone that it did so because of its removal protections.

Finally, Calcutt asks this court to remand to the FDIC to determine whether the removal restriction "inflicted harm" in his case, as the *Collins* court also remanded for further findings. We do not think this step is necessary. The record is sufficiently clear that the removal protections did not cause harm, and Calcutt provides only vague, generalized allegations in response. *See Decker Coal Co.*, 8 F.4th at 1137 (declining to remand where "the record is clear"). We also note that, unlike the

Collins Court or the Eighth Circuit in *Bhatti*, we would be remanding to an agency rather than another court. *See Collins*, 141 S. Ct. at 1789 (remanding to court of appeals); *Bhatti*, 15 F.4th at 854 (remanding to district court to determine whether Fannie Mae and Freddie Mac shareholders suffered compensable harm entitling them to relief under *Collins*). We do not see how yet another proceeding before the FDIC would aid in developing the record on this point.

B. FDIC ALJ Structure

Calcutt's separation-of-powers challenge to the removal protections of FDIC ALJs is unsuccessful for similar reasons as his challenge to the structure of the FDIC Board. First and foremost, even if we were to accept that the removal protections for the FDIC ALJs posed a constitutional problem, Calcutt is not entitled to relief unless he establishes that those protections "inflict[ed] compensable harm," and he has not made this showing. *Collins*, 141 S. Ct. at 1789. Second, even if he established that the removal protections caused him harm, *Free Enterprise Fund* explicitly excludes ALJs from its prohibition on multiple levels of for-cause removal protection, and thus, like *Seila Law*, it only provides weak support for his position. *See Free Enter. Fund*, 561 U.S. at 507 n.10.

To recall, FDIC ALJs can only be removed if the MSPB finds that there is "good cause" for removal on the record after an opportunity for a hearing. 5 U.S.C. § 7521(a). The President may remove MSPB members "only for inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d). Additionally, the FDIC ALJs are housed in an interagency body—the Office of Financial Institution Adjudication, or OFIA—composed of the

FDIC, OCC, FRB, and NCUA. The memorandum of understanding for OFIA states: "Any change to the Office Staff personnel shall be subject to the prior written approval of all Agencies." *See* Ex. L to Emergency Motion for Stay Pending Review, at 3. According to Calcutt, OFIA's structure "magnifies the constitutional problem" by requiring all four member agencies to consent before "initiat[ing] ALJ removal proceedings." Br. of Petitioner 30.

We begin with the *Collins* issue. As previously discussed, that decision requires a showing that an unconstitutional removal restriction "cause[d] harm" to invalidate an agency action. 141 S. Ct. at 1789.[10] Here, again, Calcutt offers vague assertions that it "cannot be ruled out" that the multiple levels of for-cause removal protections insulating ALJ McNeil caused him harm, but a generalized allegation is insufficient for affording relief. Reply Br. 18 (quoting *Collins*, 141 S. Ct. at 1789). He also argues that had these removal restrictions not been in place, ALJ McNeil would have been more responsive to executive-branch policy, would have properly offered a new hearing after *Lucia*, and would not have issued a recommended decision that conflicted with the FDI Act. But those arguments are premised on the success of Calcutt's other claims of constitutional and statutory violations, and as we explain below, none of those claims succeed. *See infra* at 30–35, 37–53. Thus, he cannot rely on those allegations of harm, either.

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[10] Even if the restrictions on the *removal* of FDIC ALJs were invalid, both parties agree that ALJ McNeil was validly *appointed*. Therefore, we need not address whether Calcutt would be entitled to relief on grounds specifically relating to McNeil's appointment. *See Collins*, 141 S. Ct. at 1787–88.

An additional feature in this case further suggests that no harm was caused by the removal restrictions. Before *Lucia*, FDIC adjudications were performed by two ALJs who were not appointed by the FDIC Board: ALJ Miserendino and ALJ McNeil. After *Lucia* held that similar ALJs in the SEC were inferior officers who must be appointed by the President, a court of law, or a head of department, *see* 138 S. Ct. at 2051 (citing U.S. Const. art. II, § 2, cl. 2), the FDIC could have appointed new ALJs. However, it simply appointed the officials who had previously been acting as ALJs—including ALJ McNeil. In the specific circumstances of this case, where the FDIC newly appointed an ALJ when it had the option not to do so, it is unlikely that the restriction on the removal of the ALJ prevented the agency from pursuing a different path respecting Calcutt.

Even if relief were available, we doubt Calcutt could establish a constitutional violation from the ALJ removal restrictions. Though *Free Enterprise Fund* concluded that the two layers of for-cause protections enjoyed by the members of the Public Company Accounting Oversight Board were "incompatible with the Constitution's separation of powers," *Free Enter. Fund*, 561 U.S. at 498, the Court took care to omit ALJs from the scope of its holding, *id.* at 507 n.10 ("[O]ur holding also does not address that subset of independent agency employees who serve as administrative law judges."). The Court explained that its decision did not apply to ALJs for several reasons: "Whether administrative law judges are necessarily 'Officers of the United States' is disputed," and many ALJs "perform adjudicative rather than enforcement or policymaking functions, . . . or possess purely recommendatory powers." *Ibid.* (citing *Landry v. FDIC*, 204 F.3d 1125

(D.C. Cir. 2000) (statutory citations omitted)). Similarly, as then-Judge Kavanaugh explained in dissent in the District of Columbia Circuit proceedings, the for-cause protections of ALJs are distinguishable because agencies can choose not to use ALJs in adjudications; ALJs may not be officers (as the law stood at that time); and many ALJs perform adjudicatory functions that are subject to review by higher agency officials, which "arguably would not be considered 'central to the functioning of the executive Branch' for purposes of the Article II removal precedents." *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 537 F.3d 667, 699 n.8 (D.C. Cir. 2008) (Kavanaugh, J., dissenting) (quoting *Morrison v. Olson*, 487 U.S. 654, 691–92 (1988)).

Other than the argument that ALJs are not officers, which *Lucia* forecloses, *see* 138 S. Ct. at 2053–54, these rationales still apply to the FDIC ALJs. First, the FDIC ALJs perform adjudicatory functions, and they file a recommended decision that is subject to review by the FDIC Board. *See Free Enter. Fund*, 561 U.S. at 496 n.10; *Free Enter. Fund*, 537 F.3d at 699 n.8 (Kavanaugh, J., dissenting); 12 C.F.R. § 308.38(a). Second, "Congress has not tied the President's hands and hindered his control over his subordinates here." *Decker Coal Co.*, 8 F.4th at 1133. Rather, the FDIC must conduct hearings "in accordance with the provisions of [the APA]," 12 U.S.C. § 1818(h)(1), and the APA permits an agency to choose whether to preside over an adjudication itself, allow one or more members to be presiding officers, or use an ALJ, 5 U.S.C. § 556(b). In short, though Calcutt is correct that *Free Enterprise Fund* left open whether it applied to ALJs, that decision's reasoning for exempting ALJs still extends to this case.

Calcutt and amicus Chamber of Commerce of the United States of America also argue that the structure of OFIA provides particularly egregious removal protections for FDIC ALJs that violate the separation of powers. Under OFIA's governing memorandum of understanding, all the constituent agencies of OFIA—the FDIC, OCC, FRB, and NCUA—must approve "[a]ny change to the Office Staff personnel." Ex. L to Emergency Motion for Stay Pending Review, at 3. According to Calcutt, this provision means that each agency has veto power over any other agency's attempt to remove an ALJ. Exacerbating this problem, he adds, several of the agencies who must agree to removal also enjoy for-cause protection. *See* 12 U.S.C. § 242 (FRB); 12 U.S.C. § 1752a(c) (NCUA Board members serve fixed terms); *supra* at 6 (FDIC for-cause protections).

Although OFIA may present a "novel structure," *Free Enter. Fund*, 561 U.S. at 495, the *Free Enterprise Fund* exception for ALJs centers on their status as adjudicatory officials that issue non-final recommendations to an agency, and not on how many levels of removal protections they enjoy, *see id.* at 496 n.10. Consequently, OFIA does not present a reason for us to hold that the removal restrictions for FDIC ALJs violates constitutional separation of powers. More importantly, even if we were to find such a violation, *Collins* decisively precludes relief for Calcutt.

C. Appointments Clause

The Appointments Clause requires that "Officers of the United States" be appointed by the President with the advice and consent of the Senate, but Congress may allow "inferior Officers" to be appointed by the President alone, by courts, or by heads of departments. U.S. Const. art. II,

§ 2, cl. 2. "[T]he 'appropriate' remedy for an adjudication tainted with an appointments violation is a new 'hearing before a properly appointed official.'" *Lucia*, 138 S. Ct. at 2055 (quoting *Ryder v. United States*, 515 U.S. 177, 188 (1995)). Calcutt argues that he did not receive this "new hearing," but he is wrong.

Calcutt states that the FDIC ALJs are "inferior Officers," and the FDIC does not contest this point. We agree that FDIC ALJs are inferior officers and that they were improperly appointed before *Lucia*. *Cf. Burgess v. FDIC*, 871 F.3d 297, 302–03 (5th Cir. 2017) (reasoning that FDIC ALJs are officers). Because they are inferior officers, the FDIC ALJs must be appointed by the President, a court, or the FDIC Board. U.S. Const. art. II, § 2, cl. 2. Prior to 2018, the FDIC Board did not appoint the ALJs, so their appointments were invalid. *See Jones Bros.*, 898 F.3d at 679.

Calcutt and the FDIC also agree up to a point that the remedy for the prior Appointments Clause violation is "a new 'hearing before a properly appointed' official" distinct from the previous ALJ. *Lucia*, 138 S. Ct. at 2055 (quoting *Ryder*, 515 U.S. at 188). However, Calcutt argues that a new hearing must consist of an entirely new proceeding, where the new adjudicator starts from scratch and ignores the record from the prior proceeding. He specifically objects to ALJ McNeil's admission of stipulations and transcripts from the 2015 proceedings, and he contends that ALJ Miserendino's procedural rulings in 2015 narrowed the scope of discovery in a manner that impacted the 2019 proceedings. The FDIC, in contrast, contends that the "new hearing" requires only a new, independent evaluation of the merits of a case without limiting consideration of the prior record, and that therefore ALJ

McNeil's use of the 2015 record was proper.

Lucia does not specify what features a "new hearing" must contain, other than a new adjudicator. 138 S. Ct. at 2055. Other decisions addressing the remedies for Appointments Clause violations are similarly vague. *See Ryder*, 515 U.S. at 188 (holding that petitioner "is entitled to a hearing before a properly appointed panel" of military court); *Jones Bros.*, 898 F.3d at 679 (holding that petitioner "is entitled to a new hearing before a constitutionally appointed administrative law judge" and remanding for "fresh proceedings").

Other decisions indicate that courts afford agencies more leeway on remand after Appointments Clause violations than Calcutt's all-or-nothing position suggests. In *Lucia*, for example, the Supreme Court recognized that in situations where "there is no substitute decisionmaker" after an Appointments Clause violation, a new hearing before the original decisionmaker could be proper. *Lucia*, 138 S. Ct. at 2055 n.5 (citing *FTC v. Cement Inst.*, 333 U.S. 683, 700–03 (1948)). The Federal Circuit, after finding that administrative patent judges were invalidly appointed, also explained that it required a "new hearing" before a "new panel" of judges, but that it saw "no error in the new panel proceeding on the existing record" and left to the agency's "sound discretion" whether to "allow additional briefing or reopen the record in any individual case." *Arthrex, Inc. v. Smith & Nephew, Inc.*, 941 F.3d 1320, 1340 (Fed. Cir. 2019), *vacated on alternate grounds and remanded sub nom. United States v. Arthrex, Inc.*, 141 S. Ct. 1970 (2021).[11] For its part, the Court of Appeals

[11] We note that although the Supreme Court stated that a new hearing was unnecessary in *Arthrex*, it explained that Arthrex was not entitled to a new hearing before a new panel "[b]ecause the source

for the District of Columbia Circuit rejected a petitioner's claim that a new proceeding by a properly appointed official must involve entirely new proceedings that ignore the prior record. *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d. 111, 117–19 (D.C. Cir. 2015). Instead, that court concluded that a subsequent proceeding is valid when "a properly appointed official has the power to conduct an independent evaluation of the merits and does so," *id.* at 117, and that as a constitutional matter this "independent evaluation" could include a review of prior records and transcripts, *see id.* at 122.

This reluctance to adopt a bright-light rule makes sense. To hold that all adjudications must start from zero after a judicial decision invalidating ALJ appointments would result in cumbersome, repetitive processes throughout the executive branch simply to produce findings and orders that would often be identical the second time around. Moreover, as the District of Columbia Circuit observed, an "independent evaluation of the merits" does not require an ALJ to *ignore* all past proceedings: Independence is not a synonym for ignorance. *See id.* at 121–23.[12]

of the constitutional violation is the *restraint on the review authority* of the Director [of the Patent and Trademark Office], *rather than the appointment* of [administrative patent judges] by the Secretary [of Commerce]." *Arthrex*, 141 S. Ct. at 1988 (emphases added). This decision thus did not reject the Federal Circuit's conclusion that, if the administrative patent judges' appointments had been invalid, a new hearing would be appropriate, including some consideration of the original record.

[12] Our dissenting colleague characterizes our approach as a cost-benefit balancing exercise. *See* Dissent at 74. But determining whether a new ALJ can conduct an "independent evaluation of the

Thus, our inquiry focuses on whether ALJ McNeil's consideration of the 2015 stipulations and testimony showed "sufficient continuing taint arising from the first [proceeding]" to demonstrate that the second proceeding was not "an independent, de novo decision." *Id.* at 124 (citing *Fed. Election Comm'n v. Legi-Tech, Inc.*, 75 F.3d 704, 708 n.5 (D.C. Cir. 1996)). No such ongoing impact occurred here.

First, ALJ Miserendino's general ability to shape the record at the 2015 hearing does not demonstrate that ALJ McNeil lacked independence. Calcutt implies that any decision at a prior proceeding that shapes the record of a later proceeding invalidates the latter's outcome. That goes too far. *See Intercollegiate Broad. Sys.*, 796 F.3d at 124 (explaining that "not every possible kind of taint is fatal because, if it were, there would be no way to remedy an Appointments Clause violation"); *Legi-Tech*, 75 F.3d at 708–09 (accepting that past Appointments Clause violation will have some impact on later proceedings, but refusing to restart administrative process). And where a party receives an opportunity to submit additional evidence and to specify alleged defects in the first proceeding, as the FDIC's order after *Lucia* provided

merits," *see Intercollegiate Broad. Sys.*, 796 F.3d at 117, involves analyzing the impact of those past proceedings on a current adjudication—an inquiry that bears little resemblance to a weighing of the relative costs and benefits of a new administrative proceeding. Though we mention prudential considerations that favor our approach, we do not rely on them. Instead, our conclusion rests on the principle illustrated in *Intercollegiate Broadcasting System* and other decisions that, following an Appointments Clause violation, a new proceeding affords adequate remedy when a new decisionmaker can independently consider the merits. *See id.* at 117–20; *Arthrex*, 941 F.3d at 1340.

here, the subsequent proceeding is even more likely to be independent.

Second, ALJ McNeil's reliance on stipulations that the FDIC, Calcutt, Green, and Jackson made during the 2015 proceedings before Green and Jackson settled did not taint the proceedings. Calcutt and amicus Washington Legal Foundation argue that the settlement altered the facts that Calcutt would have conceded. At most, however, the cases cited by the parties show that courts sometimes accept stipulations made in prior proceedings and sometimes do not, and that these decisions are reviewed for abuse of discretion. *See United States v. Kanu*, 695 F.3d 74, 78 (D.C. Cir. 2012); *Waldorf v. Shuta*, 142 F.3d 601, 616 (3d Cir. 1998); *Hunt v. Marchetti*, 824 F.2d 916, 918 (11th Cir. 1987). To the extent that these decisions about judicial proceedings apply to administrative adjudications, ALJ McNeil did not abuse his discretion. In *Waldorf*, the court specified that "a stipulation does not continue to bind the parties if they expressly limited it to the first proceeding or if the parties intended the stipulation to apply only at the first trial," 142 F.3d at 616, and in this case the parties had agreed to stipulations at the 2015 proceedings without expressly limiting the stipulations to those proceedings. Moreover, while stipulations from prior proceedings may be excluded if their admission would create a "manifest injustice," *Kanu*, 695 F.3d at 78, Calcutt did not deny that the stipulations were accurate, but rather argued that they were irrelevant or inappropriate to the new proceeding now that that his co-respondents had settled. The ALJ did not abuse his discretion by admitting the stipulations when Calcutt had failed to show that their admission would produce manifest injustice and had failed to expressly limit their use to the prior proceedings.

Finally, Calcutt contends that ALJ McNeil and the FDIC Board's use of the record of the 2015 hearing hampered their ability to make an independent judgment. At the 2019 hearing, Calcutt objected to using that record for all but two witnesses,[13] except for impeachment purposes. ALJ McNeil indicated that he was willing to use the entire 2015 record for substantive as well as impeachment purposes, and he ultimately used that record at several points throughout the hearing and his recommended decision. The FDIC Board then referred to the 2015 record in its final decision at several points, including instances when the 2015 record was the only cited evidence. It also concluded that it could consider Calcutt's testimony during 2015 as either impeachment or substantive evidence.

This inclusion of the 2015 record also did not prevent ALJ McNeil and the Board from conducting an "independent evaluation of the merits." *Intercollegiate Broad. Sys.*, 796 F.3d at 122. To begin with, Calcutt's prior testimony likely qualifies as an opposing party's statement, despite his objection. *See* 12 C.F.R. § 308.36(a)(2) (permitting admission of evidence that would be admissible under Federal Rules of Evidence); *United States v. Cunningham*, 679 F.3d 355, 383 (6th Cir. 2012) (explaining that Federal Rule of Evidence 801(d)(2)(A) allows "a party's own statement to be offered as evidence against that party even where the statement would otherwise be inadmissible as hearsay"). Additional testimony from 2015 was corroborated by other evidence. The remaining isolated instances in which either ALJ McNeil or the Board relied on the 2015 record for substantive conclusions do not convince us that the agency was unable to independently

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[13] The parties agreed by stipulation to introduce the 2015 testimony of Dennis O'Neill and Charles Bird, two FDIC examiners.

consider the merits of Calcutt's case. And, if there was error at these points in its analysis, it was likely harmless due to the abundance of evidence in the record supporting the agency's decision. *See* 5 U.S.C. § 706(2); *see also infra* at 37–53.

In sum, *Lucia* required that Calcutt receive a new hearing, and that is what he got. A new hearing need not be from scratch; rather, the impact of the prior proceeding must be sufficiently muted that the new adjudicator can independently consider the merits. ALJ McNeil and the FDIC Board did not abuse their discretion by admitting the 2015 materials when they remained capable of drawing their own conclusions about Calcutt's case.

IV. HEARING CHALLENGES

We now turn from Calcutt's structural constitutional challenges to his claims regarding the specifics of his 2019 hearing. These fall into three categories: a challenge relating to the decision of the ALJ to limit cross-examination on bias at the hearing, a challenge to the substance of the FDIC Board's findings and conclusions, and an abuse-of-discretion challenge to the FDIC Board's choice of sanction.

A. Cross-Examination

Under the FDI Act and the APA, parties are entitled "to conduct such cross-examination as may be required for a full and true disclosure of the facts." 5 U.S.C. § 556(d); *see* 12 U.S.C. § 1818(h)(1) (requiring FDIC hearings to be conducted in accordance with APA adjudication procedures). The FDIC's regulations provide that evidence which would be admissible under the Federal Rules of Evidence is also admissible in an enforcement hearing, 12

C.F.R. § 308.36(a)(2), and that evidence that would be inadmissible under the Federal Rules of Evidence is admissible in the hearing if it is "relevant, material, reliable, and not unduly repetitive," *id.* § 308.36(a)(3); *see id.* § 308.36(a)(1). Calcutt argues that ALJ McNeil erred under these provisions by limiting cross-examination of Autumn Berden, Cori Nielson, and Anne Miessner regarding their purported bias against Calcutt, and that the Board erred by accepting these limitations. The parties agree that neither Berden, Nielson, nor Miessner testified about bias at the hearing.

We review an ALJ's exclusion of evidence under an abuse-of-discretion standard. *NLRB v. Jackson Hosp. Corp.*, 557 F.3d 301, 305–06 (6th Cir. 2009). An abuse of discretion occurs when the ALJ "applies the wrong legal standard, misapplies the correct legal standard, or relies on clearly erroneous findings of fact." *B & G Mining, Inc. v. Dir., Off. of Workers' Comp. Programs*, 522 F.3d 657, 661 (6th Cir. 2008) (quotation marks omitted).

Yet, "due account must be taken of the rule of prejudicial error." 5 U.S.C. § 706(2); *see* 12 U.S.C. § 1818(h)(2) (providing that the APA governs review of FDIC enforcement proceedings). This language applies the federal harmless-error standard from civil cases. *See Shinseki v. Sanders*, 556 U.S. 396, 406–07 (2009). We employ a "case-specific application of judgment, based upon examination of the record," *id.* at 407, to determine whether the error "affect[ed] the substantial rights of the parties," 28 U.S.C. § 2111. An error is not harmless when, for example, an agency violates its own procedural rules and the petitioner shows that he "has been prejudiced on the merits or deprived of substantial rights because of the agency's procedural lapses." *Wilson v. Comm'r of Soc. Sec.*, 378

F.3d 541, 547 (6th Cir. 2004) (quotation marks and emphasis omitted).

We need not reach whether ALJ McNeil abused his discretion in limiting cross-examination on the bias of Berden, Nielson, and Miessner, because even if he did, that error was harmless. As we have explained in the civil context, an adjudicator's erroneous exclusion of evidence is not prejudicial, and therefore is harmless, "if other substantially equivalent evidence of the same facts [was] admitted into evidence." *In re Air Crash Disaster*, 86 F.3d 498, 526 (6th Cir. 1996) (quoting *Leonard v. Uniroyal, Inc.*, 765 F.3d 560, 567 (6th Cir. 1985) (alteration in original)). Thus, we recently observed that where a court excluded evidence of police interview transcripts but the record contained depositions of "most of the same witnesses" quoted in the transcripts, any error was harmless. *M.J. v. Akron City Sch. Dist. Bd. of Educ.*, 1 F.4th 436, 447 (6th Cir. 2021); *see also Smith v. Woolace Elec. Corp.*, 822 F. App'x 409, 417 (6th Cir. 2020) (potential error over excluding witness's testimony was harmless where plaintiff "introduced substantially equivalent evidence" through another witness's testimony).

ALJ McNeil and the FDIC Board had access to the 2015 record, which contained substantially equivalent evidence regarding Berden, Nielson, and Miessner's bias. *See supra* at 31–35. During those earlier proceedings, Calcutt's counsel examined Berden, Nielson, and Miessner about their bias and alleged collaboration. Other documents in the record were also relevant to bias, including an email where Nielson told Miessner about difficulties with Northwestern Bank, requested that the FDIC contact Michigan regulators, and stated, "I just wish there was a fresh face to talk to at the bank—all this collateral damage is meaningless"; an email in which Miessner communicated with Michigan regulators regarding Nielson's request; Berden's handwritten notes from meetings with FDIC officials; and an email correspondence between Miessner, Nielson, and Berden about FDIC charges against Calcutt, titled "A little news to brighten your weekend." Although further cross-examination would have allowed Calcutt to further develop his bias argument, the availability of these other materials indicates that the agency's factfinders possessed sufficient information regarding the possible bias of Berden, Nielson, and Miessner to render any error harmless. Thus, the limits on cross-examination do not necessitate a new proceeding.

B. Substantive Challenges

As previously discussed, Section 8(e) of the FDI Act permits the FDIC to enter a removal and prohibition order against an institution-affiliated party after finding that three elements have been met: misconduct, effects, and culpability. *See Dodge*, 744 F.3d at 152. Misconduct occurs when a party has "directly or indirectly" violated a law or regulation, "engaged or participated in any unsafe or unsound practice" connected with an insured institution, or breached a fiduciary duty. 12 U.S.C. § 1818(e)(1)(A). The requisite effects take place when, "by reason of" the misconduct, the insured institution "has suffered or will probably suffer financial loss or other damage," its depositors' interests are prejudiced, or the party "has received financial gain or other benefit by reason of" the misconduct. *Id.* § 1818(e)(1)(B). And the culpability element is met when the party's action "involves personal dishonesty" or "demonstrates willful or continuing disregard . . . for the safety or soundness" of the insured institution. *Id.* § 1818(e)(1)(C). We review the FDIC Board's factual findings for substantial evidence and set aside the agency's legal conclusions if they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Pharaon v. Bd. of Governors of Fed. Rsrv. Sys.*, 135 F.3d 148, 152 (D.C. Cir. 1998) (quoting 5 U.S.C. § 706(2)(A)).[14]

Calcutt argues that the FDIC exceeded its statutory authority by finding misconduct when none of his actions qualified under the statutory definitions, failing to demonstrate that any effects resulted "by reason of" of the misconduct, and failing to identify qualifying effects. He therefore does not challenge the Board's finding as to his culpability, so we do not address that part of the Removal and Prohibition Order. He also challenges his civil money penalty only to the extent that the Board's reasoning for the penalty overlaps with its analysis supporting the Removal and Prohibition Order.

1. *Misconduct*

As to misconduct, Calcutt maintains that the FDIC Board erred by determining that his actions constituted an "unsafe or unsound practice" or a breach of fiduciary duties under the statute.[15] We disagree.

a. Unsafe or Unsound Practice

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[14] Though the FDIC Board's interpretation of Section 8(e) of the FDI Act may receive persuasive weight, at least one of our sister circuits has explained that the FDIC receives no *Chevron* deference to its interpretation of the Act, because several agencies administer that statute. *Dodge*, 744 F.3d at 155.

[15] The FDIC does not argue that Calcutt's actions violated any explicit statute, regulation, cease-and-desist order, or other similar requirement. *Cf.* 12 U.S.C. § 1818(e)(1)(A)(i).

The FDI Act does not define an "unsafe or unsound practice," and the term is interpreted flexibly. *See Seidman v. Off. of Thrift Supervision (Matter of Seidman)*, 37 F.3d 911, 926–27 (3d Cir. 1994). However, courts have generally treated the phrase as referring to two components: "(1) an imprudent act (2) that places an abnormal risk of financial loss or damage on a banking institution." *Id.* at 932; *see also Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012) (same); *Landry*, 204 F.3d at 1138 (identifying imprudent-act and abnormal-financial-risk components).

Calcutt emphasizes the financial-risk component and argues that the Bedrock Transaction did not pose an abnormal financial risk to Northwestern Bank. Along with amicus American Association of Bank Directors, he characterizes the Bedrock Transaction as a good-faith attempt to shore up one of the Bank's largest lending relationships during the tumult of the Great Recession by releasing collateral and extending a loan that amounted to only a fraction of the Nielson Entities' total debt. And even if the $760,000 loan and $600,000 in collateral were ultimately not collected, he says, that loss would have been insignificant, considering that the Bank's Tier 1 capital totaled more than $70 million.

The FDIC responds that the statute does not require a finding of a threat to bank stability in order to find "unsafe or unsound" practice, and that "[c]ourts have affirmed prohibition orders based on unsafe and unsound practices with a much more limited effect." Br. of Respondent 46. That reading contradicts the analyses of our sister circuits in *Seidman*, *Michael*, and *Landry*, and the decisions that the agency cites in support of its interpretation are not convincing. *Ulrich v. U.S. Department of Treasury* is a Ninth Circuit memorandum in which the court concluded that a loan "fraught" with financial risk, not just a limited effect, was an unsafe or unsound practice. 129 F. App'x 386, 390 (9th Cir. 2005). Other decisions that the FDIC cites—*Gully v. National Credit Union Administration Board*, 341 F.3d 155 (2d Cir. 2003), *First State Bank of Wayne County v. FDIC*, 770 F.2d 81 (6th Cir. 1985), and *Jameson v. FDIC*, 931 F.2d 290 (5th Cir. 1991)—did not engage with the question of whether financial risk to the institution was necessary to demonstrate an unsafe or unsound practice. Still other cited decisions linked a finding of unsafe or unsound practices to abnormal financial risks, again controverting the FDIC. *See Gulf Fed. Sav. & Loan Ass'n of Jefferson Parish v. Fed. Home Loan Bank Bd.*, 651 F.2d 259, 264 (5th Cir. 1981); *Matter of* ***, FDIC-83-252b&c, FDIC-84-49b, FDIC-84-50e (Consolidated Action), 1985 WL 303871, at *9 (FDIC Aug. 19, 1985).

Whether or not we interpret the statute to require a finding of *abnormal* financial risk, however, the FDIC's finding that Calcutt committed an "unsafe or unsound practice" is supported by substantial evidence. First, Calcutt does not address the Board's finding that he "repeatedly concealed material information about the Nielson Loans" from regulators, and that such misrepresentations "constitute unsafe or unsound practices." *See De la Fuente*, 332 F.3d at 1224 ("Failure to disclose relevant information to a government investigator can constitute an unsound banking practice."); *Seidman*, 37 F.3d at 937 (stating that "hindering [a financial regulatory agency] investigation is an unsafe or unsound practice").

Second, the record supports the FDIC Board's conclusion that Calcutt committed additional imprudent acts that posed an abnormal financial risk. In particular, the

Board underscored that when the Nielson Entities indicated to the Bank that they would not be able to pay off their loans in 2009, Calcutt declined to seek additional financial information and instead approved the Bedrock Transaction, which extended further credit to the Entities and renewed the outstanding $4.5 million in loans to Bedrock Holdings. The Board also found that Calcutt's actions violated the Bank's commercial-loan policy because he approved the Bedrock Transaction without either determining that the Nielson Entities had sufficient income to service their debt, obtaining personal guarantees on the loans, or receiving approval by a two-thirds majority of the board of directors.

Calcutt responds that such actions do not constitute "unsafe or unsound" practices absent abnormal financial risk to the Bank, and that his actions did not present such a risk. His first proposition may be correct. *See Seidman*, 37 F.3d at 932. However, Calcutt's actions concerned the Bank's largest lending relationship—the Nielson Entities—which represented approximately $38 million in loans and half of the Bank's Tier 1 capital. The FDIC Board had substantial evidence to find that his actions presented a risk in this context, even if it did not explicitly draw that connection. *See Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 377 (1998) (explaining that substantial-evidence test "gives the agency the benefit of the doubt, since it requires not the degree of evidence which satisfies the court that the requisite fact exists, but merely the degree which could satisfy a reasonable factfinder" (emphasis omitted)). We therefore hold that the FDIC Board did not err in determining that Calcutt engaged in unsafe or unsound practices.

b. Breach of Fiduciary Duties

The FDIC Board also concluded that the misconduct element was satisfied because Calcutt breached his fiduciary duties of care and candor. *See* 12 U.S.C. § 1818(e)(1)(A)(iii). These duties are determined by state law rather than federal common law. *See Atherton v. FDIC*, 519 U.S. 213, 226 (1997) (holding that state law rather than federal common law defines standard of care for corporate governance); *Mickowski v. Visi-Trak Worldwide, LLC*, 415 F.3d 501, 511–12 (6th Cir. 2005). Under Michigan law, bank directors and officers have a fiduciary duty to act with the degree of care "that an ordinarily prudent person would exercise under similar circumstances in a like position." Mich. Comp. Laws Ann. § 487.13504(1) (2021). And in other contexts, Michigan courts have recognized that "[a] fiduciary has an affirmative duty to disclose" material facts relating to the fiduciary relationship to a principal. *Silberstein v. Pro-Golf of Am., Inc.*, 750 N.W.2d 615, 624 (Mich. Ct. App. 2008); *see also Lumber Vill., Inc. v. Siegler*, 355 N.W.2d 654, 694–95 (Mich. Ct. App. 1984) (recognizing that courts may toll the statute of limitations for fraudulent concealment actions when a fiduciary fails to inform a principal of material facts relating to the claim, because "there is an affirmative duty to disclose where the parties are in a fiduciary relationship").

On appeal, Calcutt presents three arguments, none availing. First, he contends that he cannot have violated his duty of care, because his actions did not create an "undue risk" to the Bank. Br. of Petitioner 51 (quoting *Kaplan v. Off. of Thrift Supervision*, 104 F.3d 417, 421 (D.C. Cir. 1997)). This argument echoes his position that he did not commit an "unsafe or unsound" practice with regard to the Bedrock Transaction.[16] *See Landry*, 204 F.3d at 1138 (noting overlap in analyses of breach of fiduciary duties and unsafe or unsound practices). And it fails for the same reason as his unsafe-or-unsound claim: The record presents substantial evidence to support a finding of financial risk.

Second, Calcutt argues that the Board's finding that he failed to supervise his subordinates (namely Green, Jackson, and other Bank employees) does not indicate that he breached his duty of care. It is true that an officer does not necessarily violate a duty of care merely because subordinates failed to follow orders. *See Doolittle v. Nat'l Credit Union Admin.*, 992 F.2d 1531, 1537 (11th Cir. 1993); *see also Kaplan*, 104 F.3d at 422 (explaining that director's approval of plan that ultimately led other officers and directors to "dishonestly short circuit the required procedures" was not "remotely foreseeable" and did not "contribut[e] to any increased risk" to institution).

But even if Green, Jackson, and other employees committed many of the actions related to the Nielson Entities, Calcutt remains responsible if he knew about their actions and permitted them to occur. Failure to supervise subordinates breaches an officer's duty of care when the officer knows about subordinates' activities or buries his head in the sand. *See Hoye v. Meek*, 795 F.2d 893, 896 (10th Cir. 1986) (holding that bank director and president inadequately supervised subordinate, because "[w]here

[16] We note that the Board also concluded that the December 2010 release of Pillay Collateral violated the duty of care, but it did not conclude that the collateral release constituted an unsafe or unsound practice. This difference between the two types of misconduct findings does not affect our analysis.

suspicions are aroused, or should be aroused, it is the directors' duty to make necessary inquiries"). In *Doolittle*, for instance, the Eleventh Circuit clarified that an officer was not responsible for his subordinates' actions when he gave proper orders to them, they failed to follow those orders, and he attempted to take remedial measures, but that those circumstances did not present "a case where a fiduciary engaged in imprudent lending activities or stood idle and allowed damage to increase." 992 F.2d at 1537.[17]

The record provides substantial evidence that Calcutt knew about his subordinates' activities and permitted them to continue. For instance, in 2008, he was involved in discussions with Green and the Nielsons involving the suggestion that they change their methods of intercompany loans. Calcutt was aware of the Nielson Entities' difficulty in paying their loans, although he testified that he thought that they were "posturing." He received correspondence directly from the Nielsons. Berden testified that though Calcutt would not attend all meetings, Green often sought his approval before proceeding in negotiations. Calcutt had received a memo from Green in November 2009 describing the loan to Bedrock Holdings. He was aware of (and possibly participated in approving)

[17] Calcutt and amicus American Association of Bank Directors refer to the business-judgment rule and urge us not to fault Calcutt for taking what they characterize as reasonable, good-faith, but ultimately mistaken decisions in managing the Bank. Michigan courts have recognized that "[i]nterference with the business judgment of corporate directors is not justified by allegations that a different policy could have been followed." *Matter of Est. of Butterfield*, 341 N.W.2d 453, 462 (Mich. 1983). However, they also recognize that a breach of fiduciary duty merits judicial intervention. *Ibid.* The business-judgment rule thus does not prevent us from considering whether Calcutt breached fiduciary duties.

the sale of Nielson Entity loans to affiliated banks. And Green reported directly to Calcutt. There was ample evidence for the FDIC Board to find that he had breached his duty of care by failing to supervise subordinates.

Finally, Calcutt resists the Board's conclusion that he breached his duty of candor to the Bank's board of directors by failing to timely disclose the information about the status of the Nielson Loans and the Bedrock Transaction. He asserts that the duty of candor requires corporate fiduciaries to "disclose only 'material information relevant to corporate decisions from which [the fiduciary] may derive a personal benefit,'" and that he did not have a personal interest in the Bedrock Transaction. Br. of Petitioner 53 (quoting *De la Fuente*, 332 F.3d at 1222 (alteration in original)). Even if we accept this framing of the duty, however, the FDIC concluded that Calcutt derived a personal benefit from misrepresenting the status of the Nielson Loans to regulators, because he received dividends through the Bank's holding company that reflected the Bank's artificially inflated income. To the extent that substantial evidence supports the personal-benefit determination, the finding that Calcutt breached his duty of candor would also be sufficiently supported. In addition, even if Calcutt did not receive a personal benefit, the support for the Board's finding that he committed unsafe and unsound practices and violated the duty of care means that this error would be harmless. *See Sanders*, 556 U.S. at 407.

In sum, we decline to set aside the Board's conclusions that Calcutt met the misconduct element of the statute.

2. *Effects*

Under the FDI Act, the FDIC must find that "by reason of" Calcutt's misconduct, one or more of the following effects resulted: The Bank "has suffered or will probably suffer financial loss or other damage," its "depositors have been or could be prejudiced," or Calcutt "has received financial gain or other benefit." 12 U.S.C. § 1818(e)(1)(B). The FDIC Board found that three types of harms qualified under this provision: (1) a $30,000 charge-off to the $760,000 Bedrock Loan that the Bank recorded; (2) $6.443 million in other charge-offs that the Bank recorded on other Nielson Loans; and (3) investigative, legal, and auditing expenses that the Bank incurred. It also found that Calcutt received a financial benefit, because he received dividends from the Bank's holding company that would have been smaller had he reported the condition of the Nielson Loans and not approved the Bedrock Transaction or 2010 release of Pillay Collateral.

Calcutt commences by arguing that the Board erred by failing to read the statute's "by reason of" language to require proximate causation. In its final decision, the FDIC was unwilling to apply a proximate-causation standard, instead stating that "an individual respondent need not be the proximate cause of the harm to be held liable under section 8(e)."

Because Section 8(e) requires that a bank's loss or potential loss, or a party's benefit, occur "by reason of" the misconduct, it mandates proximate causation. 12 U.S.C. § 1818(e)(1)(B). Recently, we observed that "[t]he Supreme Court has repeatedly and explicitly held that when Congress uses the phrase 'by reason of' in a statute, it intends to require a showing of proximate cause." *Crosby v. Twitter, Inc.*, 921 F.3d 617, 623 (6th Cir. 2019) (quoting *Kemper v. Deutsche Bank AG*, 911 F.3d 383, 391 (7th Cir.

2018)). This interpretation has occurred in the context of other statutory schemes. *See Hemi Grp., LLC v. City of New York*, 559 U.S. 1, 9 (2010) (civil RICO statute, 18 U.S.C. § 1964(c)); *Holmes v. Sec. Inv. Prot. Corp.*, 503 U.S. 258, 268 (1992) (same); *Crosby*, 921 F.3d at 623 (Anti-Terrorism Act, 18 U.S.C. § 2333). The FDIC has not offered a reason why the phrase should not have the same meaning in Section 8(e), and "[i]n the absence of any statutory definition to the contrary, courts assume that Congress adopts the customary meaning of the terms it uses." *United States v. Detroit Med. Ctr.*, 833 F.3d 671, 674 (6th Cir. 2016) (citing *Morissette v. United States*, 342 U.S. 246, 263 (1952)).

The FDIC alternatively argues that its formulation—that "by reason of" requires only "a causal 'nexus' between the misconduct and harm, or that harm was reasonably foreseeable"—is consistent with proximate causation. Br. of Respondent 50. This has some appeal; after all, it is notoriously difficult for judges to define proximate cause. *See Associated Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters*, 459 U.S. 519, 535–36, 535 n.32 (1983); *Crosby*, 921 F.3d at 623–24. We also recognize that in prior adjudications, the FDIC has concluded that a reasonably foreseeable loss "satisfies the 'effects' requirement." *Matter of Conover*, Nos. FDIC-13-214e, FDIC-13-217k, 2016 WL 10822038, at *22 (FDIC Dec. 14, 2016); *see also Matter of* ***, 1985 WL 303871, at *114 (declining to characterize the causation standard as proximate cause). However, while reasonable foreseeability may be a necessary component of proximate causation, it is not sufficient: "substantiality, directness, and foreseeability are all relevant in a proximate cause determination," though these concepts may overlap.

Crosby, 921 F.3d at 624.

The decisions cited by the FDIC as support for its view are consistent with a proximate-causation definition of "by reason of" that incorporates substantiality, directness, and foreseeability. In *De la Fuente*, for example, the Ninth Circuit held that a risk of loss must be "reasonably foreseeable," but did not conclude that reasonable foreseeability alone was enough for liability. 332 F.3d at 1223; *see also United States v. Gamble*, 709 F.3d 541, 549 (6th Cir. 2013) (holding that harms must be reasonably foreseeable to be proximately caused, but not stating that reasonable foreseeability is sufficient). *Haynes v. FDIC*, a memorandum, seemingly treated "reasonably foreseeable" as interchangeable with "by reason of," but did so in a summary fashion that we do not consider persuasive. *See* 664 F. App'x 635, 637 (9th Cir. 2016). Although in *Landry*, the Court of Appeals for the District of Columbia Circuit recognized that an individual could be liable for the effects of misconduct even if he acted "only indirectly," the court was construing the misconduct element of Section 8(e). 204 F.3d at 1139; *see* 12 U.S.C. § 1818(e)(1)(A) (identifying relevant finding as whether a party has "directly or indirectly" committed misconduct). We do not read that decision to say that when it comes to the effects inquiry, reasonable foreseeability alone suffices to show causation.

With the causation standard established, we consider the statutory effects identified by the FDIC Board. We conclude that substantial evidence supports the conclusion that some—but not all—of the impacts to the Bank are "effects" under Section 8(e) and were proximately caused by Calcutt's misconduct.

a. The $30,000 Charge-Off on the $760,000 Bedrock

Loan

The charge-off on the loan to Bedrock Holdings, which was part of the Bedrock Transaction, is an effect under the statute. Calcutt argues that a charge-off does not reflect actual losses but rather estimates possible future loss, but the FDI Act is clear that a loss that a bank will "probably suffer" qualifies as an effect, 12 U.S.C. § 1818(e)(1)(B)(i). Similarly, an estimated loss is sufficient. *See Dodge*, 744 F.3d at 158 (explaining that effects requirement "is satisfied by evidence of either potential or actual loss to the financial institution, and the exact amount of harm need not be proven"); *Pharaon*, 135 F.3d at 157 (holding that FDIC Board need not "demonstrate the exact amount of harm"). Though Calcutt argues that some charge-offs are too small to constitute effects, we need not address this issue, because the FDIC supplemented its finding with respect to the $30,000 effect with several other findings of effects. And the record indicates that, because Calcutt participated extensively in negotiating and approving the Bedrock Transaction, his actions proximately caused the Bedrock Loan charge-off.

b. Investigative, Auditing, and Legal Expenses

The FDIC Board also agreed with ALJ McNeil that Calcutt's misconduct caused the Bank to incur expenses by retaining a CPA firm and a legal firm to conduct work relating to the regulatory problems with the Nielson Entities relationship. We conclude, however, that such professional fees are not "effects" under Section 8(e). Banks regularly engage accounting and legal firms as part of their normal business, and we do not see how employing such businesses for additional services related to imprudent loans is meaningfully different from their run-of-the-mill engagements.

The FDIC Board reasoned that though legal fees "presumptively are a normal cost of doing business," they can constitute an effect when they "are coupled with other 'non-neutral indicia of loss,'" and that the Bank's payments to a CPA firm and loan charge-offs constituted such other non-neutral indicia. *See Matter of Proffitt*, FDIC-96-105e, 1998 WL 850087, at *9 n.11 (FDIC Oct. 6, 1998) (considering "a [court] judgment of improper and illegal behavior" in a related lawsuit to be a non-neutral indicium). We are unpersuaded by this rationale: If professional fees are not a loss unless they are coupled with other "non-neutral indicia of loss," then it may be that the fees do not have any independent significance. The two FDIC decisions cited by the Board exemplify this problem, since in both instances banks suffered losses *in addition to* their payment of professional fees. In *Matter of Proffitt*, the Board explained that "a judgment of improper and illegal behavior"—in that context, a court judgment awarding a bank to pay damages—plus legal fees could establish a qualifying loss. *Id.* at *3, *9 & n.11. And in *Matter of Shollenburg*, the bank suffered additional losses besides professional fees in order to satisfy tax laws that the respondents had violated. *See* FDIC-00-88e, 2003 WL 1986896, at *12–13 (FDIC Mar. 11, 2003).

c. $6.443 Million in Other Losses

Next, the Board found that Calcutt's actions cost the Bank $6.443 million in losses from other loans to the Nielson Entities, and that his approval of the release of approximately $1.2 million in Pillay Collateral prevented the Bank from using those funds to recoup part of those losses. Apart from asserting that the Board failed to apply a proximate-causation standard, Calcutt argues that under that standard, the $6.443 million loss does not count as an effect, because it represents a probable future loss from the entire Nielson Entity loan portfolio that would have occurred regardless of his actions, and because the $1.2 million in released collateral was used to pay off the Nielson Entities' debts, thereby benefitting the Bank.[18]

Only part of the $6.443 million in charge-offs can be described as an effect proximately caused by Calcutt's misconduct. Recall that the Nielson Entities indicated that they were unable to pay off debts as early as 2009. The Bank probably would have incurred *some* loss no matter what Calcutt did: Although multiple parties' actions can proximately cause the same outcome, the state of the Bank's relationship with the Nielson Entities suggests that Calcutt's actions did not substantially or directly contribute to *all* of its ultimate losses.

Additionally, the FDIC's explanation for considering the $1.2 million of released collateral in its loss calculation is unconvincing. In its decision, the FDIC Board reasoned that had Calcutt not participated in the release of the Pillay Collateral in 2009 and 2010, those funds would have been available to pay off debts owed by certain Nielson Entities that were secured by that collateral. But that view ignores that the release of Pillay Collateral was used to satisfy *other* Nielson Entity debts, and that the FDIC, in calculating the $6.443 million in losses, considered all of the Bank's loans to the companies together. We fail to see how the agency could reasonably consider the interrelatedness of the Nielson Entities in one part of its loss calculation and ignore those connections in another. Thus, the mere release of the $1.2 million in collateral does not

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[18] Calcutt also suggests that because the $6.443 million was recorded in charge-offs, it does not qualify as a loss. For the reasons previously discussed, this view fails. *See supra* at 45.

qualify as an effect.

Nevertheless, there is substantial evidence that part of the $6.443 million in losses was an effect of Calcutt's actions. The record indicates that Calcutt, knowing that the Nielson Entities were near default and that they were a large lending relationship, extended credit and renewed loans to them while concealing these transactions and the scale of the problem from the Bank's board and from regulators. ALJ McNeil also found that, in 2009, the Nielson Entities had proposed loan renewals, forbearance, deeds in lieu of foreclosure, and other mechanisms to relieve their obligations. Though Calcutt may have thought that these options would have resulted in "sure losses" to the Bank, the FDIC could have concluded from the record that his decision to extend additional loans ultimately exacerbated the problem.

Additionally, there is substantial evidence that Calcutt's actions resulted in probable future losses to the Bank. *Cf.* 12 U.S.C. § 1818(e)(1)(B)(i) (permitting effects finding where bank "will probably suffer financial loss or other damage"); *Proffitt v. FDIC*, 200 F.3d 855, 863 (D.C. Cir. 2000) (noting that "the effect prong can be met by either potential or actual 'financial loss or other damage'"). Even if there were insufficient evidence that Calcutt's actions surrounding the Bedrock Transaction and 2010 release of Pillay Collateral caused an *actual* loss, his negotiation with the Nielson Entities and approval of loans despite indications that they would not be able to repay their debts was a direct, substantial, and foreseeable cause of a situation in which the Bank could suffer a potential loss. The record also shows that Calcutt's actions prevented the board and regulators from discovering and mitigating the probable losses from these activities. *Cf.*

Seidman, 37 F.3d at 937 (noting, in the context of identifying an unsafe or unsound practice, that a chairman of a board of director's "attempt to obstruct the investigation, if continued, would pose an abnormal risk of damage" to the agency). Relying on board members' testimony and contemporaneous board minutes,[19] ALJ McNeil found that the board did not approve the loan to Bedrock Holdings until several months after the loan had already been made. And Miessner testified (despite Calcutt's theory that she was biased) that, in her opinion, misrepresenting the condition of the Bank's loans with the Nielson Entities exposed the Bank to additional risk. In these circumstances, we conclude from the record as a whole that Calcutt's actions proximately caused an actual and potential loss to the Bank—even if the loss did not amount to the total of $6.443 million.

d. Holding Company Dividends

Finally, the Board concluded that the dividends Calcutt received from the Bank's holding company qualified as a financial benefit that satisfied the "effects" element. *See* 12 U.S.C. § 1818(e)(1)(B)(iii) (providing that an effect is present when a party "has received financial gain or other benefit by reason of such violation, practice, or breach"). The holding company, Northwestern Bancorp, wholly owned the Bank, and Calcutt held approximately ten percent of the shares in the holding company. In 2010 and 2011, the Bank paid dividends to Northwestern Bancorp. The holding company, in turn, paid a dividend to its shareholders. Calcutt argues that his alleged misconduct

[19] ALJ McNeil also found that Calcutt's testimony regarding the timing of the board's approval of the Bedrock Transaction was not credible.

cannot have proximately caused a financial benefit, because Northwestern Bancorp operated independently from the Bank and had alternative sources of income; thus, even if the Bank's income appeared inflated due to the improper reporting of the Nielson Loans, it did not substantially affect the holding company's payout to shareholders.

As in the circumstance of the FDIC's categorization of the $6.443 million in losses, the record compels an answer somewhere in between the two parties' positions. On one hand, the FDIC did not point to specific evidence in the record showing that Northwestern Bancorp's dividends with certainty reflected the inflated earnings from the Nielson Entities. It simply assumed (and reasonably so) that the dividends paid by the holding company reflected the value of the dividends paid by the Bank. On the other hand, Calcutt does not really challenge the findings that the Bank paid a dividend to the holding company, nor that the Bank's dividend reflected its inflated representation of the Nielson Loans' performance. Rather, his position is that the holding company still might have paid out dividends from its other sources of income. He does not provide evidence (other than his own testimony, which is stated in general terms)[20] that the holding company had ever paid dividends over and above a reflection of the Bank's perceived performance. Absent such evidence, we

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[20] "Q. Did the holding company have sufficient capacity to make payments to shareholders regardless of whether there were dividends being paid by the Bank to the holding company?

A. [Calcutt:] Yes, for some years the holding company not only had its own assets that generated some income but it had a line of credit so it had capacity to make dividend payments to shareholders. Again, we were, we were laughed at a bit in the industry because we had one of the lowest dividend payout ratios that was recorded."

are skeptical that the Bank's earnings did not impact its holding company's dividend payments. On balance, the evidence and common sense support the agency's position as to this effects finding.

e. Cumulative Effects

In sum, the support for the effects findings made by the FDIC Board are mixed. Taken together, the $30,000 charge-off on the Bedrock Loan, some of the $6.443 million in other losses related to the Nielson Entities, and some of the dividend payments that Calcutt received from Northwestern Bancorp occurred "by reason of" his misconduct surrounding loan activities and misrepresentations to the Bank's board of directors and regulators. But the Bank's auditing and legal fees do not qualify as an effect, and Calcutt's actions may not have proximately caused some of the losses and dividend payments.

These conclusions lead to a further question: If some, but not all, of the FDIC's effects findings are supported, should the Removal and Prohibition Order be remanded? One might argue that had the FDIC only considered those effects for which the record presented substantial evidence, it would not have thought it appropriate to remove Calcutt from his banking positions and prohibit him from participation in the industry. Or, perhaps one might say that the whittled-down effects findings are sufficiently minimal to compel us to send the matter back to the agency for further findings and proceedings.

A remand is not necessary, for several reasons. To start, the text of the statute indicates that if substantial evidence supports the FDIC's finding as to *one* effect out of multiple possibilities, the fact that it fails to adequately support its other effects findings does not limit its power to issue a removal and prohibition order. Section 8(e)(1)(B) separates the categories of permissible effects by the disjunctive term "or": The agency must find that "by reason of" the misconduct,

> (i) such insured depository institution . . . has suffered *or* will probably suffer financial loss *or* other damage;
>
> (ii) the interests of the insured depository institution's depositors have been *or* could be prejudiced; *or*
>
> (iii) such party has received financial gain *or* other benefit . . . .

12 U.S.C. § 1818(e)(1)(B) (emphases added). Generally, "terms connected by a disjunctive [are] given separate meanings, unless the context dictates otherwise." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979). For example, when a statute lists two activities connected by "or," the natural reading is usually that it applies to *either* activity. *See Encino Motorcars, LLC v. Navarro*, 138 S. Ct. 1134, 1141 (2018). Thus, the text of the FDI Act permits the FDIC to remove and prohibit a party (assuming that the misconduct and culpability elements are met) as long as the evidence supports a finding of one out of any of the options provided by Section 8(e)(1)(B). Because we conclude here that substantial evidence supports several of the FDIC's effects findings, the statutory text indicates that the Removal and Prohibition Order should stand.

Additionally, other circuits have also suggested that when such a finding can be supported by one of several alternative bases, courts should deny petitions challenging the agency's order. In *Dodge*, for example, the District of Columbia Circuit upheld an effects finding when substantial evidence supported the Comptroller of the Currency's conclusions that a bank's depositors could be prejudiced under Section 8(e)(1)(B)(ii) and that the petitioner received a financial benefit under Section 8(e)(1)(B)(iii)—even when the court declined to rely on the Comptroller's finding of potential harm to the bank under Section 8(e)(1)(B)(i). 744 F.3d at 158. And in *De la Fuente*, the Ninth Circuit held that the FDIC Board "correctly concluded that De La Fuente's [sic] actions had an impermissible effect because he received financial benefit from the transaction *and/or* because the interests of [the bank's] depositors were prejudiced thereby." 332 F.3d at 1223 (emphasis added). That is, the court suggested that even if the Board had incorrectly concluded that the petitioner received financial benefit, its separate finding of prejudice to depositors was sufficient to satisfy the effects element.

Finally, a remand would be in tension with the substantial-evidence standard of review for factual findings. In conducting this review, we consider the whole record, 5 U.S.C. § 706(2), but we must uphold an agency's decision even if we "would decide the matter differently . . . and even if substantial evidence also supports the opposite conclusion." *Gen. Med., P.C.*, 963 F.3d at 520 (quoting *Cutlip*, 25 F.3d at 286). As we have explained, the record in this case provides substantial evidence to conclude that Calcutt's actions produced sufficient effects to merit the FDIC's sanction, even if some findings as to other effects were incorrect. We cannot nitpick the agency's factfinding more than that.

Our dissenting colleague would nonetheless remand the petition to the FDIC, reasoning that only that remedy is consistent with the principle that courts may not uphold an agency's order "unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained." *SEC v. Chenery Corp.*, 318 U.S. 80, 95 (1943). While we do not question *Chenery*, that decision does not mean that a court must remand where the agency makes *any* legal error, especially where substantial evidence amply supports an agency's findings. Remand is unnecessary where an agency's "incorrect reasoning was confined to that discrete question of law and played no part in its discretionary determination," and it reaches a conclusion that it was bound to reach. *United Video, Inc. v. FCC*, 890 F.2d 1173, 1190 (D.C. Cir. 1989); *see also Morgan Stanley Cap. Grp. Inc. v. Pub. Util. Dist. No. 1.*, 554 U.S. 527, 545 (2008) ("That [the agency] provided a different rationale for the necessary result is no cause for upsetting its ruling."). Reading *Chenery* so broadly as to compel remand in such circumstances would result in yet another agency proceeding that amounts to "an idle and useless formality." *NLRB v. Wyman-Gordon Co.*, 394 U.S. 759, 766 n.6 (1969) (plurality op.). And it would risk contradicting the harmless-error rule in courts' review of agency action. *See Sanders*, 556 U.S. at 406–07.

Thus, we do not uphold the FDIC's order in this case simply by substituting our reasoning for the agency's discretionary determinations. Rather, our inquiry focuses on whether substantial evidence supports the FDIC's factual findings that the charge-offs, dividends, and other expenses were "effects" under the statute. Notwithstanding the agency's error in identifying the appropriate causation standard, and our conclusion that legal expenses do not qualify as "effects," the agency's findings clear this hurdle. We decline to remand the petition to the FDIC.

3. *Sanction*

Finally, Calcutt claims that the FDIC's order removing him from his position and prohibiting him from future banking activities is an abuse of discretion. Courts review a removal sanction for abuse of discretion. *Grubb v. FDIC*, 34 F.3d 956, 963 (10th Cir. 1994). A sanction constitutes an abuse of discretion when it "is unwarranted in law or without justification in fact." *Ibid.* (quoting *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 185–86 (1973)) (quotation marks omitted). According to Calcutt, his penalty is "plainly excessive" in light of his subsequent, misconduct-free work for State Savings Bank, his age, and the harshness of the penalty. Br. of Petitioner 63. True, removal and prohibition are "extraordinary sanction[s]." *De la Fuente*, 332 F.3d at 1227. And, as Calcutt notes, the FDIC could have opted to proceed with only a cease-and-desist order or civil monetary penalty. But for the reasons we have explained, Section 8(e) clearly permits removal and prohibition for the actions that the FDIC alleges in this case, and the FDIC's conclusions are well supported. The agency's sanction choice is not an abuse of discretion under these circumstances.

V. CONCLUSION

For the reasons above, we deny Calcutt's petition for review and vacate our stay of the FDIC's Removal and Prohibition Order.

DISSENT

MURPHY, Circuit Judge, dissenting. After adjudging Harry Calcutt guilty of misconduct in the management of a bank, the Federal Deposit Insurance Corporation (FDIC) issued an order that would bar him from working in his profession and fine him $125,000. Calcutt challenges this order on constitutional and statutory grounds. My colleagues reject all of his claims. I agree with them on his constitutional claims but must part ways on his statutory ones.

Calcutt's three constitutional claims do not entitle him to relief. He first alleges that Congress has unconstitutionally restricted the President's right to terminate (and so to control) the FDIC's Board of Directors. But his argument rests on a misreading of the Board's enabling statute. It gives the President complete authority to fire most of the Board's members. Calcutt next argues that Congress at least gave one Board member and the FDIC's administrative law judges unconstitutional protections from removal. Even assuming that this claim has merit, however, he fails to show why these unconstitutional *statutes* would entitle him to the relief that he seeks—vacatur of the FDIC's *actions* in his case as "void." The Constitution itself requires no remedy. And I would read recent Supreme Court precedent to bar his preferred remedy because that reading best comports with the historical practices that we should follow until Congress says otherwise. Calcutt lastly notes that the first administrative law judge who heard his case had not been appointed in a manner that comported with the Constitution's Appointments Clause. The Board agreed and gave him a new hearing before a new judge. Calcutt now claims that the Appointments Clause barred this new judge from relying on any evidence developed at the initial hearing. But again, nothing in the Constitution required any remedy, let alone Calcutt's expansive one.

Calcutt's statutory claims are another matter. The FDIC misread the statute on which it relied to sanction him. Of most note, the FDIC cannot bar Calcutt from banking unless it proves that his bank will suffer a loss (or that he will receive a benefit) "by reason of" his misconduct. 12 U.S.C. § 1818(e)(1)(B). As the Supreme Court has long made clear, the phrase "by reason of" incorporates common-law principles of but-for and proximate cause. Yet the FDIC's order ignored but-for cause and disavowed proximate cause. In fact, the agency held Calcutt liable for his bank's entire loss from underwater loans even though the Great Recession likely would have caused the bank to suffer much (if not all) of this loss no matter what he did. Congress has given the FDIC "extraordinary power" to regulate private parties with only limited judicial oversight. *In re Seidman*, 37 F.3d 911, 929 (3d Cir. 1994). After *Stern v. Marshall*, 564 U.S. 462 (2011), one might wonder whether the agency exercises judicial power by adjudicating cases that deprive individuals of private rights. At the least, its significant authority should make us diligent to ensure that the agency has "turn[ed] square corners when" dealing with the regulated community. *Niz-Chavez v. Garland*, 141 S. Ct. 1474, 1486 (2021). Because the FDIC did not do so in this case, I would remand for it to apply the proper law. I thus respectfully dissent.

I. Background

Calcutt served for years as the President and Chairman of Northwestern Bank in Traverse City, Michigan. During his tenure, entities controlled by the Nielson family (the "Nielson Entities") became the Bank's largest borrowers with $38 million in loans. The Nielson Entities ran real-estate businesses that struggled during the Great

Recession. They defaulted in September 2009. Two months later, the Bank entered into the "Bedrock Transaction" with the entities. It issued them another $760,000 loan and released to them $600,000 of funds held as a security interest. Yet things did not improve. The Nielson Entities again defaulted in September 2010. After the Bank released to them another $690,000 in secured funds, the entities defaulted a final time in January 2011. The Bank incurred $6.443 million in "charge-offs" (amounts unlikely to be collected) from the loans and $30,000 in charge-offs from the Bedrock Transaction.

These events led the FDIC to seek to "remove" Calcutt "from office" and to impose a "civil penalty" on him. 12 U.S.C. § 1818(e)(1), (i)(2)(B). The first administrative law judge who heard his case had been unlawfully appointed, so the FDIC assigned him a new judge. This judge found that Calcutt had committed many statutory violations and that the FDIC should bar him from banking and fine him $125,000. The FDIC agreed. It held that Calcutt had engaged in "unsafe or unsound practice[s]" and committed "breach[es]" of his "fiduciary dut[ies]" mainly in connection with the Bedrock Transaction. *Id.* § 1818(e)(1)(A)(ii)–(iii). Among other misconduct, it found that he had violated the Bank's lending standards by agreeing to that transaction, had hid the transaction's true nature from the Bank's board of directors, and, perhaps most seriously, had lied to regulators about it. The FDIC also found that the Bank would likely suffer "financial loss" and that Calcutt had "received financial gain" "by reason of" this misconduct. *Id.* § 1818(e)(1)(B).

II. Constitutional Claims

I agree with my colleagues that Calcutt's constitutional arguments all fall short. But my reasoning rests largely on different grounds.

A. Restrictions on the President's Ability to Control the FDIC

Calcutt first argues that the FDIC's statutory scheme gives the President constitutionally insufficient control over the agency's exercise of executive power. Why? He assumes that the statute creating the FDIC's five-member Board of Directors bars the President from removing most of its members except "for cause." *See* 12 U.S.C. § 1812. This limit, Calcutt reasons, impairs the President's ability to command the "executive Power" and to "take Care that the Laws be faithfully executed." U.S. Const. art. II, § 1, cl. 1; *id.* § 3. He has a point. The Supreme Court recently found unconstitutional similar "for cause" limits on the President's ability to remove the Director of the Consumer Financial Protection Bureau (CFPB). *Seila Law LLC v. CFPB*, 140 S. Ct. 2183, 2197–2207 (2020). In response, the FDIC "does not dispute Calcutt's assumption" that § 1812 gives the Board these removal protections. Resp. Br. 17 n.7. But it argues that they pass muster under *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), which upheld similar protections for the Federal Trade Commission (FTC). *Id.* at 626–30.

As an intermediate judge, I find this constitutional question difficult. On the one hand, *Humphrey's Executor* relied on the FTC's nonpartisan, multimember structure to uphold the provision limiting the President's ability to fire its commissioners. *Id.* at 624–25. The FDIC shares the same structure. *Compare* 12 U.S.C. § 1812(a)(1)–(2), *with* 15 U.S.C. § 41. And while *Seila Law* may well call *Humphrey's Executor* into doubt, lower courts must follow a case that is directly on point even if another decision has undercut it. *See Agostini v. Felton*, 521 U.S. 203, 237

(1997).

On the other hand, *Humphrey's Executor* may not be directly on point. It also upheld the FTC's removal protections because, as the Court understood the FTC's duties in 1935, the agency undertook "no part of the executive power[.]" 295 U.S. at 628. The FDIC, by contrast, performs core executive functions. Here, it has essentially brought a civil-enforcement suit against Calcutt to ban him from banking and impose a hefty fine on him. It thus is executing (i.e., carrying into effect) the law barring "unsafe or unsound" banking practices. 12 U.S.C. § 1818(e)(1)(A)(ii); *see* Saikrishna Prakash, *The Chief Prosecutor*, 73 Geo. Wash. L. Rev. 521, 537–40 (2005). For executive officers of this kind, "the President's removal power [has been] the rule, not the exception." *Seila Law*, 140 S. Ct. at 2206; *see Myers v. United States*, 272 U.S. 52, 111–75 (1926); Michael W. McConnell, *The President Who Would Not Be King* 161–69, 335–41 (2020).

But I see no reason to resolve the parties' constitutional debate because I do not read the FDIC's statutory scheme to implicate it. Rather, I read the statute that creates the FDIC's Board (12 U.S.C. § 1812) as giving the President *full* power to remove all but one of the Board's five members. Since the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Board has consisted of the Comptroller of the Currency, the CFPB's Director, and three other presidentially appointed members. Pub. L. No. 111-203, § 336(a), 124 Stat. 1376, 1540 (2010); 12 U.S.C. 1812(a)(1). All agree that the President may fire the Comptroller for any reason. 12 U.S.C. § 2.

So the President's ability to control the Board turns on whether he has free rein to fire its three appointed members. The statute creating their offices provides:

"Each appointed member shall be appointed for a term of six years." *Id.* § 1812(c)(1). This statute says nothing that expressly grants for-cause removal protections to these members. Maybe the mere creation of a fixed-year term *implies* that the President may not remove them before their terms end? That view raises a host of problems. If read this way, wouldn't the text create an "absolute" ban on removal even if the President has an excellent reason (like fraud)? *Parsons v. United States*, 167 U.S. 324, 343 (1897). How can we read the text to include an implied gloss authorizing some removals (for cause) on top of an implied restriction generally barring them? That is an awful lot of implications. And if we were to create this gloss, how do we decide what counts as adequate "cause"? Judicial intuition? Simply put, we would be legislating rather than interpreting if we read § 1812 to bar all but for-cause removals. *See Morgan v. Tenn. Valley Auth.*, 115 F.2d 990, 992–93 (6th Cir. 1940).

Historical context confirms that § 1812 does not interfere with the President's ability to remove the Board's appointed members. The provision establishing their six-year term dates to the creation of the FDIC in 1933. Banking Act of 1933, Pub. L. No. 73-66, § 8, 48 Stat. 162, 168. At that time, a "well-approved" "rule of" "statutory construction" directed courts to interpret laws that gave the President the power to appoint an executive officer as including the power to remove the officer. *Myers*, 272 U.S. at 119. So if a law was silent on removal, the President could terminate the officer for any reason. *See Shurtleff v. United States*, 189 U.S. 311, 316 (1903); *Parsons*, 167 U.S. at 338–39. The Congress that created the FDIC operated against this interpretive rule. *See Collins v. Yellen*, 141 S. Ct. 1761, 1782 (2021). And while the Court has since departed from the rule once, it relied on the "philosophy of *Humphrey's Executor*" to do so. *Wiener v. United States*, 357 U.S. 349, 356 (1958). That philosophy did not exist in 1933.

A constitutional concern points the same way. Before *Humphrey's Executor*, the Supreme Court had broadly held that Congress could not constitutionally limit the President's power to fire officers who are appointed with the advice and consent of the Senate. *See Myers*, 272 U.S. at 109–76. The FDIC was created between *Myers* and *Humphrey's Executor*—when the Court treated these removal protections as presumptively invalid. *Myers* "aroused wide interest," *Morgan*, 115 F.2d at 992, so Congress would have known that such protections raised "grave" constitutional "doubts," *United States v. Jin Fuey Moy*, 241 U.S. 394, 401 (1916). These concerns make it all the more implausible to read a law passed at this time as *silently* including them. *See Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 545–46 (2010) (Breyer, J., dissenting). In short, the President has unfettered power to fire (and control) most of the FDIC's Board.

To be sure, both parties seem content to assume that the statute grants the Board protections from removal. *Cf. United States v. Sineneng-Smith*, 140 S. Ct. 1575, 1579 (2020). In a related case, the Supreme Court also assumed that another agency had these protections. *Free Enter. Fund*, 561 U.S. at 487. Yet parties cannot force courts to accept their stipulations of law. *See Young v. United States*, 315 U.S. 257, 258–59 (1942). Under basic avoidance principles, moreover, our power to address an unraised issue reaches its apex when parties ask us to resolve a weighty constitutional question that a statute might not present. *Cf. Nw. Austin Mun. Util. Dist. No. One v.*

Holder, 557 U.S. 193, 205 (2009). That is especially true here. Calcutt's constitutional claim, if accepted, would take us right back to a statutory "severability" question: Which parts of the statute must we set aside as unconstitutional? *See Free Enter. Fund*, 561 U.S. at 508–10; John Harrison, *Severability, Remedies, and Constitutional Adjudication*, 83 Geo. Wash. L. Rev. 56, 88–89 (2014). If the removal protections are imaginary, this question has an easy answer. We should disregard those protections. Since we may have to consider this statutory issue even if we reach Calcutt's constitutional claim, we might as well reach it immediately. *See* William Baude, *Severability First Principles*, 109 Va. L. Rev. ____ (forthcoming 2023) (manuscript at 44–45).

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Even so, Calcutt responds, the President and Board *believed* that § 1812 contained removal protections. This belief, Calcutt argues, "shows that the Board enjoyed *de facto* tenure protections while pursuing this enforcement action, causing" him harm. Reply Br. 7 n.1. I agree that the executive branch likely read the statute this way. But why would "de facto" protections violate the law? Consider a hypothetical: Disagreeing with my reading, the President issues an order stating that he will adhere to for-cause removal rules for the Board due to his views of § 1812 and the Constitution. If we conclude that this order misreads § 1812 and that the statute would be unconstitutional if it imposed such protections, would the order violate the Constitution or statute?

I fail to see why it would violate the Constitution. Like the Supreme Court when resolving cases, the President must interpret the Constitution when performing his constitutional duties. *See Island Creek Coal Co. v. Bryan*, 937

F.3d 738, 753 (6th Cir. 2019) (citing Frank H. Easterbrook, *Presidential Review*, 40 Case W. Res. L. Rev. 905 (1990)). Presidents have routinely done so. When exercising his pardon power, President Jefferson pardoned those convicted under the Sedition Act of 1798 because he believed that the convictions violated the First Amendment. *See New York Times Co. v. Sullivan*, 376 U.S. 254, 273–76 (1964). When exercising his veto power, President Jackson vetoed a bill reauthorizing the national bank because he believed that Congress lacked the power to create it. *See* Easterbrook, *supra*, at 909–10. Like these powers, the removal power belongs to the President. *See Seila Law*, 140 S. Ct. at 2197–98. So what constitutional provision would the President offend by self-limiting this power? If anything, a court's intrusion on his authority would raise the concerns. If an injured bank customer had sued President Jackson over his national-bank veto, nobody (I hope) would claim that a court could enjoin the President's veto with a citation to *McCulloch v. Maryland*, 17 U.S. 316 (1819). *See Collins*, 141 S. Ct. at 1794 (Thomas, J., concurring). We would raise identical separation-of-powers problems if we intruded on the President's lawful exercise of the removal power with a citation to *Seila Law*.

Nor would this hypothetical executive order violate § 1812. The statute gives the President the power to remove any of the Board's appointed members for any reason. The President thus may *retain* any member for any reason—whether based on his reading of the statute or on the benefits of a civil-service system. In this respect, the statute is not much different than a provision that sets the minimum process that an agency must provide. That floor does not foreclose the agency from offering additional process. *Cf. Vt. Yankee Nuclear Power Corp. v. Nat. Res. Def. Council, Inc.*, 435 U.S. 519, 543–49 (1978); *Al-Saka v. Sessions*, 904 F.3d 427, 432 (6th Cir. 2018); Easterbrook, *supra*, at 908. So while § 1812 does not impose for-cause removal protections on the President, it also does not bar him from imposing those protections on himself.

Now adjust my hypothetical slightly: Before the FDIC acted in Calcutt's case, "suppose that the President had made a public statement expressing displeasure with actions taken by [its Board] and had asserted that he would remove [its members] if [§ 1812] did not stand in the way." *Collins*, 141 S. Ct. at 1789. If the President's (mis)reading of § 1812 does not violate the law once he knows that the courts will interpret it differently than he does, why would this reading violate the law before he knows how they will interpret it? I am not sure. Yet I would leave open whether courts may vacate agency action as "arbitrary and capricious" under the Administrative Procedure Act (APA) if the President's reading tangibly affected the disputed action. 5 U.S.C. § 706(2)(A); *Collins*, 141 S. Ct. at 1794 n.7 (Thomas, J., concurring). We need not decide this question because the APA tells us to take "due account" "of the rule of prejudicial error." 5 U.S.C. § 706. Calcutt thus would have needed to show that any mistaken belief about the Board's removal protections harmed him (by, for example, affecting the Board's makeup). *See Jicarilla Apache Nation v. U.S. Dep't of Interior*, 613 F.3d 1112, 1121 (D.C. Cir. 2010). He presented no such evidence.

Calcutt responds that we should remand to the FDIC to allow him to seek discovery over whether any de facto protections harmed him. That leads to my final point. An FDIC regulation contains an issue-exhaustion rule that requires parties to raise all exceptions to an administrative law judge's decision with the Board. 12 C.F.R. § 308.39(b). Calcutt concedes that he did not raise this facial constitutional challenge with the agency but says that exhaustion mandates categorically do not apply to those challenges. I am not so confident. Courts must tread lightly before creating implied exceptions to regulatory exhaustion rules (as opposed to judge-made ones). *Bryan*, 937 F.3d at 751–52. Yet I find the FDIC's *specific* regulation unclear as to whether its text even covers these types of challenges. *Cf. id.* at 752. I thus would leave this question for another day because exhaustion is a nonjurisdictional affirmative defense. *See Jones v. Bock*, 549 U.S. 199, 211–12 (2007). A rejection of Calcutt's claim on statutory grounds makes the issue unnecessary to decide. *Cf. Woodford v. Ngo*, 548 U.S. 81, 101 (2006). Apart from exhaustion, however, I see no reason why we should give Calcutt a redo to obtain discovery that he did not seek the first time around.

B. Restrictions on Removal of the CFPB Director and Administrative Law Judge

Calcutt next challenges two unambiguous removal protections. First, the law that created the FDIC's final Board member—the CFPB Director—gives the Director these protections. 12 U.S.C. § 5491(c)(3). As noted, *Seila Law* found this provision unconstitutional. 140 S. Ct. at 2201–07. And while the President could control all of the other Board members, Calcutt claims that Congress may not create a multimember agency with even one tenure-protected member. Second, "dual for-cause limitations" on removal insulated the administrative law judge who heard Calcutt's case from presidential oversight. *Free Enter. Fund*, 561 U.S. at 492. The judge could be fired only if the Merit System Protection Board found "good cause," 5 U.S.C. § 7521(a), and the President could remove that entity's members only for cause too, *id.* § 1202(d). Calcutt claims that the Constitution bars the judge's "double insulation" from the President. *Compare Decker Coal Co. v. Pehringer*, 8 F.4th 1123, 1129–36 (9th Cir. 2021), *with Fleming v. U.S. Dep't of Agric.*, 987 F.3d 1093, 1113–18 (D.C. Cir. 2021) (Rao, J., concurring in part and dissenting in part).

I see no need to opine on the merits of these claims. We must distinguish the constitutional questions that Calcutt raises (do the removal statutes violate the Constitution?) from a separate remedies question (if so, do these defects entitle him to his requested relief?). As his proposed remedy, Calcutt asks us to vacate the FDIC's order as "void." But he fails to identify the source of law that requires (or permits) courts to treat the FDIC's *past actions* as void because potentially unconstitutional *statutes* attempted to insulate two of the FDIC's officers from the President's removal power. And my review of the relevant legal authorities leads me to conclude that Calcutt could not obtain this relief even if he successfully established the statutes' unconstitutionality.

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Because Calcutt seeks relief for a constitutional violation, the Constitution provides the place to start on this remedies question. But it says almost nothing about remedies. *Cf. Hernandez v. Mesa*, 140 S. Ct. 735, 741–43 (2020); *Armstrong v. Exceptional Child Ctr., Inc.*, 575 U.S. 320, 324–27 (2015). Except for a few provisions like the requirement to pay "just compensation" for a taking, *see Knick v. Township of Scott*, 139 S. Ct. 2162, 2171 (2019), the Constitution sets only limits on government conduct without prescribing specific relief for violations, *see* Alfred Hill, *Constitutional Remedies*, 69 Colum. L. Rev 1109, 1118 (1969). One thus will search Article II in vain for an explicit constitutional remedy that applies to an invalid removal provision.

Where else should we look? The founders enacted the Constitution against the backdrop of a preexisting legal system with preexisting causes of action and remedies. *See id.* at 1131–32. Before the founding, for example, this system often allowed equity courts to issue injunctions to stop "illegal executive action[.]" *Armstrong*, 575 U.S. at 327; *Ex parte Young*, 209 U.S. 123, 150–51 (1908). The Supreme Court has held that we may use these preexisting "judge-made" remedies to redress constitutional wrongs unless Congress displaces them. *Armstrong*, 575 U.S. at 327–28.

But courts should not take this allowance too far. The Constitution does not give us freewheeling power to adopt federal common-law remedies based on our views of wise policy. *See Hernandez*, 140 S. Ct. at 741–42 (citing *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938)). And the Court "disfavor[s]" remedies that are rooted in legislative-like choices about the best way to deter illegal acts. *Ziglar v. Abbasi*, 137 S. Ct. 1843, 1857 (2017) (citation omitted).

This dichotomy points the way here. We lack an inherent power to treat the FDIC's actions as "void" because we think it would be a good idea. *See Hernandez*, 140 S. Ct. at 741–42. We instead must look to the causes of action and remedies that traditionally applied to claims like Calcutt's—that a statutory provision related to an office was illegal and that this defect rendered the officer's actions void. When courts traditionally chose remedies for this sort of claim, they distinguished between two types of officers: a "de facto officer" in a lawful office (whose actions were enforceable) and a "mere usurper" in an unlawful one (whose actions were void). Albert Constantineau, *A Treatise on the De Facto Officer Doctrine* §§ 5, 34, at 8–10, 52–53 (1910).

De Facto Officer in Lawful Office. For centuries, parties have alleged that an officer was unlawfully holding (and performing the duties of) an office. To give an example at the time of the founding, a party claimed that a sheriff could not hold that office because the sheriff had not lived in the county as long as the law required. *State v. Anderson*, 1 N.J.L. 318, 324–28 (N.J. 1795).

English courts channeled these claims into a specific writ ("quo warranto") with a specific remedy (prospectively ousting the officer). *See* 3 William Blackstone, *Commentaries* *262–64; 2 Edward Coke, *Institutes of the Laws of England* 282, 494–99 (1642). American courts followed suit. Constantineau, *supra*, § 451, at 635 n.1; *State v. Parkhurst*, 9 N.J.L. 427, 437–38 (N.J. 1802). Three aspects of the quo warranto action deserve mention. For one, invalid officers caused public harms, so the government itself typically needed to sue them. *See Wallace v. Anderson*, 18 U.S. 291, 292 (1820). Yet private parties could sue on the government's behalf if they showed a unique interest. *See Newman v. United States ex rel. Frizzell*, 238 U.S. 537, 549–51 (1915). For a second, the remedy was exclusive. Constantineau, *supra*, § 451, at 635. A party disputing an officer's authority could not sue for an injunction "to restrain the exercise of official functions[.]" Floyd R. Mecham, *A Treatise on the Law of Public Offices and Officers* § 478, at 307 (1890). For a third, the remedy exists today. *See* D.C. Code § 16-3503. Parties may ask the Attorney General to seek this relief or request leave of court to seek it themselves—a process that may look "cumbersome" to modern eyes. *Andrade v. Lauer*, 729 F.2d 1475, 1497–98 (D.C. Cir. 1984) (Wright, J.).

Yet the process has always looked cumbersome. Rather than file a direct quo warranto suit to oust invalid officers, parties harmed by the officers' actions have tried to collaterally attack their qualifications in suits involving the actions. *Id.* at 1496. Since 1431, English courts have rebuffed these attacks under the "de facto officer doctrine." Constantineau, *supra*, § 5, at 8–10 (citing *The Abbé de Fontaine*, 1431 Y.B. 9 Hen. VI, fol. 32, pl. 3 (Eng.)); Clifford L. Pannam, *Unconstitutional Statutes and De Facto Officers*, 2 Fed. L. Rev. 37, 39–42 (1966). That doctrine treats the past actions of an officer with a colorable claim to office as valid whether or not the officer met all conditions to hold the office. Constantineau, *supra*, § 1, at 3–4. English courts introduced it "into the law as a matter of policy and necessity, to protect the interests of the public and individuals, where those interests were involved in the official acts of persons exercising the duties of an office, without being lawful officers." *State v. Carroll*, 38 Conn. 449, 467 (1871).

American courts likewise adhered to the de facto officer doctrine as a corollary to the exclusive quo warranto remedy. *See Cocke v. Halsey*, 41 U.S. 71, 81–88 (1842); *Taylor v. Skrine*, 5 S.C.L. 516, 516–17 (S.C. 1815); *Fowler v. Bebee*, 9 Mass. 231, 234–35 (1812); *People ex rel. Bush v. Collins*, 7 Johns. 549, 554 (N.Y. 1811) (per curiam). Notably, these courts upheld the actions of invalid officers who did not meet *constitutional* conditions on their offices. An officer might not have taken an oath. *Cf. Bucknam v. Ruggles*, 15 Mass. 180, 182–83 (1818) (per curiam). Or the officer might have been appointed in an illegal way. *Cf. Ex parte Ward*, 173 U.S. 452, 454 (1899). Or the officer might have flunked an eligibility requirement. Perhaps the officer was too young. *Cf. Blackburn v. State*, 40 Tenn. 690, 690–91 (1859). Or maybe the officer had been in the Congress that increased the office's salary before taking office. *Cf.* U.S. Const. art. I, § 6, cl. 2; William Baude, *The Unconstitutionality of Justice Black*, 98 Tex. L. Rev. 327 (2019); *In re Griffin*, 11 F. Cas. 7, 27 (C.C.D. Va. 1869) (No. 5,815). The same rules applied even if the officer held the office by reason of an unconstitutional *statute*. *See* Constantineau, *supra*, §§ 192–96, at 264–70. An early decision thus upheld the acts of an officer who had been appointed by the governor under a statute authorizing this appointment, even though the state constitution had required the legislature to elect the officer. *See Taylor*, 5 S.C.L. at 516–17; *Carroll*, 38 Conn. at 474; *see also State v. McMartin*, 43 N.W. 572, 572 (Minn. 1889); *Ex Parte Strang*, 21 Ohio St. 610, 615–18 (1871); *cf. Buckley v. Valeo*, 424 U.S. 1, 142 (1976) (per curiam).

Usurper in Unlawful Office. Other times, parties have alleged that a generic office could not exist because it had been assigned "sovereign functions" that it could not possess. Mecham, *supra*, § 4, at 5. In one case, for example, a party alleged that a legislatively created "court" could not perform judicial duties because those duties had been vested in a wrongly abolished life-tenured court. *Hildreth's Heirs v. McIntire's Devisee*, 24 Ky. 206, 207–08 (1829); Jeffrey S. Sutton, *Who Decides? States as Laboratories of Constitutional Experimentation* 76–80 (2022).

Courts granted much broader relief for this type of claim. Parties affected by an illegal office did not need to sue in quo warranto to dispute the officeholder's power to perform the challenged function. Parties instead could dispute the officer's conduct "in any kind" of suit. *Walcott v. Wells*, 24 P. 367, 370 (Nev. 1890); Mecham, *supra*, §§ 324–26, at 216–18. And the opposing party could not defend the officer's past acts using the de facto officer doctrine. Constantineau, *supra* §§ 34–36, at 51–55. The officer instead was "merely a usurper, to whose acts no validity can be attached[.]" *Norton v. Shelby County*, 118 U.S. 425, 449 (1886).

This rule extended to constitutional defects. The Supreme Court may have followed it as early as *United States v. Yale Todd* (U.S. 1794). *United States v. Ferreira*, 54 U.S. 40, 52–53 (1851) (note by Taney, C.J.). This unreported case addressed a law allowing pensions for disabled Revolutionary War veterans. The law ordered circuit courts to determine whether applicants were disabled and to send their findings to the Secretary of War. Circuit judges (including Supreme Court Justices) found that the law unconstitutionally gave courts executive power by making them the Secretary's administrators. *Hayburn's Case*, 2 U.S. 408, 410 n.* (1792). Given the law's benevolent goals, though, some judges awarded pensions by claiming to act as "commissioners." *See* Wilfred J. Ritz, United States v. Yale Todd *(U.S. 1794)*, 15 Wash. & Lee L. Rev. 220, 228–29 (1958). Congress ordered the Attorney General to seek Supreme Court review of pensions granted by judges "styling themselves commissioners." Act of Feb. 28, 1793, 1 Stat. 324, 325. In Yale Todd's case, the Court required him to return the funds. Ritz, *supra*, at 228–30. As others have noted, the Court may well have found the judges' actions void because they unconstitutionally undertook executive functions. *Ferreira*, 54 U.S. at 53 (note by Taney, C.J.); Keith E. Whittington, *Judicial Review of Congress before the Civil War*, 97 Geo. L.J. 1257, 1270–74 (2009).

Many decisions followed this remedial approach for claims that a legislative body had granted functions to an office that it could not lawfully possess. *See Town of Decorah v. Bullis*, 25 Iowa 12, 18–19 (1868); *Hildreth's Heirs*, 24 Ky. at 207–08; G. L. Monteiro, Annotation, *De Jure Office as Condition of De Facto Officer*, 99 A.L.R. 294 § III(a) (1935), Westlaw (database updated 2022). When, for example, a legislature assigned local-government functions to a board of commissioners that the state constitution vested in justices of the peace, the Supreme Court treated the board's actions as void. *Norton*, 118 U.S. at 441–49. It refused to apply the de facto officer doctrine because that doctrine required a valid ("de jure") office. *Id.* at 444–45.

The Supreme Court's modern cases also treat an officer's actions as void if the generic office could "not lawfully possess" the power to take them. *Collins*, 141 S. Ct. at 1788. The Court thus found invalid a bankruptcy judge's decision in a suit that an Article III court needed to resolve. *See Stern v. Marshall*, 564 U.S. 462, 503 (2011). And a plurality rejected the de facto officer doctrine when a party claimed that Congress assigned to Article I judges a duty (sitting on circuit courts) that Article III judges must perform. *See Glidden Co. v. Zdanok*, 370 U.S. 530, 535–37 (1962) (plurality opinion); *cf. Bowsher v. Synar*, 478 U.S. 714, 732 (1986); *Young v. United States ex rel. Vuitton et Fils S.A.*, 481 U.S. 787, 815 (1987) (Scalia, J., concurring in the judgment).

This "long history of judicial review" has relevance for Calcutt's request that we vacate the FDIC's order in his case because invalid removal protections shielded two of its officers. *Armstrong*, 575 U.S. at 327. To begin with, the history refutes the theory that the Constitution of its own force compels courts to treat as "void" any action taken by officers whose exercise of an office does not comport with a constitutional command. That view would treat the de facto officer doctrine *itself* as unconstitutional. Yet it formed part of the legal backdrop against which the founders enacted the Constitution. Near the founding, judges described the doctrine as "a well settled principle of law," *Bush*, 7 Johns. at 554, or "too well established to admit of a doubt," *Taylor*, 5 S.C.L. at 517. Nothing in the Constitution can be read to do away with it.

This history also highlights the key inquiry for deciding whether courts may vacate an officer's actions as a "judge-made remedy" when a statute unconstitutionally limits the President's removal authority. *Armstrong*, 575 U.S. at 327. Does the unconstitutional removal provision show that Congress vested "sovereign functions" in an invalid office that cannot possess them? Mecham, *supra*, § 4, at 5; *Norton*, 118 U.S. at 449. If so, courts should treat the officer's actions as void wherever they arise. Or is the removal provision "distinct from the provisions creating the . . . office" such that the office itself is valid "even assuming that the [removal provision] is" not? *McMartin*, 43 N.W. at 572; *Carroll*, 38 Conn. at 449. If so, courts should enforce the officer's acts in suits involving third parties (in contrast to suits between the government and the officer).

Unfortunately for Calcutt, his claim falls on the wrong side of this divide. He does not even argue that the two executive officers (the CFPB Director and administrative law judge) sat in offices that constitutionally "could not exist" (because, for example, the Constitution vested their duties in another branch). *Ashley v. Bd. of Supervisors of Presque Isle Cnty.*, 60 F. 55, 65 (6th Cir. 1893). Indeed, his argument's very premise—that Congress has illegally insulated the officers from the President—assumes that they perform *executive* functions. *Cf. Seila Law*, 140 S. Ct. at 2209. So I would treat the constitutional "condition" in this case (that an officer be accountable to the President) like other constitutional conditions the violation of which does not void an officer's acts. The condition is not much different than, say, a condition that an officer be of a certain age, *see Blackburn*, 40 Tenn. at 690–91, or be elected rather than appointed, *see* Constantineau, *supra*, § 192, at 264–65. If statutes departing from these mandates did not render an officer's actions void, I fail to see why an unconstitutional removal provision would. Under traditional remedial principles, then, Calcutt could not obtain the relief that he seeks in this case.

The "lack of historical precedent" to attack removal provisions in a suit like Calcutt's reinforces the conclusion that the provisions did not traditionally render an officer's actions void. *Seila Law*, 140 S. Ct. at 2201 (citation omitted). If any private party could collaterally attack removal provisions in any suit implicating an officer's acts, one would expect to see many of these suits. After all, Congress began to enact constitutionally dubious removal provisions shortly after the Civil War during President Johnson's administration. *See Myers*, 272 U.S. at 166–73. Yet Calcutt cites no historical example in which courts evaluated removal provisions in this type of litigation. So constitutional questions about the provisions lingered for decades. *Id.* at 173.

Challenges to the validity of removal provisions instead arose in employment disputes. *See Humphrey's Executor*, 295 U.S. at 618–19; *Myers*, 272 U.S. at 106; *cf. Shurtleff*, 189 U.S. at 311–12; *Reagan v. United States*, 182 U.S. 419, 424 (1901); *Ex parte Hennen*, 38 U.S. 230, 256–57 (1839). A discharged officer would sue to recover a salary (or seek reinstatement) on the ground that the termination violated a tenure-protection statute. *Myers*, 272 U.S. at 106. The government would respond that the statute could not restrict the President's power. *Id.* This different kind of suit required courts to resolve the constitutional question. Courts "almost universally recognized" that the de facto officer doctrine did not apply because the suit was between the government and the officer (not a third party) and because only valid officers could receive salaries. Constantineau, *supra*, § 236, at 331; 2 James Kent, *Commentaries on American Law* 355 n.2 (11th ed. 1867).

Modern precedent confirms my conclusion. The Supreme Court's recent cases have all held that unconstitutional removal provisions do not render the office to which they attach invalid or require courts to find actions taken by the officers void. *See Collins*, 141 S. Ct. at 1787–89; *Seila Law*, 140 S. Ct. at 2207–11; *Free Enter. Fund*, 561 U.S. at 508–10. Take *Free Enterprise Fund*. There, accountants under investigation by the Public Company Accounting Oversight Board filed an *Ex Parte Young* suit seeking to enjoin all of the Board's actions as void because of its removal protections. *See* 561 U.S. at 487, 491 n.2, 508. The Court agreed that various removal provisions unconstitutionally intruded on the President's authority. *Id.* at 492–98. But it refused to treat the Board's actions as void. *Id.* at 508–10. It held that the Board could perform the executive functions assigned to it despite the invalid removal provisions because they were "severable from the remainder of the statute." *Id.* at 508. The Court analyzed this issue in terms of "severability." *See id.* at 509. But it could just as well have reasoned that the unconstitutional *statutes* did not render the Board's *actions* void in third-party suits and so did not entitle the accountants to their requested remedy. *Cf. McMartin*, 43 N.W. at 572; Harrison, *supra*, at 73–75.

Seila Law fits a similar mold. The CFPB in that case issued a civil investigative demand seeking documents from a law firm. 140 S. Ct. at 2194. The firm refused to comply, so the CFPB filed a petition to enforce its demand. *Id.* The district court rejected the firm's request to deny the CFPB's petition on the ground that its Director's removal protections rendered all CFPB actions void. *Id.* After agreeing that the protections were unconstitutional, the controlling Supreme Court opinion again held that the invalid provisions were severable and did not render all CFPB actions void. *Id.* at 2208–11 (opinion of Roberts, C.J.). Admittedly, the opinion did not simply reject the law firm's remedy and affirm the enforcement of the CFPB's demand. Rather, it remanded for the lower courts to decide whether the demand had been "validly ratified" by a Director accountable to the President. *Id.* at 2211. This resolution might have implied that all CFPB actions (including the investigative demand) had been void *prior to* the Court's severance "remedy." *Id.* at 2208. But the Court has since clarified that *Seila Law* did *not* hold that the CFPB's prior actions were invalid and instead had left all remedy-related issues for the lower courts. *See*

Collins, 141 S. Ct. at 1788.

Most recently in *Collins*, the Court expressly held that unconstitutional removal provisions do not render an officer's past actions void in suits by third parties. Headed by a director with removal protections, the agency in *Collins* served as the conservator to two large mortgage-financing companies. 141 S. Ct. at 1771–72. This agency entered into agreements with the Department of Treasury requiring the companies to pay large dividends to the Treasury. *Id.* at 1772–74. The companies' shareholders sued to compel the Treasury to return the dividends on the ground that the director's removal protections were unconstitutional and that they voided the agency's past acts (including the challenged agreements). *Id.* at 1775. Although the Court agreed that the removal protections were unconstitutional, *id.* at 1783–87, it rejected the broad remedy, *id.* at 1787–89. The Court found "no reason to regard any of the actions taken by the" agency "as void" simply because its head had been protected by invalid removal provisions. *Id.* at 1787.

All told, under traditional remedial rules, unconstitutional removal provisions do not render the offices to which they attach invalid and so do not allow courts to vacate the actions of officers as void in suits by third parties. This tradition compels me to reject Calcutt's proposed remedy.

3

I end with two disclaimers about things I need not decide. Disclaimer One: Congress may generally displace judge-made remedial principles. *Armstrong*, 575 U.S. at 327–29. Congress, for example, has sometimes restricted a court's power to grant *Ex Parte Young*'s injunctive relief for violations of federal law. *See id.* And *Bowsher* teaches that Congress may adjust the relief for structural constitutional claims too. There, the Court followed the statutory remedy once it found that Congress had illegally entrusted a legislative officer with executive duties. 478 U.S. at 734–35. Congress thus may permit courts to vacate actions taken by officers subject to unconstitutional removal protections even if traditional judge-made remedial limits would foreclose relief.

Has Congress done so here? The FDIC's statute incorporates the APA. 12 U.S.C. § 1818(h)(2). It orders a court to "hold unlawful and set aside agency action" that is "contrary to constitutional right, power, privilege, or immunity[.]" 5 U.S.C. § 706(2)(B). Perhaps this text could be read to allow courts to depart from traditional limits and vacate agency "actions" if a law has structured the agency in a way that is "contrary to constitutional right" or "power." *Id.*; *cf. Collins*, 141 S. Ct. at 1795 (Gorsuch, J., concurring in part). That the Constitution's structural principles exist to protect individual liberty could reinforce this reading that a structural problem is "contrary to constitutional right" within the meaning of the APA. *See Bond v. United States*, 564 U.S. 211, 220–24 (2011).

In most structural constitutional cases, however, a private party claims that the challenged action *itself* is "contrary to constitutional right." 5 U.S.C. § 706(2)(B). So parties routinely allege that a prosecution violates the Constitution because the relevant law reaches conduct that Congress may not proscribe. *See, e.g.*, *Bond*, 564 U.S. at 224. Yet, as I have explained, an unconstitutional removal statute for an office would not necessarily render the officer's "actions" void and so would not necessarily render those actions "contrary to constitutional right." 5

U.S.C. § 706(2)(B). Perhaps the APA's text is thus best read to incorporate—not depart from—traditional remedial limits. *Cf. id.* § 702; Tom C. Clark, *Att'y Gen.'s Manual on the Admin. Proc. Act* 108 (1947).

And even if the APA expanded the available relief, recall that it requires courts to take "due account" "of the rule of prejudicial error." 5 U.S.C. § 706. The Court has read this text to adopt the harmless-error principles that "ordinarily apply in civil cases." *Shinseki v. Sanders*, 556 U.S. 396, 406 (2009). Under those principles, constitutional errors can be harmless. *See O'Neal v. McAninch*, 513 U.S. 432, 440 (1995). Although *Collins* did not cite the APA, this harmless-error provision might be one way to understand its suggestion that third parties could seek relief for unconstitutional removal provisions if they showed that the provisions harmed them (that is, if they showed that the error was not harmless). 141 S. Ct. at 1788–89. At day's end, I would leave these statutory questions open. The parties did not address the APA's scope and focused only on whether the removal provisions rendered the FDIC's order unconstitutionally void. They did not.

Disclaimer Two: The parties *assume* that the FDIC performs only executive functions. Our resolution should not be taken to have impliedly adopted that premise. The FDIC did not just *prosecute* this action. It also *adjudicated* the action—finding Calcutt guilty and imposing a punishment on him in the form of an end to his career and a $125,000 penalty. Once an Article III court finally enters the picture, moreover, it may review the FDIC's factual findings only under a deferential substantial-evidence test—a test that has been called more deferential than the one governing our review of a district court's factual findings. *See Dickinson v. Zurko*, 527 U.S. 150, 153 (1999).

Yet both Article III and the Due Process Clause generally require the government to follow common-law procedure (including, fundamentally, the use of a "court") when seeking to deprive people of their private rights to property or liberty. *See Stern*, 564 U.S. at 482–84; Caleb Nelson, *Adjudication in the Political Branches*, 107 Colum. L. Rev. 559, 569–70 (2007). At first blush, one might think that the FDIC has sought to deprive Calcutt of his "core private rights" to both. *B&B Hardware, Inc. v. Hargis Indus., Inc.*, 575 U.S. 138, 171 (2015) (Thomas, J., dissenting). According to Blackstone, Calcutt had a "property" interest in the thousands of dollars that the government seeks to take. *See* 1 Blackstone, *supra*, at *134–35. According to Coke, he had a "liberty" interest in continuing in his profession. *See* 2 Coke, *supra*, at 47. So perhaps the FDIC has undertaken judicial functions here—functions that the Constitution vests in courts. *See Stern*, 564 U.S. at 482–84. If the FDIC needed to file suit, moreover, the filing would have triggered the Seventh Amendment's right to a jury, which Justice Brennan made clear applies to suits seeking civil penalties. *See Tull v. United States*, 481 U.S. 412, 422–25 (1987).

The government traditionally has responded to this call for more "process" with the defense that its action seeks to vindicate "public rights," rights that need not be litigated in a court with a jury. *See Oil States Energy Servs., LLC v. Greene's Energy Grp., LLC*, 138 S. Ct. 1365, 1373 (2018); *Atlas Roofing Co. v. Occupational Safety & Health Rev. Comm'n*, 430 U.S. 442, 450–51 (1977). And maybe Calcutt did not raise this argument here because a healthy amount of caselaw has accepted that defense in the banking context. *See Cavallari v. Off. of Comptroller of Currency*, 57 F.3d 137, 145 (2d Cir. 1995); *Simpson v.*

Off. of Thrift Supervision, 29 F.3d 1418, 1422–24 (9th Cir. 1994). Yet this precedent predates the Court's recent instructions in cases like *Stern*, which held that the adjudication of a state tort claim required an Article III court. *See* 564 U.S. at 487–501. And while *Stern* did not involve an agency, the Court "recognize[d]" that its cases may not provide "concrete guidance" on the scope of the public-rights doctrine in the administrative context. *Id.* at 494. Several Justices have also expressed concern with extending the doctrine too far. *See Oil States*, 138 S. Ct. at 1381–85 (Gorsuch, J., joined by Roberts, C.J., dissenting); *B & B Hardware*, 575 U.S. at 170–74 (Thomas, J., joined by Scalia, J., dissenting).

There must be *some* limit to the government's ability to dissolve the Constitution's usual separation-of-powers and due-process protections by waiving a nebulous "public rights" flag at a court. When the government indicts a person for a crime, it also vindicates "public rights" that belong to the community. *Spokeo v. Robins*, 578 U.S. 330, 345 (2016) (Thomas, J., concurring) (citing Ann Woolhandler & Caleb Nelson, *Does History Defeat Standing Doctrine?*, 102 Mich. L. Rev. 689, 695–700 (2004)). But the government cannot send people to prison using a hearing room rather than a court room or an administrative officer rather than a jury of peers. *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 70 n.24 (1982) (plurality opinion). Why should this case be different simply because Calcutt must pay a civil penalty rather than a criminal fine? *Cf. Jarkesy v. SEC*, __ F.4th __, 2022 WL 1563613, at *2–7 (5th Cir. May 18, 2022). The FDIC one day must provide answers to these questions in a case that does not assume them.

C. Remedy for Appointments Clause Violation

Calcutt lastly challenges the FDIC's remedy for an undisputed constitutional wrong. The Appointments Clause sets the ground rules for the appointment of officers. U.S. Const. art. II, § 2, cl. 2. It allows Congress to vest the power to appoint inferior officers in "the President," "Courts of Law," or "Heads of Departments." *Id.* In *Lucia v. SEC*, 138 S. Ct. 2044 (2018), the Court held that the SEC's administrative law judges are inferior officers who must be appointed by the President or the Commission. *Id.* at 2051–55. The parties agree that the FDIC's administrative law judges are likewise inferior officers, but Calcutt litigated his first hearing before a judge who had not been appointed by the President or FDIC. The FDIC thus granted Calcutt a "new" hearing before a different, lawfully appointed judge—the remedy that *Lucia* ordered. *See id.* at 2055. Calcutt argues that this remedy still fell short because the FDIC allowed the second judge to use records, stipulations, and orders from the invalid judge's first hearing. According to him, the Appointments Clause required the second judge to ignore everything that occurred before.

To decide what *Lucia* meant by its "new hearing" remedy, my colleagues engage in a cost-benefit balance that resembles the Supreme Court's test for whether a court should suppress evidence in a criminal trial under the Fourth Amendment's "exclusionary rule." *Davis v. United States*, 564 U.S. 229, 236–38 (2011). They point out that Calcutt's remedy would impose heavy administrative costs (because it would require inefficient, duplicative processes). They add that it would offer few private benefits (because it is unnecessary to insulate the valid judge's decision from the first hearing's "taint"). Based on this prudential balancing, they reject Calcutt's claim that the second judge had to ignore items from the first hearing. Their balance seems reasonable enough. But I would reject Calcutt's view of *Lucia* based on structural grounds rooted in the best reading of the Appointments Clause and the Court's current approach to judge-made remedies.

At the outset, I do not mean to critique my colleagues for engaging in a cost-benefit inquiry. The Supreme Court's instructions in Appointments Clause cases may well be read to contemplate it. *See Lucia*, 138 S. Ct. at 2055 & nn.5–6; *Ryder v. United States*, 515 U.S. 177, 182–83 (1995). In *Ryder*, a court-martialed member of the Coast Guard had his conviction upheld by a panel that included judges whose appointments violated the Appointments Clause. 515 U.S. at 179–80. The Court of Military Appeals affirmed the panel's conviction under the de facto officer doctrine. *Id.* at 180. The Supreme Court reversed and refused to apply this doctrine. It held that "one who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case is entitled to a decision on the merits of the question and whatever relief may be appropriate if a violation indeed occurred." *Id.* at 182–83. Did *Ryder* look to the "original meaning" of the Appointments Clause to adopt this remedy and reject the de facto officer doctrine? *Fin. Oversight & Mgmt. Bd. for P.R. v. Aurelius Inv., LLC*, 140 S. Ct. 1649, 1659 (2020). No, the Court rested on a sentence of pure policy: "Any other rule would create a disincentive to raise Appointments Clause challenges[.]" *Ryder*, 515 U.S. at 183. The Court summarily found the "proper" remedy to be a second appeal before a lawfully constituted panel. *See id.* at 188.

Lucia followed the same reasoning. It noted that *Ryder* called for a new hearing before a properly appointed administrative law judge. 138 S. Ct. at 2055. It then added a new requirement: an agency may not assign the case to the judge who initially heard it even if that judge had been properly appointed in the interim. *Id.* When responding to the claim that this "new judge" remedy was not needed to further the Appointments Clause's purposes, the Court reasoned that its remedies in this area have been "designed not only to advance those purposes directly, but also to create '[]incentive[s] to raise Appointments Clause challenges.'" *Id.* at 2055 n.5 (quoting *Ryder*, 515 U.S. at 183). In both cases, therefore, the Court chose a remedy to "incentivize" these claims.

This reasoning should look familiar. The Court once expansively created judge-made remedies that would best promote the purposes of constitutional rights. Although, for example, Congress has allowed damages claims *only* against state officers who violate the Constitution, 42 U.S.C. § 1983, the Court felt free to create a remedy allowing parties to seek damages from federal officers who violate the Fourth Amendment. *See Bivens v. Six Unknown Fed. Narcotics Agents*, 403 U.S. 388, 395–96 (1971). And although the Fourth Amendment says nothing about the rules of evidence in criminal trials, the Court created the exclusionary rule to "remov[e] the incentive to disregard" its ban on unreasonable searches. *Mapp v. Ohio*, 367 U.S. 643, 656 (1961) (citation omitted). *Ryder* bears the hallmarks of *Bivens* and *Mapp*. It even discussed the exclusionary rule. The Court noted that its cases have rejected that rule when the rule's costs (allowing criminals to go free) exceeded its benefits (incentivizing officers to obey the law). *See Ryder*, 515 U.S. at 185–86 (citing *United States v. Leon*, 468 U.S. 897 (1984)). Analogizing to this approach, *Ryder* foresaw no ill effects from granting an Appointments Clause remedy on direct appeal and suggested that this appellate relief would create "incentives to make such challenges." *Id.* at 186.

Although *Ryder* might mesh well with *Mapp*, the Court in recent years has treated these types of judge-made innovations with a healthy dose of skepticism. *See Hernandez*, 140 S. Ct. at 747. The creation of remedies amounts to "lawmaking" that must balance the benefits of any remedy against its costs. *Id.* at 741–42. Yet the Constitution reserves this task to Congress, not the courts. *See id.* As a result, the Court has all but held that *Bivens* was wrong and has refused to extend it to any other constitutional right for some 40 years. *See id.* at 742–43 (citing cases); *Abbasi*, 137 S. Ct. at 1856–58. It has also continued to narrow the scope of the exclusionary rule, acknowledging that it is a "judicially created remedy" that must be applied cautiously only in cases of clear police misconduct. *Davis*, 564 U.S. at 238 (citation omitted); *see, e.g.*, *Utah v. Strieff*, 579 U.S. 232, 237–38, 241 (2016); *Herring v. United States*, 555 U.S. 135, 140–44 (2009).

What do these principles mean for the issue that confronts us? I agree that *Ryder* and *Lucia* leave open whether a lawful judge at a "new 'hearing'" may rely on evidence developed at the invalid hearing or on orders entered by the invalid judge. *Lucia*, 138 S. Ct. at 2055 (quoting *Ryder*, 515 U.S. at 182–83). To resolve the ambiguity, I would read the cases in a way that best comports with the Constitution's "original meaning," *Aurelius*, 140 S. Ct. at 1659, and with the Court's recent guidance to act cautiously before expanding judge-made remedies, *Hernandez*, 140 S. Ct. at 747. When analyzed in that fashion, the FDIC's remedy more than sufficed.

The Appointments Clause does not compel Calcutt's conclusion that a valid judge must ignore all prior proceedings before an invalid one. If anything, the clause itself requires *no* remedy. The de facto officer doctrine broadly applied to claims like Calcutt's that an officer had been appointed by the wrong person. *See* Constantineau, *supra*, §§ 182–86, at 248–55. An English judge who sat on the first case to enforce the doctrine in 1431 "apparently recognized" its application in this setting. *Id.* § 182, at 248. American courts routinely relied on it when an officer was unconstitutionally appointed by, say, the governor rather than the legislature, *see Carroll*, 38 Conn. at 474 (discussing *Taylor*, 5 S.C.L. at 516–17), or the mayor rather than the governor, *see Strang*, 21 Ohio St. at 615–19. And if the Constitution requires some way in which to dispute an officer's right to an office, Congress left open the traditional (if narrow) quo warranto remedy. D.C. Code § 16-3503; *cf.* Henry M. Hart, Jr., *The Power of Congress to Limit the Jurisdiction of Federal Courts: An Exercise in Dialectic*, 66 Harv. L. Rev. 1362, 1366–67 (1953).

Ryder and *Lucia* thus must rest on a power to create judge-made remedies for constitutional violations. But we must act with caution when asked to expand these remedies because the weighing of the costs and benefits amounts to a legislative task, not a judicial one. *See Abbasi*, 137 S. Ct. at 1856–57. On the benefits side, Calcutt's remedy would certainly promote the purposes of the Appointments Clause. *See United States v. Arthrex, Inc.*, 141 S. Ct. 1970, 1979 (2021). But no provision—not even a constitutional one—"pursues its purposes at all costs." *Hernandez*, 140 S. Ct. at 741–42 (citation omitted). And Calcutt's remedy comes with its burdens too. It would add to the "administrative costs" already associated with the new hearings. *Abbasi*, 137 S. Ct. at 1856. More fundamentally, courts long recognized that permitting parties to challenge an officer's validity *at all* in appeals of the officer's actions could create "endless confusion[.]" *Norton*, 118 U.S. at 441–42; *see* Constantineau, *supra*, § 4, at 7. That is why they channeled these challenges into special suits that would oust officers only *prospectively*, not into appeals that would reverse their actions *retrospectively*. *See* Constantineau, *supra*, § 451, at 635–36. I see no judicial mode of analysis that can resolve this legislative weighing of interests.

All told, the Court's cautious approach to judge-made remedies comports with traditional remedial practice governing challenges to the validity of an officer's appointment. *See Hernandez*, 140 S. Ct. at 742. I thus would not read *Ryder* and *Lucia* broadly to compel administrative judges to disregard all that occurred at a prior hearing. I would instead read them literally to compel a new hearing before a properly appointed judge. Calcutt got just that.

III. Statutory Claims

In my view, Calcutt's statutory claims fare better. The statute allowing the FDIC to bar bankers from the industry requires it to prove three things: that a banker has engaged in a listed kind of misconduct, that the misconduct will harm the bank (or benefit the banker), and that the banker acted with a culpable state of mind. 12 U.S.C. § 1818(e)(1)(A)–(C). The statute allowing the FDIC to impose penalties largely covers the same terrain. *Id.* § 1818(i)(2)(B). Here, Calcutt argues that the FDIC failed to prove the "misconduct" and "effect" elements. I agree that the FDIC misread these provisions and would remand for it to reconsider the case under the proper law.

A. Misconduct

To remove Calcutt from the Bank, the FDIC first must prove that he engaged in one of three types of misconduct. *Id.* § 1818(e)(1)(A). Specifically, the statute allows the FDIC to remove an "institution-affiliated party" if that the party "has, directly or indirectly":

> (i) violated—
>
> (I) any law or regulation;
>
> (II) any cease-and-desist order which has become final;
>
> (III) any condition imposed in writing by a Federal banking agency in connection with any action on any application, notice, or request by such depository institution or institution-affiliated party; or
>
> (IV) any written agreement between such depository institution and such agency;
>
> (ii) engaged or participated in any unsafe or unsound practice in connection with any insured depository institution or business institution; or
>
> (iii) committed or engaged in any act, omission, or practice which constitutes a breach of such party's fiduciary duty[.]

Id. The FDIC found that Calcutt violated the second and third clauses by engaging in "unsafe or unsound practice[s]" and committing "breach[es]" of his "fiduciary duty." App. 18–26. (It imposed the $125,000 penalty for the same reasons. *See* App. 35.)

1. *Unsafe or Unsound Practice*. The statute gives the FDIC the power to ban a banker from the profession if the banker has "engaged or participated in any unsafe or unsound practice in connection with any insured depository institution or business institution[.]" 12 U.S.C. § 1818(e)(1)(A)(ii). Regulators have long defined the key phrase—"unsafe or unsound practice"—using a two-part test that courts have generally accepted. *See First Nat'l Bank of Eden v. Dep't of Treasury*, 568 F.2d 610, 611 n.2 (8th Cir. 1978). Under this test, an act qualifies as an unsafe or unsound practice if it conflicts with "generally accepted standards of prudent operation" and creates an "abnormal risk of loss or harm" to the bank. App. 18 (quoting *Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012)).

This test was not intuitive to me from a review of the text, so I looked into its origins. One court transparently identified its source: "Because the statute itself does not define an unsafe or unsound practice, courts have sought help in the legislative history." *In re Seidman*, 37 F.3d 911, 926 (3d Cir. 1994). The Fifth Circuit started down this path. *See Gulf Fed. Sav. & Loan Ass'n v. Fed. Home Loan Bank Bd.*, 651 F.2d 259, 263–65 (5th Cir. 1981). Rather than seek out the ordinary meaning of "unsafe or unsound practice," it jumped to a "lively" debate in the congressional record. *Id.* at 263. During this debate, the court noted, a few legislators had treated as "authoritative" a definition proposed by an agency chairman. *Id.* at 264. Under the chairman's view, the phrase covered "any action" that "is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." *Id.* (citation omitted). The court accepted his view as law. *Id.* at 264–65.

This straight-from-the-legislative-history test has spread widely since. The few courts with reasoned analysis regurgitate the same bit of legislative history. *Seidman*, 37 F.3d at 926. Most others, though, simply cite other precedent for this test without considering its origins. *See Frontier State Bank v. FDIC*, 702 F.3d 588, 604 (10th Cir. 2012); *Michael*, 687 F.3d at 352; *Landry v. FDIC*, 204 F.3d 1125, 1138 (D.C. Cir. 2000); *Simpson*, 29 F.3d at 1425; *Doolittle v. Nat'l Credit Union Ass'n*, 992 F.2d 1531, 1538 (11th Cir. 1993); *Nw. Nat'l Bank v. Dep't of Treasury*, 917 F.2d 1111, 1115 (8th Cir. 1990).

I am troubled by this approach. The test springs from a mode of interpretation that no Justice on the Supreme Court would endorse today. In recent decades, the Court has given us clear marching orders: the answer to an interpretive question begins by identifying the ordinary meaning of Congress's words when read against their context and structure. *See Food Mktg. Inst. v. Argus Leader Media*, 139 S. Ct. 2356, 2364 (2019); *Ross v. Blake*, 578 U.S. 632, 638 (2016). This "first canon" is also the "last" if the text has a clear meaning. *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 254 (1992). Here, however, courts have viewed the legislative history as both the beginning and the end of the analysis. *Gulf Federal* even claimed that the agency chairman's proposed test had been "adopted in both Houses"—by which the court meant that it had been read into the legislative record. 651 F.2d at 264 (citation omitted). "But legislative history is not the law." *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1631 (2018). And the Court has not been kind to other tests that developed in this manner. *See, e.g.*, *Food Mktg.*, 139 S. Ct. at 2364.

I am also troubled by this approach because courts have chosen it to create a "flexible" statute allowing regulators to address "changing business problems[.]" *Seidman*, 37 F.3d at 927. What does this even mean? If an agency condones a banker's "new business model," the agency can constrict the statute to give the banker a pass? *Henson v. Santander Consumer USA Inc.*, 137 S. Ct. 1718, 1725–26 (2017). But if the agency disapproves of a competitor's practice, it can expand the statute to punish the competitor? This accordion-like view of the rule of law has no place in our constitutional order—one in which the President lacks any "dispensing" prerogative. *Cf. Clark v. Martinez*, 543 U.S. 371, 382 (2005); McConnell, *supra*, at 115–19. If anything, this view has things backwards. This statute can deprive citizens of their property and livelihoods. So it would better align with our interpretive traditions if we construed the phrase "strictly" rather than flexibly. 1 Blackstone, *supra*, *88; *United States v. Wiltberger*, 18 U.S. 76, 95 (1820). After all, the rule of lenity (the rule that we resolve ambiguities against the government) historically applied not just to criminal laws, but also to all laws considered "penal"—"that is, laws inflicting any form of punishment" like a civil penalty. *Wooden v. United States*, 142 S. Ct. 1063, 1086 n.5 (2022) (Gorsuch, J., concurring in the judgment). This statute fits that bill. *See Proffitt v. FDIC*, 200 F.3d 855, 860–62 (D.C. Cir. 2000). At the least, courts should give a phrase that affects core private rights its ordinary meaning—not a malleable one.

How might an ordinary banker interpret the phrase? The legislative history reaches any "imprudent act." *Seidman*, 37 F.3d at 932; *see Gulf Federal*, 651 F.2d at 264. Yet this definition does not adequately account for two parts of the actual text. For starters, the statute uses the word "practice," not "act." 12 U.S.C. § 1818(e)(1)(A)(ii). Those words mean different things. If an otherwise conscientious banker makes a single imprudent loan to a couple down on their luck, the banker might have engaged in an unsound "act." But nobody would say that the banker has made it a "practice" of issuing bad loans after just the one. This word includes a connotation of repetition (of *habitual* acts). The banker must have a habit of making bad loans (or, at the least, the bank must have that habit and the banker must "participate[] in" it). *Id.*; *cf. Nw. Nat'l Bank*, 917 F.2d at 1115. That is because a "practice" is a "habitual or customary performance," *American College Dictionary* 951 (1970), or a "habitual or customary action or way of doing something," *American Heritage Dictionary of the English Language* 1028 (1973).

The statute itself contemplates this distinction. One clause bars bankers from engaging in "any unsafe or unsound practice[.]" 12 U.S.C. § 1818(e)(1)(A)(ii). The next bars them from engaging in "any *act*, *omission*, or *practice*" that breaches their fiduciary duties. *Id.* § 1818(e)(1)(A)(iii) (emphases added). We presume that Congress meant different things when it used different words in clauses that sit right next to each other. *See Nat'l Ass'n of Mfrs. v. Dep't of Def.*, 138 S. Ct. 617, 631 (2018). So even a single *act* or *omission* "that breaches [a] fiduciary duty" suffices for punishment, but only a *habit* of "unsafe or unsound" actions does.

Next, the statute does not cover every unsafe or unsound practice *in the abstract*. Rather, the practice must be "in connection with" a bank. 12 U.S.C. § 1818(e)(1)(A)(ii). The Supreme Court has recognized that this phrase has an "indeterminat[e]" scope. *Maracich v. Spears*, 570 U.S. 48, 59–60 (2013); *see Mont v. United States*, 139 S. Ct. 1826, 1832 (2019). If we read it broadly here, it could cover practices with the remotest of relations to banking—such as a banker's decision to speed to work every morning. *See Maracich*, 570 U.S. at 59. One regulator even thought that the phrase covered a decision to seek judicial review of the regulator's *own* regulatory decision. *Johnson v. Off. of Thrift Supervision*, 81 F.3d 195, 202 (D.C. Cir. 1996). Could Calcutt's decision to file a petition in this court also be an "unsound practice" because we reject his appeal? I would not read the statute this broadly. Courts instead must interpret the clause to adopt the "limiting principle" that best comports with the statute's context and structure. *See Maracich*, 570 U.S. at 59–60; *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377, 387–91 (2014).

For the reasons that a D.C. Circuit decision has explained, I would read this clause to cover only "unsafe or unsound *banking* practices." *Grant Thornton, LLP v. Off. of the Comptroller of the Currency*, 514 F.3d 1328, 1332–33 (D.C. Cir. 2008). This definition "harmonizes" this subsection with the rest of § 1818. *Id.* at 1332. The section includes several other provisions that regulate unsafe or unsound practices "in conducting the business" of a bank, including one permitting the FDIC to issue cease-and-desist orders. 12 U.S.C. § 1818(b)(1). It would be odd to permit a limited remedy (a cease-and-desist order) only for unsound banking practices but a severe remedy (removal from a bank) for any unsound practice with any connection to the bank. And a definition that covered only "banking" practices would exclude, for example, an outside auditor's deficient audit, *see Grant Thornton*, 514

F.3d at 1332–33, or a decision to seek judicial review.

All of this said, courts that apply a broad legislative-history test have recognized that their reading could lead to "open-ended supervision." *Gulf Fed.*, 651 F.2d at 265. So they compensate by adding a limiting principle that I do not necessarily see in the text either. They have read the phrase "unsafe or unsound practice" to require that an action pose a risk of *extreme* harm—one that threatens the bank's "financial stability," *Seidman*, 37 F.3d at 928, or "integrity," *Johnson*, 81 F.3d at 204 (quoting *Gulf Fed.*, 651 F.2d at 267). An "unsafe" practice (one that exposes the bank to "danger or risk") may well require a risk of *some* harm. 2 *Oxford Universal Dictionary* 2312 (3d ed. 1968). But the statute also covers an "unsound" practice in the disjunctive (a practice that is "not based on proven practice, established procedure, or practical knowledge"). *Webster's New International Dictionary* 2511 (3d ed. 1966). Perhaps the entire phrase "unsafe or unsound" may be one of those "doublets" that Congress uses to convey a single idea (like "aid and abet" or "cease and desist"). *Doe v. Boland*, 698 F.3d 877, 881 (6th Cir. 2012) (citing *Freeman v. Quicken Loans, Inc.*, 566 U.S. 624, 635–36 (2012)). Even still, I would not think that this text requires the risk of financial collapse. A loan officer at a massive bank who has followed a consistent pattern of making bad loans may have engaged in an "unsafe or unsound practice" even if the banker's portfolio cannot threaten the bank's existence.

Be that as it may, I would save the required financial-risk level for another appeal. When sanctioning Calcutt here, the FDIC did not apply my reading that the statute requires unsafe or unsound *banking practices*. I would remand for it to do so in the first instance. Most notably, the FDIC nowhere indicated that it must identify a banking "practice" as I read the phrase—i.e., a "habitual or customary action[.]" *American Heritage*, *supra*, at 1028. To the contrary, as Calcutt notes, the vast majority of its findings relied on a *single* loan—the Bedrock Transaction. It concluded, among other things, that Calcutt violated the Bank's lending policies and engaged in imprudent lending by approving that transaction. App. 19–21. It is not clear that Calcutt's actions with respect to this loan can rise to the level of an unsafe or unsound "practice." This fact contrasts Calcutt's case with those that the FDIC cited—which involved a pattern of bad loans. *See, e.g.*, *First State Bank of Wayne Cnty. v. FDIC*, 770 F.2d 81, 82–83 (6th Cir. 1985).

2. *Breach of Fiduciary Duty*. The statute also gives the FDIC the authority to ban a banker from the profession if the banker has "committed or engaged in any act, omission, or practice which constitutes a breach of such party's fiduciary duty[.]" 12 U.S.C. § 1818(e)(1)(A)(iii). The parties' briefing on this portion of the statute raises more questions in my mind than it answers.

Start with a choice-of-law question. Citing *Atherton v. FDIC*, 519 U.S. 213 (1997), my colleagues and Calcutt suggest that the relevant state's corporate-governance law supplies the rule of decision for determining whether a banker has breached a "fiduciary duty" within the meaning of § 1818(e)(1)(A)(iii). (The FDIC does not enlighten us with its position on this choice-of-law subject.) I am skeptical that their reading is correct. The relevant portion of *Atherton* that they cite was not interpreting federal statutory language like the "fiduciary duty" text in § 1818(e). It was rejecting the claim that *purely* federal common law should supply the "corporate governance standards" for federally chartered entities. *See* 519 U.S. at 217–26. Here, by contrast, we must determine the proper "interpretation of a federal statute," not whether we may create federal common law. *Id.* at 218. And when a federal statute uses a common-law term of art, the Supreme Court generally interprets its language to adopt a uniform standard of conduct for all 50 states based on generic common-law concepts. *See, e.g.*, *Burlington Indus., Inc. v. Ellerth*, 524 U.S. 742, 754–55 (1998); *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 739–41 (1989). I might take that approach here. It would likely mean that we should interpret this phrase to codify the well-known duties of care and loyalty as they existed in this corporate-governance context at the time that Congress adopted this language in 1966. *See, e.g.*, Harry G. Henn, *Handbook of the Law of Corporations and Other Business Enterprises* 362–70 (1961); William J. Grange & Thomas C. Woodbury, *Corporation Law: Operating Procedures for Officers and Directors* § 268, at 286–87, § 311, at 325–26 (2d ed. 1964); Dow Votaw, *Modern Corporations* 63–64 (1965); Harold Koontz, *The Board of Directors and Effective Management* 84–86 (1967).

Turn to the substantive standards. The Board held that Calcutt had breached his duty of care to the Bank by acting incompetently in his approval of the Bedrock Transaction and in his failure to manage the Nielson Loans. App. 23–24. But from my review of the FDIC's order, I cannot even determine the substantive standards of conduct that it applied. Its order did not use the words "negligence" or "gross negligence." And for decades, courts have debated which of these standards the statute incorporates. Julie Andersen Hill & Douglas K. Moll, *The Duty of Care of Bank Directors and Officers*, 68 Ala. L.

Rev. 965, 986–92 (2017). The Board also neglected to mention the traditional "business-judgment rule," the application of which is also contested. Patricia A. McCoy, *A Political Economy of the Business Judgment Rule in Banking: Implications for Corporate Law*, 47 Case W. Res. L. Rev. 1, 22–60 (1996). Yet another layer in this morass is that in the 1980s, Congress also adopted a "gross negligence" floor to govern the conduct of officers and directors in a related context. 12 U.S.C. § 1821(k); *see Atherton*, 519 U.S. at 226–28. That separate section's implications for § 1818(e) are unclear.

Yet I would not authoritatively answer these choice-of-law or substantive questions now. As I explain below, I would remand to allow the FDIC to reconsider whether Calcutt's misconduct was the cause of any of the claimed harms. On remand, I would give the FDIC a chance to clarify its views on these legal questions about the meaning of this fiduciary-duty statute.

B. Causation

The statute next requires the FDIC to prove either that Calcutt's misconduct had the potential to harm the Bank or that Calcutt received a benefit from that misconduct. *See* 12 U.S.C. § 1818(e)(1)(B). This "effect" subparagraph provides in full:

> (B) by reason of the violation, practice, or breach described in any clause of subparagraph (A)—
>
> (i) such insured depository institution or business institution has suffered or will probably suffer financial loss or other damage;

(ii) the interests of the insured depository institution's depositors have been or could be prejudiced; or

(iii) such party has received financial gain or other benefit by reason of such violation, practice, or breach[.]

Id. The specific civil-penalty provisions on which the FDIC relied required similar "effects." *See id.* § 1818(i)(2)(B)(ii)(II)–(III); App. 34–35.

The FDIC misinterpreted the causation element in this subparagraph. To show why, I start with the causation basics. The common law has long recognized two types of causation: factual (or "but for") causation and legal (or "proximate") causation. *See* William L. Prosser, *Handbook of the Law of Torts* §§ 45–46, at 311, 321–22 (1941). But-for causation creates a simple rule. As its name suggests, it requires a plaintiff to show that an injury would not have occurred "but for" the defendant's wrongful conduct. *See Burrage v. United States*, 571 U.S. 204, 211–12 (2014); *Univ. of Tex. Sw. Med. Ctr. v. Nassar*, 570 U.S. 338, 347 (2013). Suppose, for example, that after a neighbor's dam breaks and floods a plaintiff's property, the plaintiff sues the neighbor for building the dam negligently. *See* Restatement (Second) of Torts § 432 illus. 2 (Am. L. Inst. 1965). But-for causation requires a court to ask whether the plaintiff would have suffered this injury (the flooding) in a counterfactual world in which the neighbor did not commit the wrongful act (the negligent construction). *See id.* § 432(1) & cmt. a. And if a once-in-a-century storm would have caused the flooding even if the neighbor had built the dam to perfection, the negligent construction did not cause the harm. *See id.* § 432 illus. 2; *Burrage*, 571 U.S. at 211–12.

Proximate causation arose from the premise that a factual-cause test alone would lead to excessive liability. Prosser, *supra*, § 45, at 312. Courts recognized that, "[i]n a philosophical sense, the consequences of an act go forward to eternity, and the causes of an event go back to the discovery of America and beyond." *Id.* They thus adopted "proximate cause" rules to cut off liability even if a defendant was a but-for cause of harm. *Holmes v. Secs. Inv. Prot. Corp.*, 503 U.S. 258, 268 (1992). As one example, a defendant's conduct (say, its failure to keep a ship docked) may set in motion a chain of events that leads another party to negligently cause an injury (say, the captain incompetently runs the ship aground). *See Exxon Co., U.S.A. v. Sofec, Inc.*, 517 U.S. 830, 832–34 (1996). Under a superseding-cause test, courts will not hold the defendant liable if the other party's negligence was unforeseeable. *Id.* at 837. As another example, a defendant's misconduct (say, stock manipulation) may directly harm one person (a stockbroker who goes bankrupt) and indirectly harm third parties (the stockbroker's creditors). *See Holmes*, 503 U.S. at 262–63. Under a directness test, courts will not allow the third parties to recover. *Id.* at 271–72.

These common-law rules have significance in this case. The Supreme Court presumes that Congress enacts statutory text with common-law concepts in mind. *See Lexmark Int'l, Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 132 (2014). It thus has long read common-law causation rules into statutes that use causal language like "because of" or "results from." *See Burrage*, 571 U.S. at 213–14; *Nassar*, 570 U.S. at 350–52. Congress used one such phrase ("by reason of") here. The FDIC must prove that the Bank suffered (or will likely suffer) a loss or that Calcutt received a benefit "by reason of" his misconduct.

12 U.S.C. § 1818(e)(1)(B). So I would interpret this statute to require both but-for and proximate causation. *See Comcast Corp. v. Nat'l Ass'n of African American-Owned Media*, 140 S. Ct. 1009, 1015 (2020); *Holmes*, 503 U.S. at 265–67.

But the FDIC has not adopted these causation rules. Its enforcement orders have all but ignored but-for cause. In fact, I have found only one such order that even used this phrase. *See In re Adams*, 1997 WL 805273, at *5 (F.D.I.C. Nov. 12, 1997). And it suggested that a "'but for' relationship" was *not* required. *Id.* (quoting *ABKCO Music, Inc. v. Harrisongs Music Ltd.*, 772 F.2d 988, 995–96 (2d Cir. 1983)). The FDIC also failed to mention but-for cause in this case. It simply indicated: "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 [Calcutt's] position." App. 26 (citations omitted). The FDIC is correct that, unlike most statutes imposing liability for harm, this statute does not require a past loss. It also applies if a bank "will probably suffer" a loss in the future "by reason of" the banker's misconduct. 12 U.S.C. § 1818(e)(1)(B)(i). But it incorporates but-for cause all the same. For a past loss, the FDIC must show that it "would not have occurred without" the misconduct. *Nassar*, 570 U.S. at 347 (citation omitted). For a future loss, the FDIC must show that the probability of loss would not have occurred without that misconduct. *See id.* The FDIC's jurisprudence leaves no hint that it adheres to these first-year torts-class concepts.

The FDIC's legal error is all the more pronounced for proximate causation. For years, it has rejected outright any need to prove this causation. *See Adams*, 1997 WL 802573, at *5; *In re* ***, 1985 WL 303871, at *114 (F.D.I.C.

Aug. 19, 1985). It did so in this case too, noting that "an individual respondent need not be the proximate cause of the harm to be held liable[.]" App. 26–27. Confusingly, however, the FDIC suggested that the loss needs to be "foreseeable." App. 26, 31. Foreseeability is one component of the proximate-causation requirement that the FDIC said it was rejecting. *See Hemi Grp., LLC v. City of New York*, 559 U.S. 1, 12 (2010). If the FDIC meant to imply that the statute incorporates *only* proximate cause's foreseeability element, it still erred. Proximate causation contains a group of concepts other than foreseeability. *See id.* So the Supreme Court has already rejected this type of argument that a federal statute contains only a foreseeability test. *See Bank of Am. Corp. v. City of Miami*, 137 S. Ct. 1296, 1305–06 (2017).

*

Maybe we could overlook the FDIC's failure to identify the governing causation law if it correctly applied that law to Calcutt. But it did no such thing. The FDIC held Calcutt responsible for three injuries to the Bank and one benefit to him. The Bank incurred $6.443 million in charge-offs from the Nielson Loans. App. 27–29. It incurred a $30,000 charge-off from the $760,000 Bedrock Transaction. App. 27. And it paid its lawyers and accountants for work related to these loans. App. 29–31. Calcutt lastly received dividends from the Bank's holding company despite the loans' poor condition. App. 31–32. None of these "effects" sufficed.

As an initial matter, I agree with my colleagues that the FDIC failed to explain why the statute should even cover fees paid to lawyers or accountants. The statute reaches "financial loss or other damage" from Calcutt's misconduct. 12 U.S.C. § 1818(e)(1)(B)(i). It would be unusual to describe the money paid for these services as "financial loss" or "other damage." One does not normally use such terms to describe a payment of money for something of commensurate value. *Cf. Summit Valley Indus. Inc. v. Loc. 112, United Brotherhood of Carpenters & Joiners of Am.*, 456 U.S. 717, 722–23 (1982). The payment is more naturally described as an "expense" or "cost." Our country's litigation traditions reinforce this view. We have long followed the "American Rule" in which a plaintiff's legal costs are not recoverable "damages" even if the defendant's conduct is their but-for cause. *See Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 249–50 (1975) (citing *Arcambel v. Wiseman*, 3 U.S. 306 (1796)). When a statute allows a plaintiff to recover "damages," then, courts do not read that phrase to cover attorney's fees—or other expert fees for that matter. *See Summit Valley*, 456 U.S. at 722–23; *cf. W. Va. Univ. Hosps., Inc. v. Casey*, 499 U.S. 83, 88–92 (1991). And the Court has stuck with this rule even if a law uses a phrase ("expenses") that is "capacious enough to include" these fees. *Peter v. Nantkwest, Inc.*, 140 S. Ct. 365, 372 (2019). So I would not read the text "loss" or "damage" to cover them here.

That leaves the other three "effects." The FDIC did not apply basic causation rules to any of them. Most tellingly, the FDIC held Calcutt responsible for all \$6.443 million in charge-offs on the \$38 million in Nielson Loans—that is, for the entire loss. App. 27–28; *see id.* at 6–7. But these loans were underwater in the aftermath of the Great Recession *before* Calcutt committed most of the identified misconduct. App. 625–26. As with my hypothetical about the negligently made dam, then, the FDIC needed to ask a "counterfactual" question: How much in charge-offs would the Bank have incurred if Calcutt had not engaged in that misconduct? *Comcast*, 140 S. Ct. at 1015. Suppose that the (hopefully) once-in-a-century recession would have caused $7 million in charge-offs if the Bank started collection efforts immediately because of the collapsed real-estate market. If so, a decision to enter into the Bedrock Transaction would have helped (not harmed) the Bank. And Calcutt's misconduct (for example, the failure to undertake the usual underwriting efforts, *see* App. 19) could not be described as a but-for cause of loss. I see nothing in the record on appeal that would help answer this critical but-for question, confirming that the FDIC did not even ask it.

The same error underlies the FDIC's decision to hold Calcutt liable for the $30,000 charge-off for the Bedrock Transaction. App. 27. The FDIC did not consider the "counterfactual" of what would have occurred if Calcutt had not engaged in misconduct. *Comcast*, 140 S. Ct. at 1015. As a generic matter, the Bank suffered a total of $6.473 million in charge-offs on all Nielson Loans (including the Bedrock Transaction) and the FDIC needed to consider the amount of likely charge-offs without this transaction. Would it have lost more? Less? The FDIC did not ask these questions. More granularly, Calcutt told the FDIC that the administrative law judge had erred "by failing to tether the $30,000 charge-off (and other actual and potential losses) to specific acts of misconduct[.]" App. 27. The judge found, for instance, that Calcutt breached his fiduciary duty of candor to the Bank's directors by failing to seek their preapproval for the Bedrock Transaction. App. 25–26. Suppose the directors would have approved the transaction even if he had done so. How could this specific misconduct have caused this harm? The FDIC responded that it was "unpersuaded" by this causation argument because the Bedrock Transaction was a "main focus" of the hearing and the judge catalogued Calcutt's many misdeeds in approving it. App. 27. This (non)response said nothing about causation—an element distinct from misconduct.

Both but-for and proximate-cause problems undergird the FDIC's decision that Calcutt benefited from his misconduct. He was the largest shareholder of the Bank's holding company, and the FDIC held that his misconduct allowed him to obtain a dividend from this company. App. 31–32. Its conclusion rested on the administrative law judge's finding that the Bank paid its own shareholder (the holding company) a $462,950 dividend in mid-2011 and that the FDIC would not have approved this payment (to the holding company) if it had known that the Nielson Loans were not performing. App. 287, 751. As a matter of but-for causation, the FDIC did not ask whether the holding company would have paid its shareholders the same dividend even if the FDIC had known of the Nielson Loans' true condition. *See Comcast*, 140 S. Ct. at 1015. It cites no testimony from the company's directors about what they would have done. And Calcutt testified that the holding company had sufficient assets to pay the dividend even if the Bank had paid it nothing. A580.

As a matter of proximate causation, the FDIC failed to consider a "directness" issue. If "by reason of" incorporates usual proximate-cause rules, it would require that Calcutt *directly* benefit from his misconduct. Under the FDIC's theory, though, the holding company was the direct beneficiary that received the dividend; Calcutt was an indirect beneficiary as a shareholder of that separate company. Is this a sufficiently "direct" benefit (analogous to a larger salary)? "The general tendency" in the law has been "not to go beyond the first step." *Bank of Am.*, 137 S. Ct. at 1306 (citation omitted). And this theory potentially rests on the "independent" decision of the holding company. *Hemi*, 559 U.S. at 15. But I would leave this question for the FDIC.

All told, I would remand for the FDIC—the fact finder—to apply the correct causation rules to the two charge-offs and the dividend payment in the first instance. My colleagues recognize many of the FDIC's legal errors but say there is no need to remand. I disagree. They first invoke the deferential substantial-evidence test. But that test governs our review of the agency's factual findings. *See Dickinson*, 527 U.S. at 162. I do not quibble with those. I take issue with the FDIC's failure to follow the proper causation law. The substantial-evidence test has nothing to say on that subject. And even the FDIC does not claim that we should defer to its legal views. *See Grant Thornton*, 514 F.3d at 1331; *cf. Epic*, 138 S. Ct. at 1629–30.

If anything, my colleagues' analysis runs afoul of basic administrative-law principles. When an agency's decision rests on a collapsed legal foundation, we cannot affirm the decision on the ground that the agency might have reached the right outcome under a correct legal view. We must let the agency apply the proper law in the first instance. *See Gonzales v. Thomas*, 547 U.S. 183, 186 (2006) (per curiam); *SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943); Henry J. Friendly, Chenery *Revisited: Reflections on Reversal and Remand of Administrative Orders*, 1969 Duke L.J. 199, 209–10. But my colleagues all but find facts by applying their view of the law to the record. Recall, for example, that the FDIC held Calcutt liable for all $6.443 million in charge-offs on the Nielson Loans—a finding that leaves no doubt that the agency erred. My colleagues do not defend this finding. They nevertheless say that the FDIC "could have" found that Calcutt's misconduct caused some *unquantified* percentage of the losses. Maj. Op. 48. But this "judicial judgment cannot be made to do service for an administrative judgment." *Chenery*, 318 U.S. at 88.

Even if we could now find Calcutt liable for an (unknown) loss amount on a good-enough-for-government-work approach, I would still remand. The statute says that the FDIC "may" seek to remove a banker—not that it *must* do so—when the other requirements are met. 12 U.S.C. § 1818(e)(1). It thus leaves the FDIC with discretion over whether to bar Calcutt "from working in his chosen profession for the remainder of his career." *Doolittle*, 992 F.2d at 1538. The amount of harm properly chargeable to Calcutt should influence its discretionary decision. The FDIC found removal proper after holding Calcutt responsible for well over $8 million (including professional fees and charge-offs). If, on remand, the FDIC were to find that Calcutt's conduct caused a tiny fraction of this harm, it might reconsider its "draconian" sanction. *Id.* In fact, this logic led the Eleventh Circuit to remand a similar removal order so that a related agency could reconsider the order after the court jettisoned part of its reasoning. *Id.* Even a case that my colleagues cite issued this type of remand when it upheld only part of the FDIC's order—given the "extraordinary" nature of the sanction. *De la Fuente v. FDIC*, 332 F.3d 1208, 1227 (9th Cir. 2003). Because the FDIC's order is riddled with legal error, I find it inexplicable that we are not doing so here.

*   *   *

For these reasons, I respectfully dissent.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

ORDER

HARRY C. CALCUTT, III

Petitioner

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

Respondent

BEFORE: BOGGS, Circuit Judge; GRIFFIN, Circuit Judge; MURPHY, Circuit Judge;

Upon consideration of the petitioner's motion to stay the mandate,

It is ORDERED that the motion is DENIED. Judge Murphy would grant the motion to stay the mandate.

ENTERED BY ORDER OF THE COURT
Deborah S. Hunt, Clerk

Issued: September 21, 2022 /s/*Deborah S. Hunt*

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

HARRY C. CALCUTT, III Petitioner, v. FEDERAL DEPOSIT INSURANCE CORPORATION, Respondent.	ORDER

BEFORE: BOGGS, GRIFFIN, and MURPHY, Circuit Judges.

The court received a petition for rehearing en banc. The original panel has reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. The petition then was circulated to the full court. No judge has requested a vote on the suggestion for rehearing en banc.

Therefore, the petition is denied. Judge Murphy would grant rehearing for the reasons stated in his dissent.

ENTERED BY ORDER OF THE COURT.

/s/*Deborah S. Hunt*
Deborah S. Hunt, Clerk

APPENDIX D

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

[1] William Green was a commercial loan officer at the Bank and Richard Jackson was an Executive Vice President and a member of the

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 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-

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.

[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."

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 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).

- **September 14, 2011 Meeting with Examiners**. 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 non-accrual 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. <u>Violations of the Commercial Loan Policy ("CLP")</u>

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 dividend 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.

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

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 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.

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> 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]

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[4] Respondent does not argue, nor could he, that because Section 308.18(a) is entitled "Commencement of Proceeding," it necessarily

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

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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.

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.

[SEAL] *Robert E. Feldman*

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation

APPENDIX E

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)	FDIC-12-568e FDIC-13-115k ALJ McNeil

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND RECOMMENDED DECISION ON REMAND

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Part I. Introduction and Summary

1. Nature of the Case

The Federal Deposit Insurance Corporation (FDIC) has alleged that Harry C. Calcutt III, the Respondent in this administrative enforcement action, engaged in unsafe or unsound banking practices while serving at the President and Chief Executive Officer of Northwestern Bank of Traverse City, Michigan.[1] The allegations involve conduct attributed to Mr. Calcutt concerning a loan portfolio held by the Bank in 2009 and 2010, and involve allegations that he and others under his direction caused the Bank to suffer financial loss and placed the Bank at risk of suffering substantial additional loss.[2] Further, the FDIC alleged that conduct attributable to Mr. Calcutt constituted breaches of fiduciary duties he owed to the Bank; that the unsafe practices provided him with financial gain or other benefit; and that there was evidence of his personal dishonesty and his willful or continuing disregard for the safety or soundness of the Bank.[3]

Upon these allegations, the FDIC proposes to issue an order removing Mr. Calcutt from any banking office he

[1] Notice of Intention to Remove from Office and Prohibit from Further Participation, Notice of Assessment of Civil Money Penalties, Findings of Fact, Conclusions of Law, Order to Pay, and Notice of Hearing dated August 20, 2013 at 1.

[2] *Id.* at 22.

[3] *Id.* at 1-2.

currently may hold and prohibiting him from further participation in regulated banking activity.[4] In addition, upon alleging that he recklessly engaged in a pattern or practice of breaches of fiduciary duties or unsafe or unsound practices in conducting the affairs of the Bank causing more than a minimal loss to the Bank, the FDIC has assessed against Mr. Calcutt a $125,000 civil money penalty.[5]

Mr. Calcutt through his Second Amended Answer has admitted the FDIC has jurisdiction of the subject matter presented in the Notice of Intention,[6] but has denied that his actions constituted unsafe or unsound practices or breaches of fiduciary duties he owed to the Bank.

2. Procedural History

This enforcement action had been before the Board of Governors on a prior occasion, and is being presented now on remand. A hearing had been conducted by presiding Administrative Law Judge Miserendino in September 2015. Following that hearing, ALJ Miserendino recommended that the Board of Governors issue the proposed removal and prohibition order and impose the proposed $125,000 assessment.[7]

While ALJ Miserendino's Recommended Decision was pending before the FDIC Board of Directors, the United States Supreme Court rendered its decision in *Lucia v. SEC*.[8] Thereafter, the Board issued Resolution

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[4] *Id.* at 2.

[5] *Id.* at 26-27.

[6] Second Amended Answer dated May 22, 2019 at ¶¶1-6.

[7] Recommended Decision issued June 6, 2017 at 102.

[8] *Lucia v. Securities and Exchange Commission*, 138 S.Ct. 2044

085172, through which it appointed the undersigned to serve as an Administrative Law Judge; and it issued an Order in Pending Cases, through which it remanded this administrative enforcement action to me, with instructions that I provide the parties with "a new hearing and a fresh reconsideration of all prior actions".[9]

The second evidentiary hearing requested by Mr. Calcutt was conducted between October 29, 2019 and November 6, 2019, in Grand Rapids, Michigan.

3. Summary

Preponderant evidence presented in this enforcement proceeding has established that Mr. Calcutt willfully withheld from the public and from the Bank's regulators material information regarding the true nature of the Bank's relationship with the Bank's largest interrelated group of borrowers. Mr. Calcutt authorized and participated in a scheme that concealed the interrelationship of the borrowers; and he failed to ensure loan documentation reflecting the true nature of that relationship was maintained in the Bank's records. He approved loan and collateral release transactions that led the Bank to file false Call Reports in which the Bank's income was overstated. When regulatory examiners questioned Mr. Calcutt regarding the true nature and purpose of transactions with the interrelated group of borrowers, he knowingly provided false and misleading answers in an attempt to conceal from the examiners the nature and purpose of the transactions.

Preponderant evidence also established that once the

(2018).

[9] FDIC Board Resolution No. 085172, dated July 19, 2018.

true nature of the Bank's relationship with the group of borrowers became known to examiners, corrective actions were called for, including the restatement of Call Reports and supplemental analyses of the Bank's lending operations. Coupled with these costs to the Bank, Mr. Calcutt by his actions in concealing the true nature of a series of lending transactions profited by being paid a bonus that was based on the Bank's income figures that were later shown to be erroneous.

Preponderant evidence established that Mr. Calcutt engaged in a course of conduct that included unsafe and unsound banking practices and that constituted breaches of fiduciary duties Respondent owed to the Bank. By reason of such conduct, he received financial gain while prejudicing the interests of the Bank's depositors and demonstrating personal dishonesty and a willful and continuing disregard for the safety and soundness of the Bank. Such evidence supports a recommendation that the FDIC issue an order removing Mr. Calcutt from regulated banking activity and prohibiting his further participation in such activity, as provided for by section 8(e) of the Federal Deposit Insurance Act.

Further, preponderant evidence established that Mr. Calcutt's actions were reckless and were part of a pattern of misconduct that caused more than a minimal loss to the Bank. Upon this evidence and by reason of such misconduct, after considering all relevant evidence in mitigation, cause has been shown to recommend Mr. Calcutt be assessed a $125,000 civil money penalty, as provided for by section 8(i) of the FDI Act.

4. Findings of Fact

1. As President and CEO of Northwestern Bank,

Respondent Harry C. Calcutt III engaged in and participated in unsafe and unsound banking practices, and did so recklessly and as part of a pattern of continuing misconduct. These practices included:

a. Respondent authorized the 2009 Bedrock Loan transaction, knowing that the proceeds would be paid to entities that lacked the ability to repay the funds as disbursed.[10]

b. Respondent authorized the December 2010 transaction by which funds held as collateral for the Bank were to be paid to entities that lacked the ability to repay the funds as disbursed.[11]

c. Respondent repeatedly and knowingly failed to disclose to the Bank's Board and its regulatory examiners accurate and complete information about the Bank's condition and about the true nature of the Nielson Entities loan portfolio, including the 2009 Bedrock Loan transaction and the 2010 collateral release transaction benefitting the Nielson Entities.[12]

Respondent also engaged in conduct that breached fiduciary duties he owed to the Bank. That conduct included:

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[10] See Part II, §§ 5.A, C.1, G-L *infra*, and references to the record cited therein.

[11] See Part II, §§ 5C, F, L, P-R *infra*, and references to the record cited therein.

[12] See Part II, §§ 5F-G, O-R, T *infra*, and references to the record cited therein.

d. The duty of care concerns an employee's responsibility to act prudently and diligently in conducting business for the employer. Respondent breached this duty by failing to exercise reasonable control and supervision over the Bank's affairs when he led the negotiations that resulted in the 2009 Bedrock Loan and the 2010 collateral release.[13]

e. Respondent also failed to heed and effectively respond to repeated regulatory warnings regarding the Bank's Nielson Entities portfolio, including concerns about the increasing concentration of the Nielson Loans, the failure to conduct a global cash flow analysis and global collateral analysis, and the persistent and deliberate failure to obtain updated financial statements and appraisals of the collateral securing the Nielson Entities Loans.[14]

f. The duty of candor concerns the responsibility of an employee to disclose material information to the employer, even if not asked. Respondent withheld from the Bank's Board and its regulatory examiners the true nature of the Nielson Entities, the true condition of the entities that were to benefit from the 2009 Bedrock Loan transaction and the 2010 collateral release transaction, the true course of the payment of the 2009 Bedrock

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[13] See Part II, §§ 5N-P, T *infra*, and references to the record cited therein.

[14] See Part II, §§ 4, 5B-D, I, K-P. *infra*, and references to the record cited therein.

Loan prior to Board approval of the loan, and the true course of the condition of the Entities that would benefit from the 2010 collateral release transaction.[15]

2. Respondent's actions identified in the above findings caused the Bank to suffer financial loss and other damage. The damages the Bank sustained due to Respondent's conduct include:

    a. The Bank suffered financial loss from the Bedrock transaction, including a $30,000 charge-off on the $760,000 loan.[16]

    b. The Bank has taken a $6.443 million loss on the other Nielson Loans.[17]

    c. The Bank at Respondent's direction released $1.2 million in Pillay collateral that had supported the Nielson Loans.[18]

3. Respondent's actions created a significant risk of loss to the Bank from the Bedrock Loan transaction and the 2010 collateral release. That risk includes risk occasioned by the Bank's entering into both transactions without conducting reasonable or prudent underwriting or credit administration practices – as by not requiring financial statements or timely collateral appraisals

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[15] See Part II, §§ 5A-B, E-M. *infra*, and references to the record cited therein.

[16] See Part II, § 5Q. *infra*, and references to the record cited therein.

[17] *Id.*

[18] See Part II, §§4, 5L-N, P, *infra*, and references to the record cited therein.

prior to loan disbursement to the Nielson Entities.[19]

4. Respondent's actions in concealing the true nature of the Bedrock Loan Transaction caused other damage to the Bank:

    a. Respondent's lack of candor with both the Board and the Bank's examiners caused the Bank to incur investigative and auditing expenses the Bank in response to the disclosure of the true nature of the Nielson Entities, the disclosure of the unauthorized disbursement of Bank funds for the 2009 Bedrock Loan transaction, and the unauthorized 2009 release of Pillay collateral.[20]

    b. Respondent's concealment from both the Bank's Board and its regulators of the true nature of the Nielson Entities as a common group, and the true purpose of both the 2009 Bedrock Loan transaction and the 2010 collateral release, prevented both the Board and the Bank's regulators to take timely action in 2009 to address the risks occasioned by such concealment.[21]

5. Respondent's actions identified above gave him financial gain and other benefits, including:

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[19] See Part II, §§5N-R, *infra*, and references to the record cited therein.

[20] See Part II, §§5S-V, *infra*, and references to the record cited therein.

[21] See Part II, §§5P-U, *infra*, and references to the record cited therein.

a. Funds disbursed through the 2009 Bedrock Loan transaction and the two Pillay collateral disbursements artificially increased the Bank's income, causing the Bank to overstate its earnings by concealing the fact that the Bank's largest credit relationship (the Nielson Entities loan portfolio) was on non-accrual – resulting in the issuance of a dividend not warranted had the true nature of the disbursements been shown. Respondent received the benefit of that artificially inflated dividend in 2010 and 2011. As owner of 10% of the Bank's holding company, Respondent would benefit from the Bank Board's approval of a $462,950 dividend, representing approximately 9.87% of net income, in 2011.[22]

b. The same funds also resulted in conditions with the Bank's net income that permitted Respondent to benefit from an artificially inflated bonus that was based on the Bank's net after-tax income. Once the Bank's Call Reports were restated to reflect the true nature of the Nielson Entities Loan portfolio, the Bank established Respondent had been overpaid $68,841 in 2009 and $59,858 in 2010.[23]

6. Respondent's actions identified above involved his personal dishonesty. Those actions include:

a. Respondent persistently concealed from both

[22] See Part II, §§4, 5T, *infra*, and references to the record cited therein.

[23] See Part II, §§5U-V *infra*, and references to the record cited therein.

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.[24]

b. 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.[25]

7. Respondent's actions identified above demonstrated both willful and continuing disregard for the safety or soundness of the Bank. Those actions include: a. Respondent throughout 2009 to 2011 persistently ensured the true group nature

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[24] See Part II, §§5F-I, O-U *infra*, and references to the record cited therein.

[25] See Part II, §§4, 5A-G, I-K, P, *infra*, and references to the record cited therein.

of the Nielson Entities would be hidden from examiners and the Bank's own auditors, creating a risk to the Bank's safety and soundness. He willfully directed the disbursement of Bedrock loan proceeds and Pillay collateral without first securing Board approval, in direct and knowing violation of the Bank's loan policies.[26]

b. Respondent's conduct – notably the continued concealment from the Bank's auditors, its Board, and its examiners, facts regarding the true condition of the Nielson Entities loan portfolio from September 2009 (when all payments stopped) throughout 2011 – hid the extent of the problems of the portfolio over an extended period of time. The concealed facts were exposed only when a representative of the *borrower* provided the Bank's regulators with copies of documents that should have been in the Bank's loan files for this portfolio. These disclosures established that Respondent had actively prevented the filing and maintenance of relevant borrower correspondence showing the truly fraught condition of the portfolio as it truly existed in 2009 and then throughout 2010 and 2011.[27]

8. Respondent's actions created a reasonably foreseeable risk to the Bank. Those actions include:

    a. It was reasonably foreseeable that the Bank's release of collateral securing impaired loans

[26] See Part II, §§5A, E-I, P, *infra*, and references to the record cited therein.

[27] See Part II, §§4, 5A, E-L, O-R, T, *infra*, and references to the record cited therein.

that lacked personal guarantees would lead to financial loss to the Bank, where the borrowers made it clear there were no other available repayment sources.[28]

b. It was reasonably foreseeable that personal guarantees would be needed to protect the Bank against the risk of loss when maintaining a portfolio of loans secured only by illiquid collateral, where individual borrowers lacked cash flow sources, and when collateral values diminish in a recessionary economy.[29]

9. Factors in Mitigation Regarding the $125,000 Civil Penalty

a. Conditions proved during the evidentiary hearings in this matter established the lack of Respondent's good faith, that the violations threatened the institution, and that Respondent had notice of prior violations that threatened the safety of the Bank.[30]

b. Mitigation factors under the Federal Financial Institutions Regulatory Agency – Interagency Policy Regarding the Assessment of Civil Money Penalties include whether Respondent's misconduct was intentional or committed with a disregard for either the law or the consequences to the

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[28] See Part II, §§5D, P, Part III §2, *infra*, and references to the record cited therein.

[29] See Part II, §§4, 5O-P *infra*, and references to the record cited therein.

[30] See Part II, §6 *infra*, and references to the record cited therein.

> Bank, the duration and frequency of the conduct, the degree to which Mr. Calcutt was either cooperative or uncooperative, whether Mr. Calcutt either voluntarily disclosed breaches or concealed the same, the threat of loss or actual loss or other kinds of harm to the Bank, whether Mr. Calcutt realized any financial gain or other benefit from his misconduct, whether the evidence showed a "tendency to engage in unsafe or unsound practices or breaches of fiduciary duty," and whether there is an agreed upon order in place during the period of misconduct.[31] Upon considering these mitigating factors, the assessed penalty is warranted.

5. Conclusions of Law

1. The Bank is subject to the provisions of the Federal Deposit Insurance Act set forth in 12 U.S.C. §§ 1811 through 1831aa and the FDIC's Rules and Regulations, 12 C.F.R. Chapter III.

2. Respondent, Harry C. Calcutt III is an institution-affiliated party of the Bank. 12 U.S.C. § 1813(u).

3. The FDIC is the "appropriate Federal banking agency" with respect to the Bank. 12 U.S.C. § 1813(q)(2).

4. The FDIC has jurisdiction over the Bank, Calcutt, and the subject matter of this proceeding. 12 U.S.C. §§ 1818(e)(1) & (i).

5. As Chief Executive Officer and President of the Bank and as a director of the Bank, Respondent, Harry C.

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[31] Id.

Calcutt III, owed fiduciary duties to the Bank and its depositors.

6. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, the Respondent, Harry C. Calcutt III, has engaged in unsafe or unsound banking practices in connection with the Bank within the meaning of Section 8(e)(1)(A)(ii) of the FDIA, 12 U.S.C. § 1818(e)(1)(A)(ii),

7. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, the Respondent, Harry C. Calcutt III, has breached his fiduciary duties as an executive officer and director of the Bank within the meaning of Section 8(e)(1)(A)(iii) of the FDIA, 12 U.S.C. § 1818(e)(1)(A)(iii).

8. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, the Bank suffered actual financial loss and faced the probability of suffering financial loss or other damage within the meaning of Section 8(e)(1)(B)(i) of the FDIA, 12 U.S.C. § 1818(e)(1)(B)(i).

9. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, Respondent, Harry C. Calcutt III's received a financial gain or other benefit within the meaning of Section 8(e)(1)(B)(i) of the FDIA, 12 U.S.C. § 1818(e)(1)(B)(iii).

10. The Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, involved personal dishonesty within the meaning of Section 8(e)(1)(C)(i) of the FDIA, 12 U.S.C. §

1818(e)(1)(C)(i).

11. The Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, demonstrate his willful and continuing disregard for the safety or soundness of the Bank within the meaning of Section 8(e)(1)(C)(ii) of the FDIA, 12 U.S.C. §§ 1818(e)(1)(C)(ii).

12. Based on the foregoing findings, Respondent, Harry C. Calcutt III, has engaged in conduct satisfying the requirements of 12 U.S.C. § 1818(e) and is subject to the imposition of an order removing him from employment with a federally insured depository institution and prohibiting him from future participation in the affairs of a federally insured depository institution or organization listed in 12 U.S.C. § 1818(e)(7) without prior written approval of the FDIC and any other appropriate Federal financial institution regulatory agency.

13. Based on the foregoing findings, the Respondent, Harry C. Calcutt III, has engaged in conduct satisfying the requirements of Section 8(i)(2)(B) of the FDIA, 12 U.S.C. § 1818(i)(2)(B), and is subject to the imposition of an order assessing a Second Tier civil money penalty.

14. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, the Respondent, Harry C. Calcutt III, has recklessly engaged in unsafe or unsound practices in conducting the affairs of the Bank within the meaning of Section 8(i)(2)(B)(i)(II) of the FDIA, 12 U.S.C. § 1818(i)(2)(B)(i)(II).

15. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in

the foregoing findings, the Respondent, Harry C. Calcutt III's, has breached his fiduciary duties to the Bank within the meaning of Section 8(i)(2)(B)(i)(III) of the FDIA, 12 U.S.C. § 1818(i)(2)(B)(i)(III).

16. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, the Respondent, Harry C. Calcutt III's, practices constitute a pattern of misconduct within the meaning of Section 8(i)(2)(B)(ii)(I) of the Act, 12 U.S.C. § 1818(i)(2)(B)(ii)(I).

17. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, the Respondent, Harry C. Calcutt III's, practices caused more than a minimal loss to the Bank within the meaning of Section 8(i)(2)(B)(ii)(II) of the FDIA, 12 U.S.C. § 1818(i)(2)(B)(ii)(II).

18. By reason of the Respondent, Harry C. Calcutt III's, acts, omissions, and practices as fully described in the foregoing findings, the Respondent, Harry C. Calcutt III's, practices resulted in a pecuniary gain or other benefit to him within the meaning of Section 8(i)(2)(B)(ii)(III) of the FDIA, 12 U.S.C. § 1818(i)(2)(B)(ii)(III).

19. Upon consideration of mitigating factors, a civil money penalty in the amount of One Hundred and Twenty-five Thousand Dollars ($125,000) is recommended.

Contents

Part II. Evidentiary Proceedings

1. Background

The case presented in 2019 differs in some respects from that presented in 2015. As originally drafted, the FDIC's Notice of Intention alleged Mr. Calcutt, as the President and CEO of Northwestern Bank, collaborated with the Bank's commercial loan officer, William Green, and Richard Jackson, the Bank's executive vice president and Bank Board member.[32] The collaboration that was described in the Notice of Intention addressed actions attributed to all three Bank employees with respect to a Bank loan portfolio controlled by the Nielson family of Traverse City, Michigan.[33]

Shortly before the hearing began in 2015, Mr. Green and Mr. Jackson no longer disputed the truth of these allegations, and consented to orders prohibiting them from engaging in regulated banking activity; and Mr. Jackson consented to the assessment of a $75,000 civil money penalty, all based on the claims presented in the Notice of Intention.[34]

Also, by the time the matter was presented for a second hearing, issues not present in 2015 had been raised and need to be addressed in this Recommended Decision. Those issues include Mr. Calcutt's new claims challenging the FDIC's Order in Pending Cases, and a new affirmative

[32] Notice of Intention at ¶¶4-6.

[33] *Id.* at ¶¶7-26.

[34] See Notice of Settlement as to William Green, dated September 14, 2015; Notice of Settlement as to Richard Jackson, dated September 14, 2015.

defense regarding whether the claims in the Notice of Intention are barred either by the five year statute of limitations found at 28 U.S.C. § 2462 or the doctrine of laches.[35]

The record now being forwarded to the FDIC's Board of Directors consists of those exhibits presented in both the 2015 and 2019 hearings, along with the transcripts of testimony taken during those hearings and the briefs and arguments of counsel.

2. Findings of Fact Regarding Jurisdiction

Respondent has admitted the FDIC and its Board of Directors has jurisdiction over the subject matter presented in the Notice of Intention.

Jurisdictional Finding of Fact No. 1: At all times pertinent to this proceeding, Northwestern Bank was a corporation existing and doing business under the laws of the State of Michigan, having its principal place of business at Traverse City, Michigan. The Bank was, at all times pertinent to this proceeding, an insured State nonmember bank.[36]

Jurisdictional Finding of Fact No. 2: At all times pertinent to this proceeding Harry C. "Scrub" Calcutt III served as the Bank's president and chief executive officer and as the chairman of the Bank's board of directors. He

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[35] *Cf.* Harry C. Calcutt III, First Amended Answer to Notice at 39 (raising affirmative defenses of entrapment and Due Process violation); and [Harry C. Calcutt III,] Second Amended Answer to Notice at 32-33.

[36] Second Amended Answer to Notice at ¶1; Respondent's Proposed Findings of Fact and Conclusions of Law at ¶2 and citations to the record therein; Joint Ex. 15 (Joint Stipulations of Fact) at ¶1.

was also at all times a member of the Bank's senior loan committee.[37] He also was CEO of Northwest Bancorp, the Bank's holding Company.[38]

3. Conclusions of Law Regarding Jurisdiction

Jurisdictional Conclusion of Law No. 1: As an insured State nonmember bank, the Bank was at all times pertinent to this proceeding subject to the FDI Act, 12 U.S.C. §§ 1811-1831aa, the Rules and Regulations of the FDIC, 12 C.F.R. Chapter III; and the laws of the State of Michigan.[39]

Jurisdictional Conclusion of Law No. 2: At all times pertinent to this proceeding, Mr. Calcutt was an "institution-affiliated party" as that term is defined in section 3(u) of the Act, 12 U.S.C. § 1813(u), and for purposes of sections 8(e)(7), 8(i) and 8(j) of the Act, 12 U.S.C. § 1818(e)(7), 1818(i) and 1818(j).[40]

Jurisdictional Conclusion of Law No. 3: The FDIC

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[37] Second Amended Answer to Notice at ¶2; Respondent's Proposed Findings of Fact and Conclusions of Law at ¶3 and citations to the record therein; Joint Ex. 15 (Joint Stipulations of Fact) at ¶4.

[38] Respondent's Proposed Findings of Fact and Conclusions of Law at ¶4 and citations to the record therein. See also Mr. Calcutt's testimony that currently he is the "Chairman of the Board of a small community bank [State Savings Bank] and the Chairman and CEO of the holding company [CS Bancorp]" and is not going to return to any management function in banking. Tr. at 1350-51 (Calcutt).

[39] Second Amended Answer to Notice at ¶1; Respondent's Proposed Findings of Fact and Conclusions of Law at ¶2 and citations to the record therein.

[40] Second Amended Answer to Notice at ¶2; Respondent's Proposed Findings of Fact and Conclusions of Law at ¶2 and citations to the record therein; Joint Ex. 15 (Joint Stipulations of Fact) at ¶2.

has jurisdiction over the Bank, Mr. Calcutt, and the subject matter of this proceeding.[41]

4. Plenary Findings of Fact

Through stipulations[42] and through answers given by Mr. Calcutt in his Second Amended Answer, the following factual claims presented in the Notice of Intention are established:

Plenary Findings of Fact No. 1: The Nielson family of Traverse City, Michigan, manages multiple limited liability companies (LLCs), some of which are loan customers of the Bank. Throughout 2009, a member of the Nielson family, Cori Nielson, had discussions with the Bank regarding loans to certain LLCs controlled by the Nielson family.[43] The FDIC has defined "Nielson Entities" to mean all business entities managed by the Nielson family.[44] If viewed collectively, during the relevant period the Nielson Entities represented the Bank's largest loan relationship, in that the Nielson Entities had approximately $38 million in loans with the Bank.[45] The Nielson Entities represented a long-standing loan relationship for the Bank, having been customers of the Bank for several years prior to 2009.[46]

Plenary Findings of Fact No. 2: At all times pertinent to this proceeding, William Green served as a

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[41] Second Amended Answer to Notice at ¶3; Joint Ex. 15 (Joint Stipulations of Fact) at ¶3.

[42] See Joint Ex. 15 (Joint Stipulations of Fact).

[43] Second Amended Answer to Notice at ¶7.

[44] Id.

[45] *Id.* at ¶8.

[46] *Id.* at ¶9.

commercial loan officer for the Bank and a member of the Bank's classified asset committee.[47] Green was the loan officer assigned to all of the Nielson Entities.[48]

Plenary Findings of Fact No. 3: In or about August 2009, the Nielson Entities claimed they were facing significant financial difficulties and wanted to restructure their loans.[49] Several of the Nielson Loans were due to mature on September 1, 2009, and as of that date, the Nielson Entities stopped making payments on all of the Nielson Loans.[50] Mr. Calcutt personally engaged in discussions regarding loans to certain Nielson Entities in 2009; Mr. Green also participated in those discussions.[51]

Plenary Findings of Fact No. 4: At all times pertinent to this proceeding, Richard Jackson served as the Bank's executive vice president and as a member of the Bank's board of directors. He was also a member of the Bank's senior loan committee, classified assets committee, and asset liability committee.[52] Between August 2009 and December 2009, Mr. Jackson participated in internal Bank discussions with Mr. Calcutt or Mr. Green (or both) regarding an agreement for the Nielson Loans.[53] Under the Bank's organizational structure, Mr. Jackson reported directly to Mr. Calcutt.[54]

[47] *Id.* at ¶5.

[48] *Id.* at ¶10; Joint Ex. 15 (Joint Stipulations of Fact) at ¶5.

[49] Second Amended Answer to Notice at ¶11.

[50] *Id.* at ¶12.

[51] *Id.* at ¶13.

[52] *Id.* at ¶6; Joint Ex. 15 (Joint Stipulations of Fact) at ¶6.

[53] Second Amended Answer to Notice at ¶14.

[54] Transcript of 2019 testimony (Tr.) at 1421 (Calcutt).

Plenary Findings of Fact No. 5: The Nielson Entities consisted of nineteen separate limited liability companies. Between them, the various entities had approximately $38 million in loans at the Bank (collectively, Nielson Loans).[55]

Plenary Findings of Fact No. 6: The Bank and the Nielson Entities reached an agreement on loan terms with certain Nielson Entities in November 2009.[56] As part of this agreement, the Bank extended a loan of $760,000 to one of the Nielson Entities, Bedrock Holdings LLC (referred to here as the Bedrock Loan), and also released $600,000 in certain investment-trading funds in which the Bank held a collateral interest.[57] Mr. Calcutt consented to the Bank loaning a Nielson entity $760,000, transferring $600,000 of collateral held by Pillay Trading LLC (the Pillay Collateral) to the Bank, and obtaining additional collateral as part of the Bedrock Transaction.[58] The Nielsons used the $600,000 Pillay Collateral released from the Bank's security interest to bring current all past-due loans to the Nielson Entities and used the proceeds of the $760,000 loan to establish a reserve sufficient to payments for all loans through April 2010.[59]

Plenary Findings of Fact No. 7: The Bank had a practice of requiring certain loans to be approved by the Senior Loan Committee, the Board of Directors, or both,

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[55] Joint Ex. 15 (Joint Stipulations of Fact) at ¶7.

[56] Second Amended Answer to Notice at ¶16.

[57] *Id.* at ¶17

[58] *Id.* at ¶20

[59] *Id.* at ¶18.

depending upon the size of the loan.[60]

Plenary Findings of Fact No. 8: One of the renewed loans was a $4,500,000 loan to Bedrock Holdings.[61]

Plenary Findings of Fact No. 9: Several of the Nielson Loans were due to mature on September 1, 2009, and as of that date, the Nielson Entities stopped making payments on all of the Nielson Loans.[62] In November 2009, Mr. Calcutt, Mr. Jackson, and Mr. Green all were aware that the loans comprising the Bank's largest lending relationship, the Nielson Entities, were approaching 90 days past due.[63]

Plenary Findings of Fact No. 10: In a November 14, 2009 letter from Mr. Jackson to the Office of Financial and Insurance Regulation for the State of Michigan (OFIR) and copied to the FDIC, Mr. Jackson provided the Bank's formal response to an OFIR examination report, which had listed several of the Nielson Loans for Special Mention.[64] In this letter, certain of the Nielson Loans listed for Special Mention were described as "performing".[65] Mr. Jackson's letter did not disclose the fact that at the time: (i) the Nielsen Entities had stopped payments on all of their loans; (ii) the Bank was in the midst of extensive workout negotiations that had been ongoing for more than

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[60] *Id.* at ¶27.

[61] *Id.* at ¶30.

[62] *Id.* at ¶10.

[63] *Id.* at ¶11.

[64] *Id.* at ¶74; Joint Ex. 15 (Joint Stipulations of Fact) at ¶31.

[65] Second Amended Answer to Notice at ¶76; Joint Ex. 15 (Joint Stipulations of Fact) at ¶32.

two months; or (iii) the Nielson Entities had described significant financial difficulties, including poor or non-existent cash flow and the reduction in value of numerous properties that served as the Bank's collateral, to the point that the Nielson Entities were willing to give the Bank a deed in lieu of foreclosure with respect to several such properties.[66]

Plenary Findings of Fact No. 11: "Nonaccrual status" is when a loan is past due for 90 days.[67] On November 30, 2009, the day a majority of the Nielson Loans reached 90 days past due and were automatically placed on nonaccrual, the Nielson Entities paid $600,000, the amount of collateral released by the Bank, for the September, October, and November 2009 payments due on the outstanding Nielson Loans, thus bringing them all current.[68] On or about December 1, 2009, the Nielson Loans were taken off nonaccrual.[69] The Bank funded the Bedrock Holdings Loan on or about December 14, 2009.[70]

Plenary Findings of Fact No. 12: To avoid any gaps in the loan documentation, the renewal documents were backdated to September 1, 2009.[71]

Plenary Findings of Fact No. 13: Deposit accounts were established for the Nielson Entities with the understanding that the proceeds of the Bedrock Transaction

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[66] Second Amended Answer to Notice at ¶77; Joint Ex. 15 (Joint Stipulations of Fact) at ¶33.

[67] Tr. at 1377 (Calcutt).

[68] Joint Ex. 15 (Joint Stipulations of Fact) at ¶18.

[69] *Id.* at ¶19.

[70] *Id.* at ¶21.

[71] Joint Ex. 15 (Joint Stipulations of Fact) at ¶20.

would thereafter be used to fund payments on each of the Nielson Loans.[72] Mr. Calcutt, Mr. Jackson, and Mr. Green each consented to the Bedrock Transaction and were aware of its purpose.[73]

Plenary Findings of Fact No. 14: In March 2010, based on information that Mr. Green provided to him, Bank credit analyst Ian Hollands prepared a loan write up for presentation to the Board regarding the loans to Bedrock.[74] The loan write up did not disclose that the loan proceeds were intended to pay Nielson Loans through April 2010.[75] Instead, Hollands wrote that the loan would be used for "working capital," notwithstanding that the true purpose of the $760,000 loan did not meet the Bank's general definition of the term "working capital".[76] Mr. Calcutt, Mr. Green, and Mr. Jackson each knew part of the proceeds from the Bedrock Loan would fund loan payments on all of the Nielson Loans through April 2010.[77] They also knew that the $4,500,000 existing loan renewal, the $760,000 loan, and the $600,000 collateral release had all been completed three months *before* the loan application was presented to the Bank's Board for its approval.[78] Mr. Calcutt and Mr. Jackson initialed the loan write-up,

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[72] *Id.* at ¶15.

[73] *Id.* at ¶16.

[74] Second Amended Answer to Notice at ¶31.

[75] *Id.* at ¶36.

[76] *Id.* at ¶32.

[77] *Id.* at ¶33.

[78] *Id.* at ¶35.

which reflected prior approval of the loan and loan extension.[79]

Plenary Findings of Fact No. 15: After the Bedrock Loan transaction, and with the aid of the proceeds it generated, the Nielson Entities continued to make payments on the Nielson Loans through August 2010.[80]

Plenary Findings of Fact No. 16: Several of the Nielson Loans were scheduled to mature again on September 1, 2010.[81] At or around this time, the Nielson Entities, through Cori Nielson and Autumn Berden, claimed the Entities had financial difficulties and were unwilling to continue making loan payments.[82] As of the September 1, 2010 maturity date, the Nielson Entities once again stopped making payments on all of the Nielson Loans.[83]

Plenary Findings of Fact No. 17: Between September 2010 and December 2010, Mr. Calcutt, Mr. Green, and Mr. Jackson directly participated in negotiations with the Nielson Entities, including one meeting in December 2010 attended by Mr. Calcutt regarding the outstanding loans.[84] In December 2010, the Bank released $690,000 in investment-fund collateral held by Pillay Trading LLC.[85] As in the prior year, the released funds were again used to make payments on all of the past-due Nielson Loans

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[79] *Id.* at ¶38; Joint Ex. 15 (Joint Stipulations of Fact) at ¶13.

[80] Second Amended Answer to Notice at ¶39.

[81] *Id.* at ¶40.

[82] *Id.* at ¶41.

[83] *Id.* at ¶42.

[84] *Id.* at ¶43.

[85] *Id.* at ¶44; Joint Ex. 15 (Joint Stipulations of Fact) at ¶14.

and to bring them current.[86] The Bank, through Mr. Calcutt and others, negotiated with the Nielsons in early 2011 and then initiated foreclosure proceedings after the loans went into default.[87]

Plenary Findings of Fact No. 18: Mr. Calcutt, Mr. Jackson, and Mr. Green agreed to renew all of the matured Nielson Loans. To avoid any gaps in the loan documentation, the renewal documents were backdated to September 1, 2009.[88] After the Bedrock Transaction, payments on the Nielson Loans were made through August 2010.[89]

Plenary Findings of Fact No. 19: In May 2010 and again in July 2011, Mr. Calcutt signed an Officer's Questionnaire, each time affirming, among other things, that he was not aware of any loans since the last exam that had been renewed or extended with acceptance of separate notes for the payment of interest.[90]

Plenary Findings of Fact No. 20: In May 2010, the Bank sold almost $2 million of the Nielson Loans to two affiliates of the Bank.[91] This sale was the result of a discussion between Mr. Calcutt, Mr. Green, and Mr. Jackson, and occurred shortly before FDIC examiners arrived for a June 2010 examination.[92] Mr. Calcutt and Mr. Jackson participated in the decision to sell the loans to the affiliate

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[86] Second Amended Answer to Notice at ¶45.

[87] *Id.* at ¶ 51.

[88] *Id.* at ¶20.

[89] *Id.* at ¶22.

[90] Second Amended Answer to Notice at ¶79.

[91] *Id.* at ¶81; Joint Ex. 15 (Joint Stipulations of Fact) at ¶34.

[92] Second Amended Answer to Notice at ¶82

banks.[93] The Bank sold the loans shortly before the FDIC examiners arrived for the June 2010 examination. In late September 2010, shortly after the FDIC's examination concluded, the Bank then repurchased from the two affiliate banks the loans that had previously been sold.[94] At the time of repurchase, the loans were delinquent and past maturity.[95]

Plenary Findings of Fact No. 21: The Bank had in the past contracted with a third party consultant to perform an external loan review of the Bank's portfolio.[96] The Bank's Board also hired a third-party consulting firm to investigate the handling of the Bank's relationship with the Nielson Entities.[97]

Plenary Findings of Fact No. 22: Several of the Nielson Loans were scheduled to mature again on September 1, 2010.[98] As of the September 1, 2010 maturity date, the Nielson Entities stopped making payments on all of the Nielson Loans.[99]

Plenary Findings of Fact No. 23: In January 2011 the Nielson Entities stopped making payments; all of the Nielson Loans, including the $760,000 Bedrock Loan, have

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[93] Joint Ex. 15 (Joint Stipulations of Fact) at ¶36.

[94] Second Amended Answer to Notice at ¶87; Joint Ex. 15 (Joint Stipulations of Fact) at ¶38.

[95] Joint Ex. 15 (Joint Stipulations of Fact) at ¶38

[96] 96 Second Amended Answer to Notice at ¶89; Joint Ex. 15 (Joint Stipulations of Fact) at ¶39.

[97] Second Amended Answer to Notice at ¶114.

[98] Joint Ex. 15 (Joint Stipulations of Fact) at ¶23.

[99] *Id.* at ¶24.

been in default since that time.[100]

Plenary Findings of Fact No. 24: The 2009 Bedrock Loan transaction and the December 2010 Pillay Trading LLC Transaction were completed shortly before the end of the 2009 and 2010 calendar years, respectively.[101]

Plenary Findings of Fact No. 25: In December 2011, the Bank issued a written response, signed by Mr. Calcutt, Mr. Jackson, and other members of Bank management, to the FDIC's August 2011 examination findings.[102]

Plenary Findings of Fact No. 26: Mr. Calcutt received a bonus in certain years of his employment with the Bank; the bonus was based on 4% of the Bank's net after-tax income.[103]

Plenary Findings of Fact No. 27: In the event that a Final Order to Pay Civil Money Penalties is entered in this case, Mr. Calcutt has stipulated that he has the financial ability to pay a civil money penalty of up to $125,000, the amount set forth in the Notice.[104]

5. Controverted Claims

Through its Notice of Intention, the FDIC alleged that as of March 2010, the Bank's Board of Directors had not been made aware, either in writing or at any of the preceding monthly Board meetings, that the Nielson Entities were the Bank's largest loan relationship and were having significant financial difficulties, that they had gone

[100] Joint Ex. 15 (Joint Stipulations of Fact) at ¶29.

[101] Second Amended Answer to Notice at ¶71.

[102] *Id.* at ¶91.

[103] *Id.* at ¶117.

[104] Joint Ex. 15 (Joint Stipulations of Fact) at ¶40.

through several months without making payments on any of their loans, that senior bank management (including Mr. Calcutt) had been directly negotiating with the Nielson Entities during that time, and that the only reason the Nielson Entity loans were current in March 2010 was that the Bank, through the Bedrock Loan transaction, had provided the funds used to make all of the payments dating back to September 2009.[105]

In his Second Amended Answer, Mr. Calcutt denied these factual claims, without elaboration.[106]

A. Nature of the Bank's Relationship with the Nielson Entities, Generations Management, and Bedrock Holdings LLC

Cori Nielson (now Chekhovskiy) testified that Generations Management manages the assets for the various Nielson Family Trusts.[107] During the relevant period, here specifically in 2009 and 2010, Generations had various assets, including vacant land and commercial rental real estate.[108] Included in the assets managed by Generations were Frontier, an oil and gas company, and Team Services, an oil and gas well servicing company.[109] Throughout this period, the assets managed by Generations had loans with Northwestern Bank.[110]

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[105] Notice of Intention to Remove from Office and Prohibit from Further Participation, Notice of Assessment of Civil Money Penalties, Findings of Fact, Conclusions of Law, Order to Pay, and Notice of Hearing at ¶37.

[106] Second Amended Answer to Notice at ¶37.

[107] Tr. at 930 (Nielson).

[108] *Id.*

[109] *Id.* at 930-31 (Nielson).

[110] *Id.* at 931 (Nielson); FDIC Enforcement Counsel Exhibit (EC Ex.)

Autumn Berden served as the chief executive officer for Generations Management, between at least 2008 and 2012.[111] The Nielson Entities, as identified in the record in a Loan Summary Report issued by the Bank, consisted of 35 limited liability companies, and are referred to in this record interchangeably[112] as the Nielson Entities or entities of the Waypoint Management Group.[113] Ms. Berden stated that these companies were Bank borrowers during

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133 (chart identifying Nielson Entities with loans at Northwestern Bank).

[111] Tr. at 25-26 (Berden).

[112] EC Ex. 64 at 3 (1/19/12 letter from Scrub Calcutt to David K. Mangian, Assistant Regional Director FDIC: "The manager of Bedrock is Waypoint Management LLC . . . [and] is managed by members of the Nielson family, namely Cori Nielson, Keith Nielson, and Jonathan Crosby. When the 2009 Loan was made to Bedrock, Northwestern also had other outstanding loans with various entities managed by Waypoint Management or other (entity) managers that were managed by all or some of the managers of Waypoint Management." See also testimony of Mr. Calcutt at Tr. 1369, recognizing that the Nielson Entities was sometimes referred to as the Waypoint Management relationship, as the Bank's largest loan or credit relationship throughout 2008 to 2011.

[113] Tr. at 27 (Berden); Tr. at 227 (Gomez); EC Ex. 3_0002: EC Ex. 3 is a binder of documents that had been sent to the FDIC. Tr. at 153 (Berden). The record reflects that Ms. Berden compiled the documents found in EC Ex. 3, having done so in response to a request from Ms. Gillerlain. See Tr. at 179-80 (Berden). The record reflects that FDIC Chicago Regional Case Manager Anne Miessner sent an email to Theresa Gillerlain asking: "I was wondering if you should just ask Cori if the $600M in 2009 and $687M in 2010 Pillay funds were deposited into the bank to make the loan payments, and if so, which account(?). This may make our tracing job easier. Also, did the bank & borrower sign a collateral release agreement each time? If so, would she be willing to provide us with copies?" Resp. Ex. 98.3.

this period, and included Bedrock Holdings LLC.[114]

Ms. Berden testified that the Nielson Entities were companies that engaged in multiple related businesses, including holding vacant and developed real estate, engaging in commercial and residential property rental and home-building, holding oil and gas interests, and more.[115] Each company had different owners, including limited liability companies, trusts, and foundations.[116]

Ms. Berden stated that during the relevant period, the holdings' value was approximately $112 million, with $32 million held by various foundations and charitable trusts, and $80 million available for collateral purposes or for payment on loans.[117] Generally, the entities comprising the $80 million would not hold liquid assets (that is, assets that could be used in less than 30 days) – but would, instead, consist of real estate assets and oil and gas assets, managed by Generations Management.[118]

Ms. Nielson testified that many of the Nielson Entity loans were due to mature in September 2009, causing her to "initiate discussions with the Bank . . . regarding renewals of those loans and communicate with the Bank that we needed to have significant loan modifications in order to

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[114] Tr. at 27 (Berden). Mr. Calcutt testified that during a meeting he had with Cori Nielson in April 2008, he determined that the Nielsons had "roughly $140 million of fair market value assets, but $112 million of book value assets, and they had $39 million in debt," with $7 to $9 million in cash or cash equivalents. Tr. at 1274 (Calcutt).

[115] *Id.* at 29 (Berden).

[116] *Id.*

[117] *Id.* at 31 (Berden).

[118] *Id.* at 31-32 (Berden).

be able to continue to service the debts."[119] She testified that there was a significant economic recession affecting real estate, and that "[o]ur ability to sell real estate was nearly zero, and [Team Services], which had been historically a lot of cash flow was also going through a big question as far as its future cash flow because the price of oil had significantly plunged."[120]

Describing how she and Generations Management would work with members of the Bank's senior management, Ms. Nielson testified that she "primarily communicated with Scrub Calcutt as the decision-maker"; and Ms. Berden would have communications with Bill Green "sort of on a more administrative level."[121]

Describing his own role with the Bank and his background in banking, Mr. Calcutt testified that beyond an undergraduate degree he holds a Master's degree in business, became a certified public accountant, worked for Touche Ross, now Deloitte and Touche, for about seven years, and then moved to northern Michigan, formed a firm and was a CPA for over 20 years.[122] While working in that firm he was on the board of directors for several banks, and went to Northwestern Bank full time at the end of the 1990s.[123]

Ms. Nielson said that initially when she discussed the need for loan modifications with Mr. Calcutt, "[t]he Bank wanted renewals but they did not want to give any loan

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[119] *Id.* at 932 (Nielson).

[120] *Id.* at 933 (Nielson).

[121] *Id.* at 934 (Nielson).

[122] *Id.* at 1263 (Calcutt).

[123] *Id.*

modifications to reduce any debt service. They felt that they could not do that because it would cause red flags to the regulators who reviewed their loans," adding that Mr. Green "said similar things to Autumn Berden".[124]

Elaborating on what she understood "red flags" meant in this context, Ms. Nielson testified that Mr. Calcutt expressed concerns about state and federal bank regulators "coming in and looking over their loan portfolio on a regular basis, so red flags were things that the regulators would look at and cause them to scrutinize our loan relationship more closely".[125] She added that where she was seeking forbearance, Mr. Calcutt was unwilling to give forbearance because that would be a red flag.[126] She agreed with the premise that as the two parties discussed interest, forbearance, and deeds-in-lieu between September and November 2009, a resolution that involved deeds-in-lieu was also regarded by Mr. Calcutt as unacceptable as it, too, would be a red flag to regulators,.[127]

Asked for further details about Mr. Calcutt's report to her that with red flags there may be further scrutiny to the banking relationship, Ms. Nielson testified:

> So what he was saying was that the Regulators then would look deeper into the loan relationship, all the loan relationships between the Nielson Entities and the Bank. And I think it primarily all went back to the idea of the legal lending limit. And the Regulators trying to consolidate things.

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[124] *Id.* at 934 (Nielson).

[125] *Id.* at 935 (Nielson).

[126] *Id.* at 986 (Nielson).

[127] *Id.* at 987 (Nielson).

> And he was trying to argue that they are separate. And so any red flag would cause more looking and more . . . scrutiny of the loan relationship. And to the extent that they might sort of figure out that how closely related these entities are or the fact that if one of them is having an issue, it's really related to, to all of them having issues.[128]

Included in the exchange between Mr. Calcutt and Ms. Nielson was an email Ms. Nielson sent to Mr. Calcutt on August 21, 2009, by which Ms. Nielson said she "was trying to initiate discussions with the Bank regarding the September 1st maturities of a substantial number of our portfolios' loans".[129] In her message to Mr. Calcutt, referring to the loans between the Bank and the Nielson Entities, Ms. Nielson wrote that "We will not make our September payment or any further payment until we have the necessary meetings and discussions to reach an overall restructuring of the relationship."[130]

Providing context to this message, Ms. Nielson testified:

> I'm trying to warn him ahead of time so that we can make some progress on negotiating renewals, and I was not going to be able to make the maturity payments, nor for whatever loans were not maturing I wasn't able to continue making monthly payments because most of those entities also had loans that would be maturing and so

[128] *Id.* at 1022 (Nielson).

[129] *Id.* at 935 (Nielson); EC Ex. 3 at 82.

[130] *Id.* at 936-37 (Nielson); EC Ex. 3 at 82.

clearly they would be in default.[131]

Ms. Nielson testified that as of September 1, 2009, none of the Nielson Borrowing Entities had the ability to pay off the debts owed to the Bank, so at that time the Entities stopped making payments on those loans.[132]

Continuing to deal directly with Mr. Calcutt, on September 21, 2009, Ms. Nielson sent him an email asking that the Bank "suspend monthly payments until our cash flow returns" with the expectation that once that flow returned "our entities would resume payments until Northwestern is completely paid in full including back interest."[133] She wrote that "[t]he fact is that our entities do need a serious restructuring of their loan payments for the next period of time."[134] She wrote that "[a]t this point, some real estate values are so poor that some properties may not have any equity left in them, and some properties may not have good potential for equity recovery in the near term," explaining that "[t]he real estate market had dropped so dramatically that a lot of our loans were underwater."[135]

She wrote that cash flow from "a lot" of the Nielson Entities was negative, and that what she needed was a "[s]ignificant reduction in loan service payments."[136] She testified that she offered to share financial information

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[131] Tr. at 937 (Nielson).

[132] *Id.* at 937 (Nielson).

[133] EC Ex. 3 at 89.

[134] *Id.*

[135] *Id.* at 943 (Nielson); EC Ex. 3 at 89.

[136] Tr. at 940-41 (Nielson). See also testimony of Mr. Jackson, confirming that some of the Nielson Entities held vacant land in 2009, and stating that he could not recall ever seeing a global cash flow analysis. Transcript of 2015 hearing (Tr. (2015)) at 1659-60 (Jackson).

with the Bank, hoping that "any information we shared would be in the context of settlement discussions," but that Mr. Calcutt declined at that time to seek any financial information Ms. Nielson cared to offer.[137]

Ms. Nielson agreed with the premise that the purpose of her letter to Mr. Calcutt was that she was asking for debt forbearance to get the Nielson Entities through the recession and, if the Bank (through Mr. Calcutt) would work with her, it was her intention and objective to make sure the Bank got fully repaid.[138] She also agreed that at the time she wrote this letter, no one knew whether it would take six months, or shorter, or longer, to reach that goal.[139] She explained that whereas she sought to have the Bank accept a *reduction* of payments on these loans, Mr. Calcutt wanted *increases* in payments.[140]

Ms. Nielson added that the Nielson Entities through Generations Management was looking at another way out of their difficulties – by trying to make investments in other cash-flow businesses – but that at no time in the relationship had either Generations Management or Ms. Nielson every made any promises that Nielson *family* money would be used to pay back loans owed by the borrowing entities.[141] Ms. Nielson said "We had no intention to do things that were not part of the documentation of the loans," and generally there were no guarantees on the loans in the Nielson Entities loan portfolio.[142] She testified

[137] *Id.* at 938-39 (Nielson).

[138] *Id.*at 982 (Nielson).

[139] *Id.*

[140] *Id.* at 983 (Nielson).

[141] *Id.* at 943-45 (Nielson).

[142] *Id.* at 946 (Nielson).

that at no point prior to 2009 did Mr. Calcutt ever ask for guarantees for these loans, and even if he had asked for guarantees, none would have been given.[143]

Ms. Nielson testified that the concern here was *not* that the loans may go unpaid – but whether conditions might arise whereby the Bank's regulators would learn the true nature of the common set of loans that had been extended to the Nielson Entities. According to Ms. Nielson, Mr. Calcutt's responses to her request to address these loans "all relate[d] to red flags" – not that his "hands were tied" because regulators were "actually requiring them to do certain things" but rather "it was that the regulators were not aware of the loan relationship issues and . . . the Bank didn't want red flags to be thrown to cause the regulators to scrutinize the loan relationship."[144] She said Mr. Calcutt rejected Ms. Nielson's offer to deed properties over to the Bank – testifying that Mr. Calcutt "did not want that to happen because that would be a red flag to the regulators."[145]

Continuing in their discussions about the loans in question, on October 12, 2009 Ms. Nielson sent a letter to Mr. Calcutt describing an offer Mr. Calcutt made to her regarding the Nielson Entities:

You have offered to release Pillay LLC as collateral and extend our loans for up to one year with interest-only payments at the current mixture of 4% (floor) and 2.62% (variable). The blended rate of this offer averages out to 3.7%. We have determined that our companies are able to

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[143] *Id.* at 946-47 (Nielson).

[144] *Id.* at 941-42 (Nielson).

[145] *Id.* at 947 (Nielson).

accept this offer on the properties our companies desire to keep in their portfolio.[146]

The Pillay collateral was, according to Ms. Nielson, an asset of the Nielsons the nature and value of which "varied through the years," and she could not say whether at that point "they were simply cash, but in prior years they had been stock market investments."[147] Ms. Nielson testified that at this point, financially "it did not make any logical sense for the Borrowing Entities that had loans underwater to continue to service those loans.[148]

Mr. Calcutt described the solution involving the Pillay collateral as one that Mr. Green had presented to the Senior Loan Committee: "I don't recall the specifics of the proposal other than it in part involved the taking of some additional mortgages, security for the Bank and also the release, a partial release of Pillay funds, which were their funds," along with a new $760,000 loan.[149] At that amount, however, the Senior Loan Committee lacked the authority to approve the loan, but "would need to approve it before it would go to the Board for approval."[150] Similarly, the Senior Loan Committee lacked the authority to approve the release of the Pillay funds – such a release required the Board's approval.[151]

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[146] EC Ex. 3 at 8.

[147] Tr. at 991 (Nielson)

[148] *Id.* at 952 (Nielson).

[149] *Id.* at 1285 (Calcutt).

[150] *Id.* at 1286 (Calcutt).

[151] *Id.*; see also Joint Ex. 4 (11/16/09 email from Mr. Green to Mr. Calcutt and other members of the Senior Loan Committee regarding the Nielson Entities Loans).

On October 26, 2009, in the continuing course of her discussions with Mr. Calcutt, Ms. Nielson sent him an email in anticipation of a meeting set to take place the following day.[152] Attached to the email was a spreadsheet showing "a list of properties [that had been pledged to the Bank to secure repayment of loans] that are underwater that have negative cash flow."[153] Included in the transmission was a section "showing capital improvement requirements that those buildings urgently need in order to not start losing tenants."[154] Ms. Nielson testified that these were properties "that we felt the Bank could take back. The loans were matured. We were underwater."[155]

Mr. Calcutt, on the other hand, testified that he had no doubt that the Bank would be repaid, opining that statements to the contrary by Ms. Berden or Ms. Nielson constituted nothing more than "posturing" because "they did have the funds."[156] When asked, however, whether he did anything to determine whether or not Ms. Nielson was or was not posturing – as by asking for financial information – Mr. Calcutt responded: "I personally, no. But that wouldn't be my responsibility. It would be the lender's [i.e., Mr. Green's] responsibility and Credit administration to follow up on financial statements".[157] He

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[152] Tr. at 953 (Nielson); EC Ex. 3 at 101-02.

[153] Tr. at 953-54 (Nielson); Ex. Ex.3 at 102.

[154] Tr. at 954 (Nielson).

[155] *Id.*

[156] *Id.* at 1296 (Calcutt). See also testimony of Mr. Jackson, that the Nielsons "stated on several occasions that they intended to make us whole, and I believe that they had resources available that they were choosing not to use. We felt they were posturing." Tr. (2015) at 1668 (Jackson).

[157] Tr. at 1382 (Calcutt)

stated that had he believed otherwise, "I would have done what I did in 2011," which was to "[p]ut them on non-accrual and undertaken collection efforts."[158]

Mr. Calcutt explained why this negotiation approach was, in his opinion, good for the Bank:

> Well, because it left the door open for them finding another bank which we had requested, to refinance some of these loans. It gave us time in hope that they would repay, pay off some of these loans or sell the underlying collateral for some of these loans and use the proceeds to pay the loan off. And also they had Team Services' cash flow that we knew was there and that would have been available to service the debt, not to mention their oil and gas cash flow. So there were a number of reasons that this loan made sense but it comes back to the fact that they had financial resources and ability and they did follow through on some of these things.[159]

Ms. Nielson testified that "Scrub was not interested in discussing any loan renewals or deeds-in-lieu individually. Everything had to be part of a global discussion."[160]

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[158] Tr. at 1296 (Calcutt).

[159] *Id.* at 1297 (Calcutt).

[160] *Id.* at 956 (Nielson). See also testimony by William Calcutt regarding his advice to the Bank in January 2012. Although he testified that he was not part of developing the Bank's strategy in its negotiations with the Nielson Entities, he wrote "During the last year, Northwestern has unfortunately discovered the character of the current managers of Bedrock, who are also managing other entities which Northwestern has financed (Nielson-Related Entities) is less than acceptable. If it had been previously known what it has since discovered, it would have altered the judgment in the negotiation and renewal of

In fact, she said the discussion did lead to a "one year renewal" that would be funded from three different sources:

> One is some of our cash flow -- one, some of our cash reserves, excuse me. And by "our," I mean the broader Nielson Groups' cash reserves. And also it would be funded partially by a new loan to Northwestern Bank by Bedrock. And it would also be partially funded by Northwestern Bank releasing some collateral. It had collateral on some liquid cash, basically. And so Northwestern would lift its security on that so that we could then use that cash to also make the debt service.[161]

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that financing. Among other things, Northwestern would perhaps not have, as a negotiation tactic, cajoled those managers into the renewal of loans by informing them that pressure would be brought to bear by Northwestern's regulators if their loans became non-performing which would result in Northwestern having to play 'hardball.' Although Northwestern believed, and still believes, that they have the financial capacity to perform their loans, Northwestern now realizes that such threats did not have their intended effect. Instead, those managers have tried to unscrupulously contend, in an attempt to renegotiate and renege on their loan obligations, that those threats were part of some scheme to mislead Northwestern's regulators. That certainly was not the case. Those threats were only intended to compel them to honor their loan obligations." Tr. at 1156, 1178 (W. Calcutt); Resp. Ex. 69. See also testimony of Mr. Doherty that in the course of negotiations, the Nielsons "had given us financial information that indicated that they had substantial liquidity. Millions of dollars. They gave us a plan that indicated that they did not expect any sales, real estate sales, for five years. And, you know, they were not going to make payments but rather use their liquidity to buy other businesses." Tr. at 1206 (Doherty).

[161] Tr. at 957 (Nielson). See also EC Ex. 133, representing the agreement showing a loan of $760,000 along with the release of $600,000 in collateral.

Ms. Nielson confirmed that at the time this deal was struck, the Nielson Borrowing Entities owed the Bank approximately $38.7 million, and that under the deal, the loans could be serviced for a total of twelve months, with eight months paid by the loan and four months self-funded.[162]

Ms. Nielson acknowledged that in May 2009 she and her brother, Keith Nielson, sent letters to the Bank at Mr. Calcutt's request.[163] She explained her reason for doing so thus:

> [Scrub] spoke to us a lot about Regulators and when they were visiting. And he had told us that Regulators were coming and that they had flagged certain borrowers as potentially related at potentially [*sic*] to consolidate their loan balances together, and so he had requested that we provide something to put into the loan files saying about how they are, they are separate from other borrowers and potentially also commenting about principal pay-down which was another thing that he said the Regulators had commented about. These loans a lot of them were interest-only and not actually seeing any loan pay-down so he wanted us to comment about future potential for loan paying, loan pay-downs.[164]

Keith and Cori Nielson complied with Mr. Calcutt's request. In Keith Nielson's May 1, 2009 letter regarding NRJ LLC, for example, Mr. Nielson wrote to Mr. Calcutt that "[a]though this economy is not a favorable environment, our business is holding up quite well. We have

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[162] *Id.* at 957-58 (Nielson).

[163] *Id.* at 969 (Nielson); Resp. Ex. 12.

[164] Tr. at 969 (Nielson).

always serviced our loans with Northwestern Bank on time, and we plan to continue to do as we have always done."[165] Similarly, Cori Nielson wrote a letter to Mr. Calcutt, also dated May 1, 2009, regarding Jade Venture Group LLC, stating "We have always made our loan payments on time and would continue to do so."[166]

According to Ms. Nielson, when September 2010 came around, "it was much the same as the prior year, where we tried to initiate renewal discussions, and we let the Bank know we needed significant loan modifications."[167] With the exception of Generations Holding, the real estate market had not improved.[168] Once again the Nielson Entities stopped making payments o n the loans, effective September 1, 2010.[169]

Ms. Nielson acknowledged that it had been her intention to trigger the Bank's reaction to red flags that the FDIC would recognize with respect to these loans: she identified a series of letters addressed to Mr. Calcutt,

165 Resp. Ex. 12.

166 Tr. at 968-75 (Nielson). Resp. Ex. 13. See also, to the same effect, Resp. Ex. 14 (regarding Blueridge Holdings LLC), Resp. Ex. 15 (regarding Bedrock Holdings LLC), and Resp. Ex. 16 (regarding Immanuel LLC).

167 Tr. at 958-59 (Nielson).

168168 See testimony of Ms. Nielson that the extreme difficulty in the summer of 2009 to sell real estate "did not apply to homes Generations Development was building. . . . Generations Development was never a company that was having trouble." Tr. at 994. Team Services, owned in part by Bedrock, likewise, had positive cash flow for some of this period. Ms. Nielson testified that she offered to renew on some loans, including the Generations and Bedrock loans, but the Bank wanted a global deal. Tr. at 1000 (Nielson).

169 Tr. at 959 (Nielson).

which she testified she sent in September 2010 for two reasons: first, to communicate to Mr. Calcutt that "these entities cannot make their debt service payments," and second "to get paperwork in the [Bank's] file that would sort of throw red flags . . . because our loan negotiations were so hampered by the fact that Northwestern Bank didn't want to throw any red flags were regulators would pick up on".[170]

Elaborating, she testified: "So: We sent these letters thinking the letters would go in the file and that would in and of itself throw any red flags or cause whatever scrutiny it caused, but it would free our negotiations to be able to, to come to reasonable loan modifications."[171] Notwithstanding that these letters would likely constitute red flags, Ms. Nielson said they did not actually lead to any sort of agreement with the Bank prior to the loans' maturity date.[172] She said no agreement was reached until after Bill Green's December 11, 2010 email to Autumn Berden, which provided for additional release of Pillay collateral to fund five months of payments, from September 2010 to January 2011.[173]

Ms. Nielson testified that eventually she determined to provide banking regulators with copies of the exchanges between herself and Ms. Berden (acting on behalf

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[170] Tr. at 960-61 (Nielson); EC Ex. 3 at 31-42 regarding Nielson Entities Immanuel, Sunny, Bedrock Holdings, Tall Timber, Moxie, Frontier Energy, Blueridge Holdings, Jade Venture, and NRJ. See EC Ex. 3 at 31 regarding the date of September 2010 and Tr. at 961-62 (Nielson).

[171] Tr. at 960 (Nielson).

[172] *Id.* at 962 (Nielson).

[173] *Id.* at 962-64 (Nielson); EC Ex. 3 at 165-67.

of the Nielson Entities) and Mr. Green and Mr. Calcutt (acting for the Bank).[174] In July 2011, she assembled a binder with approximately 267 pages of copies of emails recording the discussions between these parties, highlighted parts of those emails, and sent the binder to the FDIC.[175] This became what is shown in the record as FDIC Exhibit 3. She testified that she did this unprompted by the regulators, and supplemented the original email copies with highlighting that she hoped would reflect "different categories of things I was trying to point out to the regulators."[176]

Inasmuch as the contents of this binder were predominantly emails from Ms. Nielson as a Bank borrower, Mr. Calcutt testified that he would have assumed that the emails "were in the loan file."[177] As will be discussed below, however, the record reflects otherwise.

B. History of Regulators' Concern

The Bank's lending relationship with the Nielson Entities had been a subject of review by the FDIC's examiners since at least 2008. According to the FDIC's 2011 Report of Examination,[178] the relationship had been a cause of regulatory concern in each of the three prior reports (2008, 2009, and 2010).[179]

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[174] Tr. at 967 (Nielson).

[175] *Id.* at 968 (Nielson).

[176] *Id.* at 967-68 (Nielson).

[177] *Id.* at 1313 (Calcutt).

[178] EC Ex. 48 (Start Date: 8/1/11; As of Date: 6/30/11).

[179] Tr. 725-27, 750-53 (Miessner); ED Ex. 48 (2011 Joint ROE) at 40; EC Ex. 22 (7/23/10 Joint Management Exit Meeting with Management Responses); EC Ex. 19 (2010 FDIC ROE); Joint Ex. 2 (2009

Mr. Calcutt advanced a theory, however, suggesting regulatory action came only when the FDIC's Case Manager, Anne Miessner, became involved with the Bank's examination. Mr. Calcutt testified that Northwestern is referred to as a community bank, which means that the Bank "believes in . . . taking care of our customers but building relationships with our deposit customers and our borrowers. Strong, personal relationships."[180] Consistent with his theory that regulatory conflict arose only when Ms. Miessner began participating in the Bank's supervision, Mr. Calcutt testified that given his experience as a CPA, he understood that the Bank's examiners "had a job to do," and that "all went well until 2010."[181] The record, however, does *not* support Mr. Calcutt's testimony that "all went well" until 2010.

In his own testimony, Mr. Calcutt acknowledged that the Bank's examiners started to become concerned about the aggregate size of the Nielson relationship before 2010:

> I can't recall whether it was in 2006 or '07 that they aggregated the Nielson Loans in their Report of Examination and ultimately became a unit borrowing issue; and there was, of course, a conflict with the federal and the state rules on unit borrowing or loans to one borrower. They were aggregated from then on. From the beginning, and I can't say which year exactly, 2006 or '07 every year the Nielson Loans were listed in the

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Michigan ROE). See also Tr. at 813 (Miessner); Resp. Ex. 77 (2006 ROE)

[180] Tr. at 1264 (Calcutt).

[181] *Id.*

Report of Examination.[182]

As the FDIC's Case Manager responsible for supervising the Bank, Anne Miessner testified that in her review of reports of examinations conducted in 2006 and 2007, she saw that examiners found no significant basis for regulatory concern regarding Bank Management (i.e., the *Management* component in the Bank's Capital adequacy, Assets, Management capability, Earnings, Liquidity, and Sensitivity – its CAMELS rating), and that the same was true with respect to the Bank's Composite rating.[183] She testified that she had reviewed the FDIC's 2008 Report of Examination, which indicated the Bank was in satisfactory condition overall but also reflected that as of the December 31, 2007 Examination Date, Bank management had been alerted to regulatory concerns pertaining to Part 323 of the FDIC's Rules and Regulations due to repeated instances where the Bank did not obtain an appraisal or accepted an appraisal prepared for the borrower, in violation of Part 323 of the FDIC's Rules and Regulations.[184]

Further demonstrating that regulatory supervision was a concern of the Bank prior to Ms. Miessner's entry into the scene, Mr. Calcutt wrote a letter dated August 4, 2008, to the attention of the FDIC's Division of Supervision, to Allen E. Clark, Jr., with respect to the FDIC's

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[182] *Id.* at 1275 (Calcutt).

[183] *Id.* at 814-15 (Miessner); Resp. Ex. 77 at 5 and Resp. Ex. 78 at 3. See also testimony of Examiner O'Neill, that Bank management ratings were high in 2006 through 2008, with the executive team being described by Michigan examiners as "experienced and knowledgeable" when examined by the State as of April 13, 2009. Tr. (2015) at 609-12 (O'Neill); Resp. Exs. (2015) 77, 78; Joint Ex. (2015) 2.

[184] Tr. at 816 (Miessner); Joint Ex. 1; Tr. at 728 (Miessner); Joint Ex. 1 at 20.

2008 Report of Examination.[185] In his letter to Mr. Clark, Mr. Calcutt took angry exception to "several of the ratings set forth in that Report," averring that "some of the comments or criticisms in that Report are erroneous or misleading, and overall manifest an excessive 'bureaucratic,' rather than a substantive 'performance' analysis."

Elaborating on this point, Mr. Calcutt wrote:

> Based on its observations during the examination, Northwestern was left with the impression that the ratings and criticisms of Northwestern were spawned by your examination team's lack of: 1) professionalism; 2) knowledge of the banking market in northern Michigan; and 3) business or economic experience. The unprovoked hostility of one or more of the examiners, as reflected by many comments made during the examination, made it clear to Northwestern and its personnel that the FDIC, or its examiners, had some sort of negative attitude before undertaking this examination. Although Northwestern marshaled substantial performance review documentation for the examiners' review, it was simply ignored. While the FDIC's policies prohibit abuse, retaliation or retribution, your examination team appeared to have a "preconceived" agenda.[186]

The record thus reflects that all was *not* well between Mr. Calcutt and the FDIC in 2008, notwithstanding Mr. Calcutt's testimony to the contrary.[187] Mr. Calcutt's use

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[185] Resp. Ex. 79.

[186] *Id.* at 1.

[187] Tr. at 1363 (Calcutt).

of *ad hominem* invective in 2008 may have been characteristic of the ordinary tenor of his relationship with the Bank's regulators over the years, but it is clear his sense of antipathy towards regulators preceded Ms. Miessner's arrival.

Ms. Miessner testified that she also reviewed the 2009 Report of Examination by the Michigan OFIR (reflecting an examination as of April 13, 2009), which, while finding the Bank "fundamentally sound," nevertheless "listed the Nielson relationship as special mention and included several credit administration and underwriting weaknesses that were indicative of a deteriorating financial condition."[188]

Elaborating, the 2009 Michigan ROE reported that although the Bank's overall financial performance "has deteriorated due to the adverse economic conditions as evident by the declining level of earnings and rising amount of problem credits, management has been able to maintain the financial condition of the institution at a satisfactory level.[189]

In addition to the findings of the Michigan examiners, the FDIC had by December 2009 identified concerns that led Ms. Miessner to identify Special Mention loans at the Bank related to the Nielson Entities (through Waypoint Management[190]) totaling $38 million, where the writeups

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[188] *Id.* at 726, 818-19 (Miessner); Joint Ex. 2. Note that in his testimony, Mr. Calcutt is shown Resp. Ex. 81 and identified it as the State of Michigan Exam from April 13, 2009. Tr. at 1354 (Calcutt). There is no Resp. Ex. 81, but the Exam is in the record as Joint Ex. 2.

[189] Tr. at 820 (Miessner); Joint Ex. 2 at 8.

[190] Ms. Miessner identified Resp. Ex. 37 as a chart showing "the various Nielson or Waypoint loans or credits". Tr.

for the relationships "describe the inability of the borrowers to make interest payments and express that the lack of monitoring may be allowing the extension of funds under one entity to keep another entity current."[191]

Ms. Miessner testified that the Michigan examiners noted that the "Bank had implemented improper repayment structures on many of the [Waypoint] loans. That it appeared there were draws being made on loans to keep other loans current."[192] The Michigan report also raised concerns that seven of nineteen of the entities within the Waypoint relationship "did not produce enough cash flow to service their own debt," and that the Bank "had not appropriately documented the use of loan proceeds or the source of repayment on the loans."[193]

Also of concern based on the 2009 Michigan Report was the finding that through the Waypoint Management relationship, the Nielson Entities represented 53 percent of the Bank's Tier 1 capital.[194] Ms. Miessner testified that "anytime there's a concentration of over 25 percent of capital to an inter-related group of borrowers, that gives the FDIC [cause] for concern and we have specific guidance on how to manage concentrations of that size".[195]

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at 730 (Miessner).

[191] Tr. 726-27 at (Miessner); EC Ex. 9.

[192] Tr. at 729 (Miessner).

[193] *Id.* at 729-30 (Miessner).

[194] *Id.* at 733 (Miessner); Joint Ex. 2.

[195] Tr. at 733 (Miessner). Also raised prior to the 2011 Examination were concerns, expressed by James Russell, Examiner in Charge for the FDIC's 2010 ROE, that the Bank's management, in Ms. Miessner's words, was "siloing the exam process". Tr. at 746-50 (Miessner); Resp. Ex. 84 at 5. As Ms. Miessner put it, "If we do not

Through a letter dated November 19, 2010, the FDIC's Regional Director put Mr. Calcutt and members of the Bank's Board of Directors on notice that the FDIC "is concerned with the manner in which the bank is being operated and the failure of the Board to correct problems, which could ultimately pose a threat of loss to the Deposit Insurance Fund."[196] Because of these concerns, the Regional Director proposed that the Bank and the FDIC enter into a Consent Order pursuant to section 8(b) of the Federal Deposit Insurance Act.[197]

For his part, Mr. Calcutt dismissed the regulator's concerns regarding the Bank's failure to ensure recent appraisals were supplied in conjunction with loans to the Nielson Entities, telling the Bank's regulators in 2010 that "[Bank] management is not concerned with appraised values and relies primarily on guarantor strength and character."[198] Echoing this dismissive reaction, in response to questions by regulators during a conference reflected in the 2010 ROE, responding to the examiners'

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have access to the Bank's records, then we're not able to do our jobs. If we do not have access to the Bank's other employees, that impedes our ability to do our jobs." Tr. at 751 (Miessner). See also Tr. at 779-80 (Miessner); EC Ex. 36 (2/23/11 email from Dick Jackson to Denise Keely, responding to Ms. Keely's email regarding questions presented by an FDIC examiner concerning the contents of the file for North Park Holdings, where Mr. Jackson wrote to Ms. Keely "This is a credit that they should discuss wit [*sic*] mike Denise, same on all the Nielsons. Be careful what you say on any of these.")

[196] EC Ex. 27.

[197] *Id.*

[198] Tr. at 772-73; EC Ex. 19 at 11. Given the lack of personal guarantees supporting the Nielson Entities portfolio, it

is not clear what "guarantor strength and character" Mr. Calcutt is referring to in this context.

questions regarding the adequacy of risk management policies and practices, the Bank's Chief Credit Officer, Mike Doherty, added that the FDIC "has changed the appraisal regulations since the last examination, and that the Bank's underwriting will continue to focus on principals and guarantors."[199]

C. The FDIC's 2010 Examination

FDIC Examiners from the Chicago Regional Office conducted the Bank's 2010 Examination.[200] Examiner Charles Bird served as a loan examiner for that Examination.[201] In preparation for this examination, Mr. Bird reviewed the 2009 Report of Examination prepared by the State of Michigan (examination as of April 13, 2009).[202]

Mr. Bird noted that the Michigan examiners reported

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[199] EC Ex. 19 at 11 (page 9 of the ROE).

[200] Tr. (2015) at 762 (Bird).

[201] Mr. Bird has been a Commissioned Bank Examiner for the FDIC since 1989. Over the nearly 30 years of his service with the FDIC he has participated in close to 200 bank examinations and has been the examiner in charge in close to 100 examinations. His education includes an undergraduate degree in 1981, attendance at on the job training programs throughout his service at the FDIC, covering the basics of examination, analytical and loan schools, continuing education in specialty examinations, schools focusing on fraud and interest rate risk, experience in serving as examiner for problem banks, and experience in circumstances that led to enforcement actions being taken against officers of banks under sections 8(e) and 8(i) of the FDI Act. Tr. (2015) at 758-61 (Bird).

[202202] Tr. (2015) at 763 (Bird); Joint Ex. (2015) 2. Mr. Bird's role in the examination was limited to the review of the Nielson credits. Tr. (2015) at 885 (Bird). Mr. Bird testified that with approximately 48 Nielson loans to review, his schedule permitted about one hour of review time per loan. Tr. (2015) at 890 (Bird).

that the Bank's Waypoint Management relationship referred to "a lot of money lent to the interrelated group in relation to the Bank's capital."[203] He testified that the Waypoint Management relationship "was listed for special mention in the Examination Report and these would have been all of the borrowing entities under the Waypoint Management relationship and the amounts that were outstanding to the different entities at that time."[204]

In conducting the loan review for this ROE, Mr. Bird met with Mr. Green during the second week of the examination, during which time he and Mr. Green discussed the Waypoint and Nielson Entity loans.[205] Mr. Bird noted in particular that with respect to the Waypoint relationship, "there was a lack of guarantee from the borrowing entities. There was some concessionary type of financing. Interest-only that was extended" and instances "of some loans that had been unreduced for some time."[206] He stated that as of June 21, 2010, the loan linesheet reflected Waypoint's current note balance was $4.5 million.[207]

Mr. Bird testified that in the course of his examination of the Bank's loans, he expected to find for each loan documentation in the *credit file* for the loan that included financial statements of the borrowing entity and any other financial information needed to assess the credit; and in

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[203] Tr. (2015) at 764 (Bird); Joint Ex. (2015) 2 at 20-21 (ROE pages 18-19).

[204] Tr. (2015) at 765 (Bird). Mr. Bird testified that Mr. Green was not at the Bank during the first week of the examination. Tr. (2015) at 787 (Bird).

[205] Tr. (2015) at 781 (Bird).

[206] *Id.* at 767-68 (Bird).

[207] *Id.* at 773 (Bird).

the *collateral file* he expected to find items like a deed of trust, mortgage, title insurance, or other documentation showing the Bank had perfected its liens with respect to the loan.[208] In instances where an officer corresponded with a customer regarding a loan, Mr. Bird said he would expect the proper file would contain that correspondence, including email transmissions, regarding the meeting.[209] He said he would expect that this would include both positive and negative information as it relates to a loan.[210]

Mr. Bird testified that included in the Bedrock loan file was the Officer's Memo to the File, by Mr. Green, dated June 4, 2010.[211] In this Memo, Mr. Green stated that "the loan continues to perform. All payments are current and have been current."[212] In his discussion with Mr. Green about this loan and the Memo, Mr. Bird found the file contained no negative credit information regarding

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[208] *Id.* at 772-73 (Bird). For the collateral files, Mr. Bird testified that "[i]f I was covering a piece of property on that that secures that credit, and the current insurance on that credit file is on the top; seeing they go chronologically, I would not look at the rest of the insurance that's underneath that insurance tab. So going back to your first point, there would be no need for me to flip through that. So I will retract my statement, if you will, on flipping every single page in that file." Tr. (2015) at 892 (Bird). Asked about this during cross-examination, Mr. Bird testified that although he needed to go through the file very carefully and determine the financial characteristics of the borrower and the collateral, "I had adequate time in order to look at the files" and did so with all of the files, including the Bedrock Loan file. Tr. (2015) at 894, 896 (Bird).

[209] Tr. (2015) at 773 (Bird).

[210] *Id.*

[211] Tr. (2015) at 780 (Bird); FDIC Enforcement Counsel Exhibit from 2015 hearing (EC Ex. (2015)) 20 at 28-30.

[212] Tr. (2015) at 783 (Bird); EC Ex. (2015) 20 at 29.

the Bedrock Holdings loan, nor was any negative information presented by Mr. Green.[213] He "passed" the loan, meaning that – based on Mr. Green's positive memo and the recent Board approval – all were "indicative of a credit relationship that was moving in a positive direction" and thus did not need to be classified as "substandard," "doubtful," or "loss".[214]

Mr. Bird testified that he did so *not knowing* that both the release of the Pillay collateral and the new loan of $760,000 had occurred in December 2009, not March 2010, or that the proceeds of both were used to pay past amounts due on the Bedrock loan and on other loans to Nielson-related entities.[215] He testified that had this information been provided at the time of this examination, "it would have given [him] serious concern, first of all, that

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[213] Tr. (2015) at 789 (Bird).

[214] *Id.* See also testimony of Mr. Jackson, that the assets discussed during Classified Assets Committee meetings were assets "that are having, experiencing difficulties or delinquencies." Tr. (2015) at 1686 (Jackson).

[215] Tr. (2015) at 791-92 (Bird). Mr. Bird identified Respondent's 2015 Exhibit (Resp. (2015)) Ex. 136 at 38 as a document that had not been shared with him, but that details the use of Pillay Funds that had been released on November 30, 2009 for use in servicing the Nielson Entity loans. Tr. (2015) at 793 (Bird). Also not disclosed to Mr. Bird during this meeting was information describing the proposed use of $738,000 in Bedrock loan proceeds to fund principal payments on other loans. Tr. (2015) at 793-94 (Bird); EC Ex. (2015) 3 at 113. Also not provided to him during the 2010 exam was the November 16, 2009 memo from Mr. Green to Mr. Calcutt that reflects that Northwestern would propose "a loan of $760,000 to be used to cover principal payments" of the Nielson loans. Tr. (2015) at 795-96 (Bird); Joint (2015) Ex. 4. Mr. Bird testified that had he seen this memo to Mr. Calcutt, "it would have been a serious red flag that the Bank is extending additional credit to pay on other Notes inside this relationship." Tr. (2015) at 796 (Bird).

the Borrowing Entities are demonstrating an inability to repay their debts."[216]

Mr. Bird testified that documents that had been concealed from him during the 2010 examination – including the November 16, 2009 memo from Mr. Green to Mr. Calcutt reflecting the plan to use proceeds from the $760,000 Bedrock Loan to service other Nielson Entity loans, showed the Nielson lending relationship "in a much different light as far as what's the inability to pay under contractual terms".[217] He stated the Nielsons had a "significant lending relationship to the Bank," adding that "it's a concentration of credit. And if these lending relationships have an inability to pay their debt, we would classify the credit and it would, you know, it could lead to loss for sure."[218]

Elaborating on this point, Mr. Bird testified that while the $760,000 loan was "large enough" on its own, "collectively it's supporting a concentration that was in 2009 [between] $35 and $37 million."[219] With respect to the safety and soundness of the Bank, Mr. Bird testified, "you're trying to measure risk in relation to the Bank's capital. So when that risk gets larger as this credit relationship and the whole Waypoint relationship is, it exposes

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[216] Tr. (2015) at 795 (Bird). To the same effect, see testimony from Mr. Bird regarding Frontier Energy LLC, Tr. (2015) at 852-54 (Bird); Generations Development LLC, Tr. (2015) at 853-55 (Bird); Immanuel LLC, Tr. (2015) at 855-56 (Bird); Jade Venture LLC, Tr. (2015) at 8856-57 (Bird); North Park Holdings, Tr. (2015) at 858-61 (Bird); Tall Timbers LLC, Tr. (2015) at 859-61 (Bird); all of the Nielson loans, Tr. (2015) at 860 (Bird); EC Ex. (2015) 20.

[217] Tr. (2015) at 796-97 (Bird).

[218] *Id.* at 798 (Bird).

[219] *Id.* at 797 (Bird).

the Bank to a significant risk to its capital account if something were to go wrong with the credit relationship."[220]

Mr. Bird testified that although the Commitment Review presented to the Board for the Bedrock Loan showed December 3, 2009 as the loan date, and the detailed write-up in the Review showed a nine-month loan with a maturity date of September 1, 2010, he did not notice the discrepancy in the March 16, 2010 write-up. "I did not correlate the Application date with the Note date when I reviewed it." Further, he testified that while he understood that [221]Pillay funds were released as noted in the Review, he did not gather information about *why* they were released.[222] He said that had he been provided documents during the 2010 examination showing how the Bedrock Loan and Pillay Collateral funds were to be distributed among the Nielson entities, documentation that showed how the entities' loans were being serviced, that would have indicated an unsafe and unsound transaction.

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[220] *Id.* at 798 (Bird). But see Mr. Calcutt's testimony that "for some years the [Bank's] holding company not only had its own assets that generated some income but it had a line of credit so it had capacity to make dividend payments to shareholders" such that the roughly $38 million amount of the Nielson relationship was "absolutely not" sufficient to put the Bank at risk of failure. Tr. at 1349 (Calcutt). According to Mr. Calcutt, "each of the Nielson Loans was individually underwritten. It had sufficient collateral, sufficient cash flow. And obviously the Bank, I wasn't there, but obviously we had plenty of collateral and cash flow to go after, and so no, I seriously question whether it would have suffered any loss." Tr. at 1349 (Calcutt).

[221] Tr. (2015) at 898-99 (Bird).

[222] *Id.* at 900-01 (Bird).

According to Mr. Bird:

> If I would view this in the entirety of the Waypoint transaction, my review of it would be, my analysis right now would be that you've got a distressed relationship that can't pay their debts; and this transaction that is basically trying to just pay for an extended period of time, to me it's a very large interest capitalization and a reduction in the collateral protection. I would say that this is a hazardous transaction.[223]

When regulators met with members of the Bank's Board of Directors to discuss both the 2010 ROE and the proposed Consent Order, Board members reported, according to Ms. Miessner, that "they were not aware of the ongoing nature of these weaknesses that we were citing in the 2010 report."[224] Upon considering the Board members' commitment to increase their oversight over the Bank's management, "the FDIC decided instead of pursuing a Consent Order [it would] pursue a Section 39 Compliance Plan which is designed more specifically to address safety and soundness concerns as set forth in Part 364 of the FDIC's Rules and Regulations."[225]

Apparently overlooking the antipathy against the Bank's regulators that he had displayed in 2008, discussed above, Mr. Calcutt described the tenor of the 2010 Examination "a total change from our past history in the sense of strong ratings, but that relationship ended, deteriorated during that exam on a couple of very emotional

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[223] *Id.* at 800 (Bird).

[224] Tr. at 778-79 (Miessner).

[225] *Id.* at 778 (Miessner); EC Ex. 40.

issues. One is that several of our female long-term employees were made to cry and that filtered throughout the organization, so we had some very upset people."[226]

According to Mr. Calcutt, the examiners at this time "told us just to get rid of" customers who were struggling to make payments.[227] He offered the example of an 80 year-old widow who was "making some sort of payment" but "the Examiner didn't care and wanted us to just throw her out in the street. And again, that resonated throughout the Bank and was very upsetting."[228] Mr. Calcutt testified that unlike prior exams, while he had asked the examiners to communicate "as to what issues or concerns you have so that we can discuss them," "none of that took place. So in having these emotional events related to throwing customers out in the street and crying people, the meeting did not go well."[229]

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[226] Tr. at 1265 (Calcutt).

[227] *Id.*

[228] *Id.* Apart from this testimony, there is no evidence supporting Mr. Calcutt's factual claim regarding the example presented.

[229] *Id.* at 1266 (Calcutt). See also Mr. Calcutt's testimony regarding the exit meeting he had with the FDIC's examiners, including David K Mangian, FDIC Assistant Regional Director, in which he stated that Mr. Mangian told him the Bedrock Loan made "economic sense" and that "[t]he other thing that struck me, that kind of comes back to throwing people on the street which the FDIC forced on us is that we had a couple employees during the Great Recession who were really struggling financially. In one case, one of our female employees inherited a couple of baby grandchildren because their daughter got thrown in jail, and they had no money, they had no bedding, no sheets, clothes, nothing. So some of us personally reached into our pockets. And then the Bank threw some money into the pot and we received bloody hell criticism for that from the FDIC." Tr. at 1340-41 (Calcutt). Apart from this testimony, there is no evidence in the record

Before beginning the examination that would produce the 2011 ROE, FDIC examiners conducted a visit that produced Visitation Findings and a summary in February 2011.[230] In answering those findings, on June 30, 2011 the Bank (over Mr. Jackson's signature) responded to findings concerning the Nielson/Waypoint loans. Where the Findings reported that the Bank's "Board continues to allow management to administer loans related to the Waypoint Management Group/Nielson family in a manner inconsistent with prudent banking practices," Mr. Jackson responded by stating, in pertinent part, that "[t]his relationship has existed with the lending officer for more than twenty years, and with the bank in excess of ten years during which the relationship has always performed without exception."[231]

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supporting the factual claims attested to here by Mr. Calcutt.

[230] Tr. at 781 (Miessner).

[231] EC Ex. 44 at 4. See also testimony by Examiner O'Neill regarding Mr. Green's written Memo to the File, maintained in the Bank's loan file and dated June 4, 2010, regarding Bedrock Holdings LLC stating "The loan has always performed", which Mr. O'Neill opined was a false statement because "by this time we had already seen in 2009 a default. We had only seen the loans brought current and kept current because new bank funds were advanced to do so." Because the document was in the Bank's loan file, and based on his experience as an examiner, Mr. O'Neill opined that Mr. Green maintained the false statement in the loan file knowing that examiners would see it, thus it was "an effort at concealment of a problem loan." Tr. (2015) at 603-04 (O'Neill); EC Ex. (2015) 51 at 215. To the same effect, see testimony of Examiner Bird regarding the sale and repurchase of the Sunny LLC loan in 2010. Tr. (2015) at 815-16 (Bird); EC Ex. (2015) 20 at 759-62, and of the NRJ LLC loan. Tr. (2015) at 825-28 (Bird); EC Ex. (2015) 20 at 732; Tr. (2015) at 840-43 (Bird); EC Ex. (2015) 92; and of the Blueridge loans, Tr. (2015) at 844 (Bird); EC Ex. (2015) 92; Resp.

Ms. Meissner testified that this was not an accurate statement, and explained that "the loans to this Borrower had all become past due in 2009 after the Borrowers notified the Bank that they would no longer make their payments. Those loans remained past due past the 90-day mark."[232] She added that after the Bank placed the loans in a non-accrual status, "a new loan was made and collateral was liquidated in order to make it appear that those loans were current."[233] Further, by the time Mr. Jackson had written the letter responding to the February 2011 Visitation Findings, the loans "went past due again . . . [and] more collateral was released to again bring the appearance of those loans being current."[234]

One example of correspondence seen as material to the examiners' supervision over the Bank, found in the binder provided by Ms. Nielson to the FDIC, was a September 22, 2009 email sent first from Ms. Nielson to Mr. Calcutt, and then by Mr. Calcutt to Mr. Green, a day later, regarding "Confidential Settlement Discussions".[235] Among several threads of this discussion, Ms. Nielson stated that "[a]t this point, some real estate values are so poor that some properties may not have any equity left in

(2015) Ex. 44. Mr. Bird further testified that in none of the conversations he had with Mr. Green during the 2010 examination did Mr. Green disclose the fact of loan sales to Central State Bank or State Savings Bank, nor did the Bank have copies of the Loan Purchase and Assignment Agreements to Central State Bank or State Savings Bank in the loan files. Tr. (2015) at 831-39 (Bird); Resp. Exs. (2015) 42 and 43.

[232] Tr. at 781-82 (Miessner).

[233] *Id*. at 782 (Miessner).

[234] *Id.*

[235] EC Ex. 3 at 5-7 (also at EC Ex. (2015) Ex. 3 at 5-7).

them, and some properties may not have good potential for equity recovery in the near term. That being the case, it would be prudent for the owners to deed them over to you."[236]

Although clearly material to the Bank's lending relationship with this borrower, this email exchange was *not* produced by the Bank during the 2011 examination. The 2011 ROE's Loan Examiner, Mr. O'Neill, was asked about the significance he attached to the document:

> I attach great significance to it because it shows the extent of the problems that the Nielson borrowings -- the Nielson Borrower had at the time and would have raised red flags about, first of all, is this a problem loan? Should it be recognized as such both in our Examiner Reports and in our reports to the Board of Directors? What's the underlying causes [*sic*]? If there's discussions involved which in this case indicated the CEO of the Bank, and the primary account officer, and Cori Nielson that if that's not found in the loan files? This would have been a key, a key correspondence that we would have expected to see.[237]

Mr. O'Neill testified that this "is essentially an admission on the part of the borrower that there may be substantial loss incurred by Northwestern Bank."[238] Asked why he would expect to see such a document in the Bank's loan file, Mr. O'Neill testified thus:

> Because it talks about, number one, it's between

[236] EC Ex. 3 at 6.

[237] Tr. (2015) at 78 (O'Neill); EC Ex. (2015) 3.

[238] Tr. (2015) at 78 (O'Neill).

> the CEO of the Bank and the primary account officer, the largest borrowing relationships in the Bank. And it talks about, well, how do we deal with this September 30th reporting issue. But then it goes on to talk about the fact that they were in negotiations and, and how non-accrual would be handled, and so on. So those are very key points that we would expect to see on a loan review.[239]

Ms. Miessner was asked for her opinion regarding Mr. Calcutt's concealment of facts showing the condition of the Bank's loan portfolio pertaining to the Nielson Entities.[240] She identified as among such facts: the material misstatements of fact in the Bank's November 14, 2009 letter to Michigan examiners and copied to the FDIC, where the Bank specifically responded to the examiners' request for a status update of the Nielson credits.[241] Also, she identified the Bank's false Call Reports for 12/31/09 and 3/31/10 and she identified the Bank's false reporting of the portfolio's performance:

> Then also they concealed it by not putting the documentation regarding the correspondence between the Borrower and the Bank in the files. They concealed it by having loan memos in the files saying things that would indicate that the

[239] *Id.*; EC Ex. (2015) 3. Mr. O'Neill expressed similar concerns about several documents that were included in the binder but were not produced by the Bank's management during the 2011 examination. See Tr. (2015) at 78-160 (O'Neill); EC Ex. (2015) 3 at 4, 8-9, 12-14, 16-19, 22, 24-27, 29-30, 51-52, 55-56, 60-65, 72-23, 80-87, 93-96, 98-101, 105-08, 110-13; 117-19, 123-27, and 134-40

[240] Tr. at 809 (Miessner).

[241] *Id.* at 810.

> loans were performing[242] instead of having memos in there that actually described the status of the loans and the status of the relationship and the actions that were being taken in the, you know, effort to work with the Borrowers, as you put it. That should all have been documented in memos.[243]

Ms. Miessner further stated that the Bank concealed material facts by "selling participations to their affiliates, which is prohibited by law. And with the specific intent of reducing the . . . concentration to make it appear that there was . . . performance and reduction in the overall relationship."[244]

Asked whether, in her opinion, Mr. Calcutt misrepresented the condition of the Bank's loan portfolio

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[242] Asked during cross examination whether the term "performing loan" is defined in bank regulations, Ms. Miessner said no, but "in the regulatory world a performing loan is a loan that is performing per its contractual terms," and "the International Monetary Fund defines performing loans as a loan . . . that is performing within its contractual terms, and a non-performing loan is defined as a loan that is not making its principal and/or interest payments within its contractual terms, and it specifically states that it doesn't have to be 90 days past due to be considered non- performing, it simply has to be the fact that the lender has reason to believe that principal and interest will not be collected per the contractual terms." As such, the loans became non-performing "as soon as the Borrower notified the Bank that they were not going to make their payments, that they couldn't make their payments and that they wanted this restructure". Tr. at 846-47 (Miessner). See also testimony by Mr. Doherty that a loan that's past due by more than 30 days is not a performing loan. Tr. at 1250 (Doherty).

[243] Tr. at 840 (Miessner).

[244] *Id.* at 841-42 (Miessner).

pertaining to the Nielson Entities and failed to disclose material facts regarding the Bank's loans to the Nielson Entities at the 2010 Examination in a way that obstructed the FDIC's ability to thoroughly and effectively examine and supervise the Bank, Ms. Miessner answered in the affirmative, stating that "through his actions of concealing facts about the Nielson Loans, [Mr. Calcutt] did materially obstruct our ability to effectively supervise an examination in the institution."[245]

When asked during cross-examination to identify who at the Bank would be expected to ensure loan files were accurately maintained and contained the necessary documents, Ms. Miessner testified that the "loan officer has first-line responsibility. Then the Credit Administrator would have second-line responsibility. And the ultimate responsibility lies with the CEO."[246] She said while she would not expect Mr. Calcutt, as CEO, to be physically placing documents in these files, the CEO needed "to be ensuring that they had complete loan files" and would do so by having both appropriate policies and procedures in place, and by having appropriate external loan review in place.[247] In this context, however, where, as CEO, Mr. Calcutt was himself corresponding directly with the borrowers and was directly involved in negotiating with the borrowers, it would be *his* responsibility to put "any of the

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[245] *Id.* at 808 (Miessner).

[246] *Id.* at 842 (Miessner).

[247] *Id.* at 842 (Miessner).

correspondence that came directly to Mr. Calcutt" directly into the loan file himself.[248]

During the first evidentiary hearing Mr. Calcutt acknowledged that as the CEO and Chairman of the Bank's Board of Directors, he had a responsibility to see that the Bank's loan files were maintained in a safe and prudent manner, so that auditors and examiners coming into the Bank could understand what had taken place.[249] During the second evidentiary hearing he changed that answer, "clarifying" it, by denying that he had any direct responsibility to see that the Bank's loan files were maintained in a safe and prudent manner.[250]

Asked whether Mr. Calcutt submitted inaccurate information in answers he provided to an Officer's Questionnaire as part of the 2010 Examination, Ms. Miessner opined that he had, with respect to the actual use of the proceeds of the Bedrock Loan.[251]

Mr. Calcutt acknowledged that he could not delegate his responsibility to provide true and correct answers to

[248] *Id.* at 843 (Miessner). See also testimony of Cori Nielson, when asked about Mr. Calcutt's presence or absence at meetings, Ms. Nielson testified that "while we might have had meetings with Dick Jackson or Mike Doherty, they were, they were along the lines of what I will call an employee versus Scrub to me along the lines of the CEO. . . . . [E]ven if he wasn't at a meeting, I do recall that he ended up back at the meetings . . . [so] I don't believe that he was not involved just because he was not at the meeting." Tr. at 1019 (Nielson).

[249] Tr. (2015) at 1815 (Calcutt).

[250] Tr. at 1353. (Calcutt).

[251] *Id.* at 808-09 (Miessner).

the questions in the Officer's Questionnaire, which he submitted prior to the FDIC's 2010 Examination.[252] He testified, however, that his practice when preparing responses to Officer's Questionnaires would be to "take the previous years' questionnaires and review them and see if there's something in them that I should recall to put in the one that I'm currently signing."[253] He said he would "not go to the trouble to review thousands of loans" or deposit accounts, but would submit answers that were "based on what I'd done before, reflect and then sign them."[254] He stated that looking back at them now, "on reflection, I answered [two of] them incorrectly. Inadvertently and unintentionally incorrectly."[255]

Asked whether Mr. Calcutt's concealment of the condition of the Bank's loan portfolio pertaining to the Nielson Entities obstructed the FDIC's ability to effectively supervise the Bank through off-site monitoring tools, including supervisory review of the Bank's Call Reports, Ms. Miessner opined that yes, he had obstructed the FDIC, stating that at the end of 2009, if the Bank had truthfully disclosed the status of the Nielson loans in its responses to the 2009 State Examination and truthfully disclosed the Bank management's course of action towards those loans and that relationship, then "that would

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[252] *Id.* at 1356 (Calcutt); EC Ex. 18. To the same effect, see Mr. Calcutt's testimony regarding the answers he provided through the Officer's Questionnaire prior to the 2011 Joint Examination. Tr. at 1356 (Calcutt); EC Ex. 47 at 1.

[253] Tr. at 1311 (Calcutt).

[254] *Id.*

[255] *Id.*

have significantly changed the way that we proceeded after learning that information."[256] Ms. Miessner added that the Bank's inaccurate Call Reports prevented the FDIC from receiving "accurate data to determine whether we needed to change our supervisory strategy at that point."[257]

Asked to report on how well-secured the Bedrock Loan was at the time it was made, Ms. Miessner responded that at the time, the Bank "did not obtain an appraisal," such that "Examiners couldn't appropriately analyze the value of the collateral, nor could the Bank."[258]

As noted in the loan write-up, the Bank's loan officer, Mr. Green, stated that the collateral securing the Bedrock Loan was a second real estate mortgage on 121 acres located on 60 U.S. 31 in Traverse City and a first mortgage on a one-acre lot on East Shore Road in Traverse City.[259] Also in the collateral description is the statement "LTV 59%", which compares with the 58 percent loan to value as

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[256] *Id.* at 810 (Miessner)

[257] *Id.* at 809-10 (Miessner).

[258] *Id.* at 829 (Miessner).

[259] Joint Ex. 6 at 1. See also testimony of Mr. Jackson, when asked "Do you remember receiving this write-up [Joint Ex. 6] in mid-March 2010?" he responded: "I don't recall specifically the circumstances regarding this. When it was provided to me, I was asked to sign it. I think it was probably an administrative thing where they were looking for all the signatures on it, and I believe it was brought to me and I was asked to sign it and I signed it" but did not recall spending any time reviewing the writeup. Tr. (2015) 1613-14 (Jackson). He later testified that while his general practice is to review carefully such an application, he did not review this one carefully. Tr. (2015) at 1675 (Jackson).

determined by the FDIC's loan examiner, Mr. Bird.[260]

Asked to explain in terms of risk what it means to have a loan-to-value range of 58 to 59 percent, Ms. Miessner testified that if that LTV was true and accurate based on a current appraisal, it would mean that the "loan balance is only 58 percent of the total collateral value, which would indicate that if the Bank had to take a loan back because of foreclosure, then there would be equity there."[261] The loan-to-value metric is, however, according to Ms. Miessner, "at the bottom" of the asset quality analysis, because "that's looking at liquidation of collateral."[262] Before LTV, examiners first "look at repayment capacity of the borrower, character of the borrower. So basically their ability and willingness to repay. And then, secondarily, we

[260] *Id.* See also testimony by Mr. Bird, confirming that one of the things he took into account when reviewing the loan during the 2010 examination was how well collateralized the loan was, and arrived at a 58 percent loan-to-value. Tr. (2015) at 902 (Bird). He further testified that had he known the Bedrock Loan had been used to provide money to entities other than Bedrock, he would have adversely classified the loan, agreeing that if defined as substandard, that would mean it was "inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged." Tr. (2015) at 902-05 (Bird). He said this was true even though the LTV was high – because "you would have to look at the interrelationships between those loans." Tr. (2015) at 905 (Bird). According to Mr. Bird, when you look at collateral as a repayment sources, "that's when you would take a closer look at the repayment capacity and the collateral structure." Tr. (2015) at 905 (Bird). He opined that the loan was hazardous, notwithstanding the 58 percent LTV, "because it was a loan that was not paying as agreed," in that "once the loan was made, it wasn't paying on its own. It wasn't paying from its original repayment source." Tr. (2015) at 906 (Bird).

[261] Tr. at 829-30 (Miessner).

[262] *Id.* at 882-83 (Miessner).

look at the collateral protection," and in this context, repayment ability means cash flow.[263]

Reminded during cross-examination that Pillay funds were used in conjunction with the issuance of the Bedrock Loan, Ms. Miessner was asked that since "the Bank is releasing collateral but it's allowing the Borrower to use that collateral to pay down debt, and so that is money coming into the Bank; it's not going anywhere else, right?" Ms. Miessner responded thus:

> I can't agree with your specific question because they didn't use it to pay down debt specifically, which would, which that could have been an appropriate thing to do in a situation, but instead they used it to bring loans, you know, and in quotes "current," and a lot of that was used to pay interest payments then to falsely boost the Bank's earnings position. So I can't agree specifically with what you said to pay down debt because that's not exactly, that's a mischaracterization of what the situation was.[264]

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[263] *Id.* See also testimony of Examiner O'Neill, when asked whether the reason for collateral is to ensure payment of the loan, he responded: "That's not the primary source. The primary source of repayment is what's usually what's stated in the loan service but typically it's cash flow from operations. Collateral is only looked to as a secondary source of repayment oftentimes in case of default." Tr. (2015) at 648-49 (O'Neill). In the case of interest-only loans, collateral may not repay the loan, but "it may well be that only interest is being paid on all or multiple parts of the notes. So if all you are getting are your interest payments and none of the principal back, it's typically the principal at least at the point of default that you are looking to the collateral to collect." Tr. (2015) at 649 (O'Neill).

[264] Tr. at 832 (Miessner).

Following up on this response, Ms. Miessner was asked about the Bank's rationale – that the purpose of the Bedrock Loan and release of Pillay collateral funds was "to buy time to see if the economy would improve." Ms. Miessner responded thus:

> Mr. Calcutt had said that to me not specifically in the context of the Bedrock Transaction but specifically regarding the Nielson credits. It seemed like his whole idea was to just wait until the economy improved. So instead of taking prudent action towards working out a troubled borrower and recognizing them appropriately as a troubled borrower, reporting those loans as troubled loans appropriately, instead they took actions to hide the fact that this was a troubled borrower in hopes that eventually the economy would turn around to the point that the Borrower became not a troubled borrower anymore.[265]

Asked whether, in her opinion, the Bank "was better off foreclosing in the depths of the Recession toward the end of 2009 or extending that period as occurred as a result of the Bank working with the Borrower until June of 2011," Ms. Miessner testified that she could not answer that "because I would have to have information that shows the collateral values that existed at the time in 2009 when the Borrowers said that they didn't want to continue making payments and wanted to do deeds in lieu of foreclosure. . . . Either way, the Bank should have been

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[265] *Id.* at 833 (Miessner).

reporting the loans appropriately and notifying the regulators of what they were doing."[266]

Ms. Miessner said that in her opinion, Mr. Calcutt's active concealment of the condition of the Bank's loan portfolio pertaining to the Nielson Entities did cause loss or risk of loss to the Bank, because as the Nielson credits continued to deteriorate, had Mr. Calcutt "actually been working on identifying the problems instead of concealing the problems, then the Bank could have been working towards actually resolving" the problems.[267]

1. Findings of Fact Regarding Respondent's Obstruction of FDIC Examiners:

Preponderant evidence as reported above, including substantial evidence showing Mr. Calcutt's active involvement in all communication flowing between the

[266] Tr. at 835 (Miessner). See also testimony of Examiner O'Neill, after confirming that he was familiar with the concept of a banker working with a borrower during difficult economic times to help the borrower with the income stream and make it easier for them to repay the debt: after noting Ms. Nielson's proposal (at Resp. (2015) Ex. 122 at 2) that the bank put a "temporary hold on monthly debt payments," Mr. O'Neill was asked whether this is the kind of relief the Bedrock Loan provided, Mr. O'Neill responded: "No, sir. What Bedrock provided was a manner in which we had restricted deposit accounts to cover monthly regular payments. There is no batching here tied to lumps of cash flow at different intervals as properties sell. That's quite separate and apart – two different things." Tr. (2015) at 655 (O'Neill).

[267] Tr. at 810 (Miessner). But see Mr. Calcutt's testimony that the risks associated with the Nielson relationship was "absolutely not" sufficient motivation for him to conceal the details of the Bedrock Transaction from either the Bank's Board of Directors or the Bank's regulators: "There would be no basis to do that." Tr. at 1350 (Calcutt).

Bank and its regulators with respect to the Nielson loan portfolio, establishes that Respondent was aware of the June 30, 2011 letter from Mr. Jackson, was actively involved in contributing to the response, and knew at the time the letter was issued that it contained false and misleading information regarding the performance of the Nielson Entities loan portfolio.

Such evidence, summarized above, establishes that Respondent knowingly engaged in misrepresentations, making material omissions, and engaged in other efforts to deceive Bank regulators, including the routing of funds to aid concealment, concealing loan documentation and office file memoranda, knowingly issuing false Call Reports, issuing false statements in the November 2009 letter to the Bank's regulators, making false answers in Officer's Questionnaires, through the temporary sale of Nielson loans, through exclusion of the Nielson loans from the Bank's external loan review, making materially false statements in response to the August 2011 examination, and through communications with Bank examiners, as alleged in Paragraphs 54 through 107 in the Notice of Intention.

D. Nature of the 2011 Examination

At the time of the 2011 ROE, i.e., as of June 30, 2011, the Nielson banking relationship had 35 loans to 20 different entities, with loan balances of $38.8 million – equaling 48 percent of the Bank's Tier 1 Capital.[268] In the Management/Administration review in the 2011 ROE, examiners described the concerns that had already been brought to

[268] ED Ex. 48 at 40.

the Bank's attention in the three preceding years. These included:

- Lack of complete financial information
- Lack of a global cash flow analysis
- Lack of documentation on the use of proceeds or source of payments
- The improper repayment structure – where most of the loan terms were interest-only
- The inability of several entities to service existing debt
- The lack of personal guarantees
- The failure to obtain current collateral values prior to renewal of several credits within the relationship.[269]

Among the new findings presented in the 2011 ROE were determinations that this time, "management actively concealed the accurate condition of this relationship from regulators and from the Board through the failure to maintain complete loan files and through false or misleading verbal and written statements."[270]

E. The Bedrock Holdings

From among the Nielson Entities, Bedrock Holdings LLC "primarily owned vacant land."[271] Of Bedrock's $30 million in assets, approximately $15 million was based on real estate directly owned by Bedrock, with the remaining

[269] ED Ex. 48 at 40.

[270] *Id.*

[271] Tr. at 32 (Berden).

$15 million owned through Bedrock's investment in Immanuel LLC.[272] Unlike those Nielson Entities that produced cash flow (*i.e.*, those that owned real estate rentals, oil and gas entities, and the home-building company), some did not produce a positive cash flow. These included entities, such as Bedrock, that held either vacant land or unrented residential properties.[273]

Ms. Berden, Generations Management CEO, testified that entities that did not produce a positive cash flow nevertheless generally had expenses, including property taxes, assessments, and insurance.[274] Without positive cash flow, these entities would pay for the related expenses either by borrowing from other Nielson Entities or through the sale of company assets.[275] She referred to borrowing under these conditions as inter-company lending – where loan proceeds from the Bank would be disbursed to one Nielson Entity to be used to benefit another nonproducing Nielson Entities company.[276]

Bedrock, for example, had a line of credit with the Bank, and would at times draw on that line of credit and then loan that money to another Nielson Entity – frequently Artesian Investments LLC – which would then, in turn, loan the money to another Entity.[277] In this way, Artesian would hold both the note receivable and the note

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[272] *Id.* at 34 (Berden); EC Ex. 135_002.

[273] *Id.* at 37 (Berden).

[274] *Id.*

[275] *Id.*

[276] *Id.* at 37-38 (Berden).

[277] *Id.* at 38 (Berden).

payable for the related Nielson Entities.[278]

According to Mark Smith, the Bank's Director of Global Risk, without doing an internal audit, he had no way of knowing that the Nielson Entities were related "when they all were titled differently," so from a layman's perspective, you "wouldn't know . . . one entity was related to the next".[279]

Also of concern, according to the FDIC's Case Manager, Ms. Miessner, was the finding that the Bedrock Loan was being carried on the Bank's books as a $4.5 million interest-only loan – a practice that Ms. Miessner said "is indicative to me of a deteriorating financial condition of the Borrower" – where the "Borrower doesn't really have the ability to service those loans appropriately."[280]

F. Respondent's Direction to Generations Management Regarding Accounting for Loan Proceed Distributions

Ms. Berden explained that initially under these conditions, and using Bedrock as an example, Bedrock would show on its balance sheet that it had made a loan to another related Nielson Entity.[281] She said, however, that this practice changed at the Bank's request, following a meeting held on April 29, 2008 involving herself, Scrub Calcutt, Mr. Green, and Cori Nielson.[282] During that

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[278] *Id.* at 39 (Berden).

[279] *Id.* at 399 (Smith).

[280] *Id.* at 731-32 (Miessner). The $4.5 million loan was used, according to Mr. Calcutt, for the purchase of Team

Services, an oil and gas company. Tr. at 1397-98 (Calcutt).

[281] Tr. at 39 (Berden).

[282] *Id.* at 41 (Berden); Resp. Ex. 127.2

meeting, Mr. Calcutt and Mr. Green asked that Ms. Berden "not show investment in Immanuel LLC.[283] Unlike those Nielson Entities that produced cash flow (*i.e.*, those that owned real estate rentals, oil and gas entities, and the home-building company), some did not produce a positive cash flow. These included entities, such as Bedrock, that held either vacant land or unrented residential properties.[284]

G. Respondent's Role in Concealing the Common Unit and his Directions to Generations Management Due to the Bank's Lending Limit

Also discussed during the April 29, 2008 meeting were concerns that regulators had brought to the attention of Mr. Calcutt and Mr. Green. Ms. Berden testified that Mr. Green and Mr. Calcutt "were bringing to our attention some concerns they had after meetings with the regulators. They were informing us that they had a $10 million legal lending limit."[285] The lending limit was again discussed during a phone call with Mr. Green on May 27, 2008, regarding a pledge agreement from Pillay Trading LLC, "to use their units as collateral on some of the loans with Northwestern Bank."[286] She noted that "[w]e had been told that the Bank may be prohibited from doing any further loans with us pursuant to that April 2008 meeting where they told us about their lending limit. However, on this date they said that they would do a new loan" and

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[283] *Id.* at 39 (Berden).

[284] *Id.*

[285] *Id.* at 41 (Berden).

[286] *Id.* at 45 (Berden).

"will worry about Examiners later."[287]

In this regard, Ms. Berden stated that Mr. Calcutt and Mr. Green "were discussing with us the way that we were transferring draws from the lines of credit" and instructed her that the balance sheets from Nielson Entities should no longer show inter-company notes receivable and notes payable submitted to the Bank.[288] She explained that under this revised accounting approach, "draws on the line of credit, transferring the cash to other Entities, should be shown as distributions to the owners of Bedrock rather than loans to the other Nielson Entities."[289]

Ms. Berden gave the following illustration:

> As an example, perhaps Sunny LLC needed to pay some bills. So we would have Bedrock draw on the line of credit and deposit those funds directly into the Sunny LLC, bank account. The Bank asked us to not do that anymore but to have the funds go into the Bedrock bank account, if Bedrock was the one drawing on the line of credit, and then do further transfers from that point.[290]

Ms. Berden added that while she believed there was nothing improper or illegal about the original inter-company loan process, she learned through Mr. Calcutt and Mr. Green that such a practice could be construed, by

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[287] *Id.*

[288] *Id.* at 42 (Berden).

[289] *Id.*

[290] *Id.* at 44 (Berden).

bank regulators, as a "common use of funds."[291] She identified notes she took from when the Bank "first started talking to us about regulatory issues," in an email to FDIC employee Teri Gillerlain dated September 11, 2012.[292]

Although this correspondence appears to be dated in 2012, the exchanges described above occurred in 2008 through 2010.[293] In her testimony, Ms. Berden agreed with the proposition that Mr. Calcutt suggested that rather than have one entity loan funds to another, the best way to do what the Bank and the Nielson Entities wanted to do was to have the money flow to the owner of the LLC, and the owner would then do with the funds what it deemed appropriate – loan it out again, distribute it, or whatever.[294] For his part, Mr. Calcutt defended the Bank's position regarding this approach to intercompany lending in these terms:

> And at some period I met with the lender [Mr. Green] and the Nielsons and informed them that the Borrower, funds should be disbursed to the Borrower; the Borrower could downstream them to the owners and the owners could do what they wished. They could upstream them to some other entity, but they should not be moving money back

[291] *Id.* at 150 (Berden).

[292] *Id.* at 152-53 (Berden); Resp. Ex. 127.

[293] Tr. at 152 (Berden). See Resp. Ex. 126 (email from Ms. Berden to the FDIC's Ms. Gillerlain dated September 8, 2012, stating that Mr. Calcutt "asked us to change the way we handled our inter-company loans to move them from the borrower LLC to the parent entity during a phone call on 2/11/09.")

[294] Tr. at 151 (Berden).

> and forth between entities.
>
> Q. And why did you believe that was inappropriate?
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> A. Well, I was wearing my CPA hat. The tax hat. And that is that I didn't want to see these entities collapsed, in a sense. And when you have enough inter-entity borrowing, it is easy to make the argument that they should be collapsed. So funds, as I say, should go to the borrowing entity but then distributed to the owners of that entity.[295]

In later testimony, when asked whether he knew at the time of funds being routed from the Pillay collateral to the Nielson Entities that the loan proceeds were routed through various deposit accounts, Mr. Calcutt responded "No. As I said: I was never involved in the disbursement of any funds from any loan, including this loan. So no. I wouldn't have any idea where the funds would have gone or how they would have gone from Bedrock."[296] I found this inconsistent testimony eroded Mr. Calcutt's credibility. He denied that the funding process described here was intended to conceal the transaction from the Bank's regulators, stating "there would just be no reason to do that."[297] The record, however, establishes a clear reason for attempting to conceal the common ownership of the Nielson Entities from the Bank's regulators. That record materially erodes the reliability and credibility of Mr. Calcutt's testimony in this enforcement action.

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[295] Tr. at 1277 (Calcutt).

[296] *Id.* at 1308 (Calcutt).

[297] *Id.* at 1308-09 (Calcutt).

Testimony from the Bank's Director of Risk Assessment, Mark Smith, supported the premise that the Nielson Entities constituted a common group and that its common status was hidden from the Bank's auditors, its Board members, and its regulators. Mr. Smith testified that he joined the Bank in May of 2011, and one of his first responsibilities was to identify (in advance of the exam set to begin in August 2011) whether there were commercials loans having "outside normal interest rates."[298]

In the course of this work, Mr. Smith found "a group of loans that were all I believe lower than the rest of the commercial loans, at a lower interest rate than the other commercial loan portfolio; I believe it was half a point below prime at that time."[299] He explained that when he pursued this, "somebody from the credit area said "That's the Nielson Loans. The whole group is the Nielson Loans."[300]

As he became familiar with the group, he described it as "a large group, a lot larger than I would have expected for a bank the size of Northwestern to lend to one kind of group of companies."[301] He opined that by "the sheer volume of the number of loans that were interrelated, I believe at the time it was about $35 million, that they led me to believe that they had the bargaining power to get down to that level where no other loans in the commercial portfolio were that low of an interest rate."[302]

[298] *Id.* at 397 (Smith).

[299] *Id.*

[300] *Id.*

[301] *Id.* at 397-98 (Smith).

[302] *Id.* at 398-99 (Smith).

1. Findings of Fact Regarding Respondent's Actions in Concealing the Nature of the Nielson Entities as a Common Group

Upon this testimony (and upon the witnesses' references to exhibits presented during the hearing), preponderant evidence establishes Mr. Calcutt's active, knowing, and willful participation in directing the Bank's management of the Nielson Entity Loans throughout the period relevant to this administrative enforcement action, actions that were designed to conceal the nature of the Nielson Entities as a common group of borrowers.[303]

H. The Bank's Concerns Regarding the Nielson Entities' Lines of Credit

In the fall of 2008, one of the Bank's concerns, raised during a meeting on October 9, 2008 with Mr. Calcutt, Mr. Green, Cori Nielson, and Ms. Berden, was that lines of credit held by Nielson Entities were not being paid down.[304] Ms. Berden testified that during the meeting, Mr. Calcutt and Mr. Green were "suggesting that some of our lines of credit, the balances would only increase; they were never paid back down."[305]

Ms. Berden explained that typically a line of credit "is used to have advances in payments, used back and forth for temporary cash flow needs."[306] The Nielson Entities' lines of credit, on the other hand, "would just get drawn

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[303] See also testimony of the Bank's Director of Risk Management, Mark Smith: "asset quality meetings would typically involve Scrub, Dick, myself, and Mike Doherty." Tr. at 396 (Smith).

[304] Tr. at 44 (Berden).

[305] *Id.* at 46 (Berden).

[306] *Id.*

upon and max out, and stay there at that full principal balance, so [Mr. Calcutt and Mr. Green] were asking if we might be able to pay some of them down for a period of 15 to 30 days to show that they were being used more as a traditional line of credit."[307] Further, if the Entities were not able to pay down the lines of credit, Mr. Green and Mr. Calcutt wanted the Entities "to convert them into term loans that would have principal and interest amounts."[308]

For the 2011 Joint Examination, FDIC Examiner Dennis O'Neill[309] had responsibility for reviewing the Nielson loan relationship, assuming that role upon the departure of FDIC Examiner Robert Bush.[310] He had received from Mr. Bush a binder of documents consisting of "key correspondence between the Bank and the Borrower of the Nielson Entities during the period at least through late 2009."[311] He testified the binder had been given to Mr. Bush shortly before the 2011 Examination by FDIC Case Manager Anne Miessner, who had received

[307] *Id.* at 46-47 (Berden).

[308] *Id.* at 47 (Berden).

[309] Examiner O'Neill holds an accounting degree, became an Examiner with the FDIC in 1985, and has 30 years of experience with the FDIC. He is a Commissioned Examiner, has attended courses and received on the job training in testing bank records "for the safety and soundness of the institution in compliance with laws and regulations." Tr. (2015) at 11-12 (O'Neill). He has participated in over 300 bank examinations, serving as the Examiner in Charge in over 100 such examinations. Tr. (2015) at 12 (O'Neill). He had been assisting in the examinations of Northwestern for approximately seven years, in the Trust Department and in Loan Review in the context of at least five of the Bank's safety and soundness examinations. Tr. (2015) at 14 (O'Neill).

[310] Tr. (2015) at 15 (O'Neill).

[311] *Id.*; EC Ex. (2015) 3.

the binder from officers of the Nielson Entities.[312]

Mr. O'Neill testified that upon receiving the binder, he read through its contents, in order to "become familiar enough with the correspondence so that I could then review the Bank's own records and loan files and compare it and see whether those records, those that were most important, that were most revealing in terms of the conditions of the loans, were actually kept in the records that were being presented to the Bank Examiners during the Exam."[313] Generally the correspondence consisted of emails that had not been written by Mr. Calcutt – most had been written by Cori Nielson, and from time to time Mr. Calcutt would forward transmissions to from Ms. Nielson to Mr. Green.[314]

Asked whether he disclosed his access to the documents in the binder to anyone at the Bank prior to the start of the 2011 examination, Mr. O'Neill said no, he had not: "The goal was both through reviewing records and interviewing bank management to see what was available and what they were disclosing to us, both written records supplied and statements made to us in response to specific questions about the communications with the Borrower."[315]

Mr. O'Neill found cause to believe the Nielson Entities loan folders that the Bank provided during the 2011 examination were incomplete.[316] Mr. O'Neill asked Mike

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[312] Tr. (2015) at 17 (O'Neill).

[313] Tr. (2015) at 19 (O'Neill).

[314] *Id.* at 20-21 (O'Neill).

[315] *Id.* at 21 (O'Neill).

[316] *Id.* at 24-25 (O'Neill).

Doherty for *all* of the correspondence between the Bank and the Nielsons "since there was none in the files," adding that this was "very unusual . . . especially for the largest borrowing relationship in the Bank."[317] He said the examiners made additional requests – including a written request – providing the Bank with additional opportunities to supply the examiners with records – including those records contained in the binder that Ms. Nielson had sent to the FDIC.[318]

The documents Mr. O'Neill was seeking were the kind he said he expects to find in any loan file: information stating the purpose of the loan, its use, its sources, the borrower's request, and the like.[319] In cases where a loan is "in distress" he would expect the file to have correspondence stating "the cause of the problem that led it to be in distress," and if the loan had been in a non-accrual state and then restored to accrual, he would expect documentation showing "what has changed to allow it to be restored to accrual status."[320] Further, he said he would expect to see in the file "timely payments of six months or more and other changes in the fundamental ability of the

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[317] *Id.* at 25 (O'Neill).

[318] *Id.* at 26 (O'Neill).

[319] Tr. (2015) at 26-27 (O'Neill). See also testimony of Mr. Doherty regarding the process used by the Bank regarding its loan files: "credit write-ups, financial information, any related documents outside of loan documents were kept in one file and that was up to the lender/assistant to do those files. Then, once the loan was made, the executed documents were put in a loan file, a separate file." If new material information regarding the loan came in, that was supposed to go into the credit file. He added that between 2009 and 2011, he had no reason to suspect that files did not contain complete information. Tr. at 1213-14 (Doherty).

[320] Tr. (2015) at 27 (O'Neill).

borrower to keep those payments current."[321] Given that this was the Bank's largest borrowing relationship, he expected to see, where appropriate, a history of where the loans had been delinquent and ultimately placed on non-accrual status.[322]

Mr. O'Neill testified that the binder provided by the Nielsons contained "significantly more" correspondence than had been stored in the Bank's loan folders.[323] He said the binder included documents that addressed "the reasons for the original problems and also the arrangements that were made to restore them to accrual status."[324] For the Bedrock folder, for instance, Mr. O'Neill expected to find information describing the loan review presentation to the Board, because as a loan that reached "over fifteen percent of the common stock and surplus of the capital of the Bank . . . that loan has to go to the Board of Directors, for at least two-thirds of the Board has to vote approval of it."[325] This documentation, according to Mr. O'Neill, "was absent here for the Bedrock Holdings' new loan".[326]

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[321] *Id.* See also testimony of Mr. Hollands regarding the contents of the Nielson Entities loan files as of January 14, 2010, where Mr. Green forwarded to Mr. Hollands financial statements from Nielson Entities for year-end 2008, demonstrating, according to Mr. Hollands, that there were no year-end 2008 financial statements in the files prior to January 14, 2010, and had not been in the files at the times the loans were extended in December 2009; adding that the files still lacked up to date rent rolls. Tr. at 1119-21 (Hollands).

[322] Tr. (2015) at 27 (O'Neill).

[323] *Id.* at 28 (O'Neill).

[324] *Id.* at 29-30 (O'Neill).

[325] *Id.* at 40 (O'Neill).

[326] *Id.*

I. Respondent's Responses to Regulators' Concerns about Loans to Entities that Lacked Positive Cash Flow

During their October 9, 2008 meeting with the Nielsons, the bankers also had expressed concern about "issues they were having with their Regulators and asking us if there were things that we could do to help their position."[327] These things included "more cash deposits to be held" at the Bank, and they wanted "statements to explain entities that did not have any income or cash flow."[328] Ms. Berden said that Bedrock was one such entity, and Mr. Calcutt and Mr. Green told her that Bedrock had been "brought to their attention by the Regulators in looking at the financial statements that these entities appeared not to have any cash flow or income to support their loan payments."[329]

According to Ms. Berden, while "trying to brainstorm ways to make some of these things happen," the parties agreed to "change[] the procedure where . . . [a] line of credit draw from Bedrock would go directly to Bedrock's checking account first and then from there it [would be] distributed to partners or owners of Bedrock. We would actually move the cash to those bank accounts and then make further transfers as needed from there."[330] With these changes to the Nielson Entities' accounting practices pertaining to inter-company transfers, while such transfers were still taking place, they wouldn't show up on

[327] Tr. at 47 (Berden).

[328] *Id.* at 48 (Berden).

[329] *Id.*

[330] *Id.* at 49 (Berden).

the financial statements the Entities gave to the Bank because the transfers were being made at the "ownership" level.[331]

J. The Bedrock 2009 Loan and the Bank's Legal Lending Limit

By January 2009 it became clear to both the bankers and Ms. Berden that by the time it was preparing to extend a loan of $1.15 million based on vacant land held by Bedrock, the Bank was "over our legal lending limit."[332] Elaborating on this point, Mr. Berden testified that the Bank had "informed us previously that they had a $10 million legal lending limit and that they exceeded that, and so this loan [Mr. Green is] saying needs to be capped at a certain amount because they are already over their legal lending limit."[333]

Describing the interactions between herself, Mr. Green, and Mr. Calcutt, Ms. Berden stated that typically correspondence between her and Mr. Green reflected Mr. Green's communication with Mr. Calcutt, and that while Mr. Green would "often negotiate terms with me," he would then "get approval from [Mr. Calcutt] before we could finalize."[334] She testified that as she understood it, both Mr. Calcutt and Mr. Green were the Bank's decision-

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[331] *Id.* at 50-51 (Berden).

[332] *Id.* at 52 (Berden); EC Ex. 3_0053.

[333] Tr. at 52; EC Ex. 3_0053 (1/6/09 email from Mr. Green to Ms. Berden re: Bedrock Vacant Land). See also testimony from Mr. Jackson, that the FDIC had "ignored" the claims "that we were, would be placing against both the $10 million that the Nielsons had received from the OILN claim and future payments that they anticipated as a result of the OILN claim." Tr. (2015) at 1647 (Jackson).

[334] Tr. at 52-53 (Berden).

makers in relation to the Nielson Entities loans.[335] Further, it was Ms. Berden's experience that both Mr. Calcutt and Mr. Green often would bring up as a concern the subject of what the Bank's examiners might think of a given proposal.[336]

She agreed with the premise that Mr. Calcutt did not attend *all* of the meetings held regarding the Nielson Entities. She specifically stated he was not present during a meeting held in November 2010 where Ms. Berden and Cori Nielson met with Mr. Green, Mike Doherty and Dick Jackson, to discuss plans regarding all of the Nielson loans, and identified other similar meetings where Respondent was not present.[337]

K. Regulatory Issues in 2009 with the Loans to Five Nielson Entities

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[335] *Id.* at 78 (Berden).

[336] *Id.*

[337] *Id.* at 165 (Berden); Resp. Ex. 169. See also Resp. Ex. 204 (Mr. Calcutt not present at a meeting on November 29, 2010 regarding, inter alia, short sales and a five-year cash plan; not present at a meeting on November 11, 2010 regarding possible foreclosure action and deeds-in-lieu); EC Ex. 3 at 173 (not present at a meeting on December 15, 2010 regarding loan renewals and agreements). See also testimony of Ms. Nielson confirming that Mr. Calcutt did not attend a meeting on November 12, 2010, nor one on November 29, 2010. Tr. at 1006 (Nielson). Asked whether she agreed that the negotiations between the parties between October through December 2010 actually did not involve Mr. Calcutt, Ms. Nielson said "I don't think I could agree that he was not involved, but it does refresh my recollection that we had a few meetings here with" Mr. Doherty, Mr. Jackson, and Mr. Green." Tr. at 1008 (Nielson). She testified that even if Mr. Calcutt was not at certain meetings, "I don't believe that he was not involved." *Id.* at 1020 (Nielson).

The Bank (through Mr. Green and Mr. Calcutt) continued through the spring of 2009 to address with Ms. Berden its legal lending limit practices and the Bank's regulators' responses to those practices. In an email exchange between Ms. Berden and Mr. Green on February 11, 2009, Mr. Green explained that "the Examiners were wanting to aggregate all of these loans into one relationship which put them over the legal lending limit," and indicated that the loan to Blueridge Holdings LLC was an example of that.[338] In this instance, the loans the Regulators said should be aggregated were those attributed to Bedrock LLC, Blueridge LLC, Immanuel LLC, NRJ LLC, and Jade LLC.[339]

Ms. Berden explained that in the February 11, 2009 email, Mr. Green relayed to her something Mr. Calcutt had noticed about the Blueridge account: In an email among those sent on February 11, 2009, Mr. Green explained to Ms. Berden that "One item Scrub noticed was the inter-company debt was increasing[,] which was the primary item the examiners caught and had a major problem with."[340] Mr. Green then reminded Ms. Berden that funds disbursed by the Bank were not to go directly to Blueridge from the Entity borrowing money, but she was expected instead to transfer the funds to the owners, and let the owners complete the intercompany loan.[341]

As previously noted, an email message dated February 19, 2009, reflects that Mr. Green identified five

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[338] Tr. at 55 (Berden).

[339] *Id.* at 56-7 (Berden); EC Ex. 3 at 62.

[340] Tr. at 55-56 (Berden); EC Ex. 3 at 60.

[341] Tr. at 55 (Berden).

accounts Bank examiners "tried to tie together" – Bedrock, Blueridge, Immanuel, NRJ, and Jade.[342] By abiding in making the accounting change requested by Respondent and Mr. Green – that is, by "moving the loans out to the owners so that they did not appear on the borrower's balance sheet," the balance sheets she submitted to the Bank would no longer list any inter-company loans made to other Nielson Entities.[343] Ms. Berden stated that as a result of this change, in order to fully understand what sorts of transfers were being made, one would need more information than what was shown in the balance sheets she submitted to the Bank.[344] This was information that could only be provided by the owners – but the owners were in no way obligated to the Bank (in terms of guarantees on the Bedrock note) to provide this information; and the Bank did not systematically request periodic financial statements as part of the ongoing relationship between the Bank and Bedrock.[345]

In another similar example, when Ms. Berden found a need for funds to go to Lake Miona LLC, she stated the LLC "didn't have an account that I can deposit" loan proceeds into, as it was an LLC owned by Blueridge.[346] She explained that Mr. Green was willing to help (and said so in an email dated February 27, 2009 to Ms. Berden), but told her:

> [The deposits] will be loan proceeds from an entity and [would] go directly into Blueridge, and

[342] Tr. at 56-7 (Berden); EC Ex. 3 at 62.

[343] Tr. at 58 (Berden); Resp. Ex. 126.

[344] Tr. at 58 (Berden).

[345] *Id.*

[346] *Id.* at 59 (Berden).

> the examiners will be all over Blueridge and the deposit accounts in a month. They will see it. I am concerned it will cause another 'co-mingling of funds issue.' Is there another way to do it? Can you get the check and then cash it and make a separate deposit?"[347]

Ms. Berden testified that by proceeding as directed by Mr. Green, if the check was cashed as Mr. Green proposed, no one would know what the source of the cash was, without tracing it.[348]

The lending-limit issue remained a topic of discussion throughout 2009. At one point in April, 2009, Ms. Berden offered to help the Bank as it responded to concerns raised by the Bank's regulators. In an email to Ms. Berden on April 19, 2009, Mr. Green wrote to Ms. Berden stating "the examiners are here and they are reviewing every loan with us. My guess is that we will certainly be required to have you move most of the loans. I will keep you posted."[349]

Later that day, Ms. Berden responded by asking if there was anything she could do to help.[350] Specifically, she stated that "[t]here are good arguments for a lot of these to show the separation of ownership and the reasons why they do not have common use of funds because of fiduciary relationships, etc."[351] Her response carried with it signs of consternation, where she asked what the result

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[347] *Id.* at 60 (Berden); EC Ex. 3 at 63.

[348] Tr. at 60-61 (Berden).

[349] Resp. Ex. 10.

[350] *Id.*

[351] *Id.*

would be if the examiners found a common use of funds among these Entities – that the examiners may require the Entities to leave the Bank at a time when few banks were lending money on land properties, while relating that she had been trying to "reach out to other banks" without success, having been "turned down due to our loyalties to [Northwestern]," and asking "[w]hat if we simply can't find alternatives due to industry and market conditions at this time?"[352]

Ms. Berden testified that through an email sent on March 2, 2009, Mr. Green told her that Mr. Calcutt had met with FDIC staff members in 2008 and learned that the FDIC examiners raised the issue of whether the Nielson Entities were tied together, but "decided to wait for the State examiners to review it," adding that the State examiners would be at the Bank in April 2009.[353] She testified that Mr. Green and Mr. Calcutt "were still arguing at the time that these loans should not be grouped together, but in anticipation of the fact that they weren't sure that they could prevail on that issue they wanted us to try to move some of the loans to other banks."[354]

Ms. Berden testified that in responding to these concerns, and at Mr. Calcutt's request and that of Mr. Green, she attempted to move some of the Entity loans to other banks, but had no success – partly because the loans were not guaranteed by the owners, and partly because many of the loans were secured by vacant land that had no cash flow.[355] She added that the request that she try to move

[352] Tr. at 156-57 (Berden); Resp. Ex. 10.

[353] EC Ex. 3 at 66.

[354] Tr. at 63 (Berden).

[355] *Id.*

some of these loans came "at a time when the real estate market was crashing and most of the banks were not even interested in looking at real estate loans of any type."[356]

Ms. Berden agreed with the premise that early in 2009 the Bank, through Mr. Calcutt and Mr. Green, had made it clear that it was absolutely necessary, because of regulatory concerns, to move some of the Entity loans out of the Bank.[357] She also agreed with the premise that due to the economic effects of the Great Recession, both the Nielson Entities and the Bank were adversely impacted – with the Bank wanting the Entities to move out these loans, and the Entities being unable to do so.[358] Ms. Berden clarified, however, that as of May 2009, the Nielsons were still making their loan payments, so the reason for moving the loans elsewhere wasn't because of performance issues, but was instead a response to the Bank's *regulatory* concerns regarding the common use of funds and the Bank's lending limit.[359]

For his part, when asked to describe why the Bank wanted the Nielson Entities to "look for other financing," Mr. Calcutt testified as follows:

> Q. [W]hat was the nature of the concern that was being raised by the Examiners over the Michigan unit rule? What was the Borrower doing that was of concern?
>
> A. Well, it was the aggregate amount of debt, that it was beyond our lending limits and but the state

[356] *Id.* at 54 (Berden).

[357] *Id.* at 152 (Berden).

[358] *Id.*

[359] *Id.* at 158-59 (Berden).

> statute was so vague that they were clearer on the federal rule but the state statute was very unclear. So it actually got dropped as a discussion item after, I don't know if it was 2007 or '08. In other words, it was brought up. Discussed. We discussed it with the Nielsons, suggested they look for another bank but ultimately that discussion was dropped.[360]

L. Respondent's Authorization of the Use of Funds from Pillay Trading LLC to Service Nielson Entity Loans

Apart from moving existing Nielson Entity loans to other banks, Mr. Green and Ms. Berden also discussed using funds in Pillay Trading LLC.[361] In an email dated January 21, 2009, Ms. Berden broached the subject with Mr. Green, stating that "with the current condition of the market," the Pillay funds were "sitting on the sidelines with our trading activity – meaning that the funds are still in Pillay, but we're not actively trading them, it's just sitting there in cash and T-bills."[362]

Although the assets in Pillay were currently being used as collateral for Nielson Entity loans, Ms. Berden asked Mr. Green: "We're wondering what options we have to release some of the security that [the Bank] has on these Pillay units. Could we use a portion of the funds to pay down on principal to release the security interest?"[363] Breaking down the proposal, Ms. Berden stated

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[360] *Id.* at 1276 (Calcutt).

[361] *Id.* at 153 (Berden); Resp. Ex. 3.2.

[362] EC Ex. 3 at 59.

[363] *Id.*

the Bank held a $1 million security interest for the Bedrock Holdings LLC loan, a $500,000 security interest for Moxie LLC, and a $100,000 security interest for AuSable LLC.[364]

The Bank initially rejected Ms. Berden's proposal to use these funds to service Nielson Entity loans. Mr. Green advised, in a March 16, 2009 email to Ms. Berden, that "The Pillay funds were used to cover down payment and/or cash flow shortages on the loans to Moxie, Bedrock, and AuSable. We cannot release those funds. It could be used to pay down the loans provided there is existing cash flow to cover the remaining loan."[365]

As will be reported below, however, Mr. Green later abandoned this position and, according to Ms. Berden, agreed "to release Pillay funds which they had previously said they would not do," even arranging funding for a new loan – the $760,000 Bedrock Loan – even though previously they had told Ms. Berden and Cori Nielson there would be no new loans.[366]

M. The Distressed State of the Nielson Entities Loan Portfolio in August 2009

In a memo dated April 22, 2009, in which the subject is "Nielsons," Mr. Green wrote to Mr. Calcutt that "[t]he examiners are looking at every loan they have at NW. The four they claim may be tied together are as follows", listing Bedrock Holdings, Blueridge Holdings, Jade Venture, and Immanuel.[367] After acknowledging that the

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[364] *Id.*

[365] Tr. at 65, 155 (Berden); EC Ex. 3 at 69; Resp. Ex. 8.

[366] Tr. at 87 (Berden).

[367] EC Ex. 80 at 35.

handwritten notes on the April 22, 2009 memo were his, Mr. Calcutt explained what his note "Money sent directly. Your issue" meant in context:

> Well, this comes back again to earlier testimony where I made it clear wearing my CPA hat that money should be disbursed from a loan to the Borrower. What the Borrower does then, they downstream it to the owners. The owners may upstream it somewhere, but it came back to not, not recommending that there be inter-company movement of money. That's what that note is probably referring to is my thoughts concerning how, you know, loan proceeds -- and this would have been clear to our team, the loan proceeds should go to the Borrower.[368]

The record reflects that at least in January 2009, assets in Pillay Trading LLC had been pledged to the Bank as collateral for three Nielson Entities; Bedrock, AuSable, and Moxie.[369] Pillay was seen as a valuable asset, one that (in 2008) earned 18.77% between 1/1/08 and 4/25/08 (for an annualized return of 59/23%).[370] The record also, however, includes evidence that "[i]t was difficult to determine what [the Pillay Trading Units] would be worth."[371] This evidence came from Frederick Bimber, Esq., who served as co-counsel to the Bank in cases in which the Bank sued Bedrock and other Nielson Entities, seeking foreclosure of Nielson assets held as collateral to

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[368] Tr. at 1372 (Calcutt).

[369] *Id.* at 155 (Berden); Resp. Ex. 3.

[370] Tr. at 163 (Berden); Resp. Ex. 2.

[371] Tr. at 377 (Bimber).

the Entities' loans with the Bank.[372]

Mr. Bimber described the Pillay Units as "illiquid," adding that there were questions regarding whether the Bank actually had perfected its own lien against the Units "because you in effect would be asking one Nielson-controlled entity to do the Bank's bidding with respect to the pledge of the Pillay Units, which were themselves simply membership/ownership interests in Pillay Trading."[373] As Mr. Bimber put it, Pillay "traded stocks according to some procedures that the Nielsons thought were very clever and likely profitable, but I suspect Pillay Trading wasn't worth very much as we got into the early years after 2008."[374]

Ms. Berden agreed with the premise that by August 2009, three negative factors were in play: first, the Bank wanted the Nielsons to refinance and move their debt out of the Bank; next, the Bank wanted to improve its position with regard to the loans by getting greater debt service on the loans; and third, the Great Recession presented problems that prevented the Nielson Entities from making the sought-after debt service payments because of vacancies in the properties held by the Entities and difficulties in the Entities' cash flow.[375]

By late summer 2009 it was clear to Ms. Berden that conditions had changed – both because of the increased

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[372] *Id.* at 354 (Bimber).

[373] *Id.* at 378 (Bimber).

[374] *Id.*

[375] *Id.* at 163-64 (Berden). See also testimony of Examiner O'Neill confirming that the FDIC had issued a report stating "The economic condition throughout the state remains weak. Real estate values are depressed." Tr. (2015) at 614 (O'Neill); EC Ex. (2015) 49 at 2.

attention being paid by the FDIC's examiners regarding common use of funds among the Nielson Entities, and because of market conditions that were hurting the Entities' cash flow. Although Mr. Green and Ms. Berden engaged in ongoing email discussions about loan repayment, by mid-August 2009 Ms. Berden made it clear that repayment of loans held by the Nielson Entities was not assured, writing:

> In conjunction with the problems Northwestern Bank is experiencing with your regulators, we find ourselves also having to take a hard look at our financing situation. Due to the continued extreme low prices of natural gas, the complete lack of real estate developers purchasing development land in Michigan, and the drop in all real estate values due to the glut of foreclosures on the market, the current recession/Michigan depression is causing us increased need to restructure our loans.[376]

Through this email correspondence, Ms. Berden explained that upon finding that the Nielson Entities had been unable to move its loans to other banks, "we were facing a situation where our overall cash flow portfolio was unsustainable."[377] The Entities' weakening position also was described in an email sent on August 21, 2009, from Cori Nielson to Mr. Calcutt, where Ms. Nielson stated she "could not understand why you are delaying scheduling to meet with" Ms. Nielson and her attorneys and advisors, and informed Mr. Calcutt that the Entities "will not make our September payment or any further payments until we

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[376] EC Ex. 3 at 78.

[377] Tr. at 67 (Berden).

have the necessary meetings and discussions to reach an overall restructuring of the relationship."[378]

Cori Nielson followed this with a more detailed email message on September 21, 2009, in which she informed Mr. Calcutt that the Entities "need a serious restructuring of their loan payments for the next period of time," and asked that the Bank "suspend monthly payments" due "until our cash flow returns".[379] She advised that some of the real estate securing the Bank's loans have values "so poor that some properties may not have any equity left in them, and some properties may not have good potential for equity recovery in the near term."[380]

N. Using Pillay Trading LLC Funds and the New Bedrock Loan to Service Existing Loans in 2009

Following the news that the Entities had stopped making payments on any of the Bank's loans, Mr. Green extended to Ms. Berden the possibility that, notwithstanding what he had stated earlier that year, he and Mr. Calcutt now agreed to allow the Entities to use Pillay funds to make payments on the loans.[381] When combined with a new loan from the Bank, the funding would pay "a little bit more than eight months" of loan service – and would bring the loans current for an entire year from September 1, 2009 (when the Entities had stopped making payments on the loans).[382]

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[378] EC Ex. 3 at 82.

[379] *Id.* at 89.

[380] *Id.* at 89-90.

[381] Tr. at 71-72 (Berden);EC Ex. 3 at 93.

[382] Tr. at 88 (Berden); EC Ex. 3 at 116.

Ms. Berden explained that funds from the Pillay account and from the new loan would be deposited into a special reserve account to be on hold for the payments, – all "in the name of Bedrock, but pursuant to their previous request [from as early as April 2009] about line of credit draws, [Mr. Calcutt and Mr. Green] didn't want any of those funds to go directly into the other Borrower accounts."[383]

Through this process of negotiation between Mr. Calcutt (with Mr. Green's assistance) and representatives of the Nielson Entities, $600,000 was drawn from the Pillay LLC funds, and the new "Bedrock Loan" of approximately $760,000 was issued by the Bank, leading to $1.36 million being made available to bring the Entities' loans current and fund payments for eight months.[384]

In a memo dated November 16, 2009, Mr. Green presented to Mr. Calcutt a plan which he hoped would close by November 30, 2009, wherein the Bank would disburse a loan of $760,000 "to be used to cover principal payments", and accept from the Entities a pledge a second mortgage on the real estate currently held for the Bedrock loan.[385] The plan also called for the loan to be "interest only" with a floor of 4%; and for one of the loans (the Eighty Eight Investments loan) to be amended to permit repayment over 36 months instead of 12 months.[386]

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[383] Tr. at 88-89 (Berden); EC Ex. 3 at 122-23.

[384] Tr. at 90 (Berden); EC Ex. 3 at 126-27.

[385] Resp. Ex. 6 (which included a provision for the Bank to receive a "junior secured position" in equipment securing the Bedrock loan, but with the caveat that this "may not be possible as it's a lease transaction with 5/3 and therefore owned by 5/3").

[386] Resp. Ex. 6.

Ms. Berden testified that Mr. Green's November 16, 2009 proposal to Mr. Calcutt (which did not include releasing any Pillay Trading assets from the collateral position held by the Bank) would be an acceptable arrangement to try to deal with the "perfect storm" the Bank and the Nielson Entities were facing in late 2009.[387] Use of the Pillay Trading LLC's funds came into the picture only after Ms. Berden requested and received the Bank's permission to use funds presently held as collateral to pay down some of the Entities' debt.[388]

As the negotiations concluded, Mr. Green wrote to Ms. Berden on November 27, 2009, advising that "At this time, we can't do transactions online so I will need you to help by making the deposit. I am not sure where the money is coming from, but try to remember not to leave the paper trail. In other words, try not to deposit a check from Bedrock into Immanuel, etc."[389]

Ms. Berden then identified the documents showing that proceeds from the Pillay fund, which was owned by Artesian Investments, went first from Pillay into Artesian, and then "Artesian would disburse out to various Nielson entities. Those first set of transactions are the owners of the LLCs. They would receive the funds first."[390] From there, the owners would transfer these Pillay proceeds and loan disbursements into the Nielson Entities.[391]

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[387] Tr. at 165 (Berden).

[388] *Id.* at 167 (Berden).

[389] *Id.* at 92-93 (Berden); EC Ex. 7 at 1.

[390] Tr. at 94 (Berden); Resp. Ex. 136.38-136.42.

[391] Tr. at 94-95 (Berden); Resp. Ex. 136.38-136.42.

Mr. Jackson explained the negotiations in these terms:

> [I]n November and December of 2009 following a series of meetings with members of the senior management committee that included myself, we came to a solution which we thought would help us continue discussions with the Nielsons and to keep the door open for us to work towards some amicable agreement as far as the resolution of their debt, and we agreed to do a new loan for them which is referred to as the Bedrock Loan of $760,000. We also agreed to release some funds called Pillay funds which was 600- or $680,000 which had been pledged by the Nielsons, and it was questionable as far as the validity of the lien that we had against that. So we thought, well, we can use that money to reduce the debt, which we did. It was the Borrower's money given to us ultimately for debt service and that's what we used it for.[392]

According to Ms. Berden, total principal indebtedness to the Bank by the Nielson Entities at the time of this transaction was approximately $38.7 million.[393] Ms. Berden explained that although initially Mr. Calcutt and Mr. Green sought to have the proceeds of the $760,000

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[392] Tr. (2015) at 1600 (Jackson).

[393] Tr. at 97 (Berden); Resp. Ex. 37, EC Ex. 133. See also testimony of Ms. Miessner, who testified that EC Ex. 133 concerns the Bedrock transaction "where the Bank made a new loan and released collateral – liquid assets that were held as collateral in order to bring all the loans within the Waypoint Nielson relationship current, take them off nonaccrual and set up payment reserve accounts going into several months of 2010." Tr. at 739 (Miessner).

Bedrock loan used only for principal and interest payments, they ultimately accepted Ms. Berden's proposal that those funds be allocated "based on the monthly payment so that . . . all of the loans would cover the same number of payments."[394]

Ms. Berden also acknowledged that by June 2010 she had reported positive results – including receipt of more than $10 million by Frontier LLC awarded in a civil lawsuit, along with indications that Team Services (a recently-acquired source of cash flow for Bedrock) would be responsible for positive cash flow for Bedrock, and an improving market for sales of new houses by Generations Development.[395] When asked why, with these positive factors, the Nielson Entities once again stopped paying on their loans in the fall of 2010, Ms. Berden clarified that the $10 million could not be spent because "we were being counter-sued for that $10 million."[396] She explained that while the Entities ultimately were able to use those funds for cash flow purposes, that did not occur until "several years later when that litigation was settled."[397] Mr. Calcutt apparently was not aware of this restriction on the

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[394] Tr. at 100 (Berden); EC Ex. 3 at 134.

[395] Tr. at 169 (Berden).

[396] *Id.* at 170 (Berden).

[397] *Id.* at 170-71 (Berden). See also testimony from Cori Nielson to the effect that in the summer of 2010, there was a $10 million mineral lease payment related to the Olin lease: "Our burn, our cash burn at that time for the portfolio was around $6 million per year. So $10 million doesn't go very far when you are burning $6 million a year, and we did use some of that money for some debt service, and we did use some of that money for investing in a cash flow in a new investment that we had been looking for." Tr. at 1020 (Nielson). She denied, however, that there was a claim made against that $10 million. *Id.* See also testimony from William Calcutt, with respect to the claim against

use of the proceeds of the lawsuit, testifying that he expected the Entities to use the proceeds to pay the Entities' debts "because they were already doing it in other situations."[398] He stated that "some Entities . . . had very strong cash flow, including Frontier, so I didn't have any doubt that they could use that money if they so chose."[399]

Mr. Calcutt testified that he generally absented himself from discussions in the early stages of negotiations from October to December 2010, but did send a letter on December 1, 2010 to Dale Nielson, hoping that Mr. Nielson would "step in here and see that we needed to work out some kind of resolution going forward here".[400] In the letter, Mr. Calcutt let Mr. Nielson know that the suggestion that the Bank should "simply accept deeds in lieu of

foreclosure of the properties" was "disappointing in light of our past relationship."[401]

In response, in December 2010 Dale Nielson met with

Chesapeake Energy which the Bank considered when determining the Nielson Entities' capacity to repay the group of Nielson Entities loans – "The Nielsons had a claim on one or more oil and gas leases I think it was against Chesapeake Energy, okay. I think they claimed that they were going to get at least $10 million from this. And if my recollection is right, there was, that somehow that they would apply some of this recovery – as I say, it was either $10 million or more, [and] use it to help bring down the loans, you know, reduce the loans." Tr. at 1180-81 (W. Calcutt). There is, however, no evidence that the Nielson Entities had any legal obligation to apply funds available to one entity for the benefit of another entity.

[398] Tr. at 1321 (Calcutt).

[399] *Id.*

[400] *Id.* at 1322 (Calcutt); EC Ex. 28.

[401] Tr. at 1323-24 (Calcutt); EC Ex. 28 at 1.

Mr. Calcutt in what Mr. Calcutt described as a "very unusual meeting":

> We talked just broadly because I hadn't seen him in years, about the economy and the market and their businesses and their success and, and then I asked him point blank, you know, "Will you help us resolve this situation going forward?" And what I'll never forget about this meeting is he turned his back on me and he walked up to a board and he said "We intend to pay you in full. But after we buy some more businesses." And I was just, I was dumbfounded. And I was polite, but that was pretty much the end of the meeting because I was just shocked that "That's not why I'm here, Dale. I am here to try and resolve this."[402]

Mr. Calcutt testified that the solution the Bank reached after the loans were again delinquent in December 2010 involved the use of the Pillay Funds "which were used to bring the loans current".[403] Mr. Calcutt explained why this solution served the Bank's purposes:

> Well, the same thing we did with, with Bedrock and that is we were hopeful because this was a short-term solution, we were hopeful for a long-term solution and for the reasons I cited earlier with Bedrock. But it also corrected obviously a delinquency that would have been reflected in the Board Reports and that everybody was aware of because the loans had gone delinquent.[404]

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[402] Tr. at 1324 (Calcutt).

[403] *Id.*

[404] *Id.* at 1325 (Calcutt).

Mr. Calcutt confirmed that the meeting minutes for the Board's December 17, 2010 meeting included this entry: "The Board was advised that the renewals for the various matured Nielson related loans would be completed shortly. This action will eliminate the temporary increase of the delinquency ratio and provide benefit to net interest income for December."[405] The minutes, however, are silent with respect to the fact that the loan proceeds and released collateral had already been paid out and would be the basis for bringing the renewed loans current.

Also in these minutes is an entry by which the Board approved the renewals of eleven Nielson Entities, including Bedrock.[406] Although the minutes are silent with respect to any details of the approval process that involved the release of the Pillay Collateral, Mr. Calcutt testified that he was "confident it was discussed" – based on his belief that "I shared information with the Board consistently. Every month we shared plenty of information with the Board. And obviously the spike in delinquencies would have been worthy of addressing."[407] Again, although no mention of this is found in the minutes, Mr. Calcutt was confident that the Board also discussed how the spike in delinquencies occurred and how they were being cured.[408] Preponderant evidence does not,

[405] *Id.* at 1327 (Calcutt); Resp. Ex. 58 at 2.

[406] Tr. at 1327-28 (Calcutt); Resp. Ex. 58 at 4.

[407] Tr. at 1328 (Calcutt). See also testimony of Mr. Jackson: "I recall at some point I asked Mr. Green, 'We did receive Board approval for this loan, is that correct?' And I don't recall his response, but I did question whether or not we had received it." Tr. (2015) 1612 (Jackson).

[408] Tr. at 1329 (Calcutt).

however, support Mr. Calcutt's testimony in this regard.

Mr. Calcutt described a similar meeting, this time with Cori Nielson, held at the Bank in early 2011, in which, according to Mr. Calcutt, "Cori Nielson threatened me. Threatened to destroy me."[409] It is not clear what weight Mr. Calcutt actually gave to this position, as he testified he found the threat to be "unbelievable".[410] According to Mr. Calcutt, his brother Bill regarded the Bank's negotiating position to include its use of "a 'club' to encourage [the Nielsons] to come to some resolution here."[411] The "club," according to Scrub Calcutt, was to cajole the Nielson managers "into the renewal of loans by informing them that pressure would be brought to bear by Northwestern's regulators if their loans became non-performing which would result in Northwestern having to play 'hardball'."[412]

Elaborating on this "tactic," Scrub Calcutt testified: "From time to time we had used the regulators as a – as you would call it – a 'club' to encourage them to come to some resolution here. So I could use another word, but yes; we were using them as a club. A hammer."[413] Part of this strategy, according to Mr. Calcutt, was to identify "red flags" and use these as a way to say no to Ms. Nielson if there were things she wanted to do "that just couldn't

[409] *Id.*

[410] *Id.*

[411] *Id.*; Resp. Ex. 69.

[412] Tr. at 1325 (Calcutt); Resp. Ex. 69; Tr. at 1156, 1178 (W. Calcutt).

[413] Tr. at 1331 (Calcutt).

be done," as "[t]hey wouldn't be acceptable to us or potentially the regulators" if the Bank did things her way.[414]

Mr. Calcutt denied, however, any suggestion that he was actually concerned about increased regulator scrutiny over the Nielson loans – because "the regulators were well aware of all of these loans. They had access to them. They were reviewing them every year, not to mention that they had access to all of our information in the Bank, so no. I was not concerned about that at all."[415] Given the record before me, little weight is given Mr. Calcutt's claim that the regulators were between "well aware of" the true nature of the Nielson Entities loans.

When Mr. Smith, the Bank's Director of Global Risk, reviewed the proposal to use the Pillay Trading Units as collateral, he was concerned about "whether or not we could perfect our interest in those units."[416] At the time, in 2011 when he was writing his report, Mr. Smith was not aware there were questions about the perfection of the Bank's interests, and stated that had he known this, he would have responded differently when preparing his response to the Bank's Examiners during the 2011 exam.[417]

Mr. Smith testified that once he became aware of the problems with using the Pillay Units in this way, he knew that it "wouldn't be used as collateral, so additional losses, they couldn't be used to offset additional losses or the losses that the Examiners had contended."[418] As a result,

[414] *Id.* at 1331-32 (Calcutt).

[415] *Id.* at 1332 (Calcutt).

[416] *Id.* at 413 (Smith).

[417] *Id.*

[418] *Id.* at 413-14 (Smith); Resp. Ex. 168.

Mr. Smith opined, "there would be additional losses that would need to be recorded and . . . it would impact the impairment calculations because there would be additional losses because you couldn't use the collateral."[419] Stated another way, from what he learned about the Pillay Trading Units, after comparing "your loan balance to the collateral value," "if you have less collateral here in this instance, the Pillay Trading Units, it would be a higher loss because you have less collateral to offset the loan balance."[420]

O. Bank Management's Misrepresentation of the Condition of the Nielson Entities

Ms. Berden provided insight into potential discrepancies between the condition of the Nielson Entities as described in correspondence between the Bank and its regulators, and as actually existed during the time relevant to this enforcement proceeding. Writing on behalf of the Bank, Executive Vice President Richard Jackson addressed a letter to the state regulator – Michigan's Office of Financial and Insurance Regulation, with a copy to the FDIC, dated November 14, 2009.[421] In it, Mr. Jackson

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[419] Tr. at 414 (Smith).

[420] *Id.*

[421] Joint Ex. 3. See also testimony of Ms. Miessner regarding information presented by the Bank at page 2, Mr. Jackson's November 14, 2009 letter to Mr. Thielsen of the Michigan OFIR and the FDIC's Chicago Regional Office: that the information was not accurate where it "indicated that there were no problems with the relationship, you know; through the statement that the loan was performing, that would indicate to me that all the loans were current and that they were paying, paying in the way that their contractual terms were laid out." Tr. at 738 (Miessner). "At the time that letter was written, the majority of the loans within the Waypoint Nielson management relationship were 74 days past due." Tr. at 739 (Miessner). See also testimony of

wrote that the Bank's Board of Directors had reviewed and discussed the April 13, 2009 Report of Examination, and offered responsive information – including information about the status of the Nielson Entity loans.[422]

According to Mr. Jackson:

> [The 2009 Report of Examination] would cover several different areas of the Bank which I might have a high-level knowledge of but not a working detail of. And if there were items contained within the Report of Examination that I did not have intimate knowledge of, I would go to the various department heads within the Bank that did have responsibility for the area being addressed and I would say "I have to respond to the Examination. Please help me come up with a response."[423]

Mr. Jackson opined that a loan that showed nonpayment for "90 days or less" would nevertheless be considered a "performing loan".[424] He added that by January 2010, there would not have been any discussion within the Classified Assets Committee regarding the classification of the Nielson Loans.[425]

With respect to the issue of whether the Bank had

Mr. Jackson, stating that "most likely" Mr. Calcutt reviewed the letter. Tr. (2015) at 1683 (Jackson).

[422] Joint Ex. 3 at 2-3. Mr. Jackson became vice president of administration at the Bank in 1980; and Executive Vice

President in the 1990s. Tr. (2015) at 1590 (Jackson).

[423] Tr. (2015) at 1616 (Jackson).

[424] *Id.*

[425] *Id.* at 1620-21 (Jackson).

reason to question whether the Nielson borrowers had in 2009 raised any issue concerning their ability or intention to service these debts, the FDIC's Case Manager Ms. Miessner testified:

> [W]e know now that the borrowers had notified the Bank in writing in August of 2009 that they did not intend to continue making payments beginning with their September 1, 2009 payment. We know that they had asserted that many of their properties were underwater, that they no longer had equity in them and didn't want to keep them and had offered deeds in lieu of foreclosure and requested significant restructure on the loans on properties that they intended to keep.[426]

Ms. Miessner noted that in his letter, Mr. Jackson identified two kinds of performing loans – one kind was performing "as agreed," and the other was just identified as a performing loan.[427] In Mr. Jackson's November 14, 2009 letter, the status of loans to non-Nielson entities – including, for example, the Bay Meadows Development relationship – was described as "performing as agreed," whereas the Nielson Entity loan status was reported as simply "performing".[428] Ms. Miessner testified that while she had not before now noticed this difference, she now regarded it as a "red flag," and that had Mr. Jackson used the same phrase for the Nielson loans as he used with Bay Meadows, that response would have been patently false.[429]

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[426] Tr. at 740 (Miessner).

[427] *Id.* at 883-84 (Miessner); Joint Ex. 3 at 2.

[428] Joint Ex. 3 at 2.

[429] Tr. at 885 (Miessner).

Asked in particular about the Immanuel LLC loan, Ms. Berden testified that "loan payments were not made starting September 1st until this restructuring plan was in place in December," and that the only payments that would have been made were those made available after the release of the Pillay Funds and the Bedrock Loan proceeds.[430]

As noted above, the November 14, 2009 letter was signed not by Mr. Calcutt, but by the Bank's Executive Vice President, Mr. Jackson.[431] When asked if she knew whether Mr. Calcutt reviewed the letter, Ms. Miessner testified thus:

> Mr. Jackson was the executive vice president as well as the Board secretary, and as far as everything that we know is that nothing happened at that bank if Scrub didn't know about it. So while I don't know specifically and while I don't have exact personal knowledge of Scrub reviewing this document, given what I know about the Bank, it would be reasonable to expect that Mr. Jackson would have never sent a letter to the FDIC without Mr. Calcutt seeing it and knowing what was being communicated on behalf of his bank.[432]

From the record, I find preponderant evidence establishes that Mr. Calcutt was fully aware of the contents of Mr. Jackson's November 14, 2009 letter, and approved the

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[430] *Id.* at 102-03 (Berden). See also Tr. at 792-94 (Miessner); EC Ex. 66, reflecting a summary of circumstances identified by Ms. Miessner as misrepresentations regarding the Nielson loan portfolio attributed to Mr. Calcutt and other senior bank managers.

[431] Joint Ex. 3.

[432] Tr. at 845 (Miessner).

letter being sent to the FDIC.

Ms. Miessner also noted answers Mr. Calcutt provided in the Officer's Questionnaire at Question 1, in May 2010, regarding the Bank's extension of credit since the last FDIC examination, where he was asked whether any of those loans had been renewed or extended.[433] Ms. Miessner described as "inaccurate" Mr. Calcutt's responses to questions pertaining to the Bedrock Loan and the Nielson Entities, because upon being asked to disclose extensions of credit that were renewed "with acceptance of separate notes for the payment of interest," he failed to disclose that through the Bedrock transaction, loan proceeds were "used specifically to make interest payments on . . . all of the Entities' loans within that relationship."[434]

When asked to characterize his own facility for remembering facts and details of events pertaining to the Bank during the Great Recession (said to be from 2008 through 2011), Mr. Calcutt answered that "[g]iven the climate, the business climate, I would have been very tuned into that period of time and what was going on and, of course, once it passed and moved on to the future worrying about where the Bank was at that time in the future."[435] He also testified, however, that he does not

[433] *Id.* at 745 (Miessner); EC Ex. 18.

[434] Tr. at 745 (Miessner); EC Ex. 18 at 2. See also Ms. Miessner's testimony that "some of the $760,000 loan proceeds were made to make payments on the same $760,000 loan, so that would be 'with capitalization of interest to the balance of the note. So that would count on (c) as well." Tr. at 745-46 (Miessner).

[435] Tr. at 1262 (Calcutt). But see also Mr. Calcutt's testimony regarding his practice that affects his ability to recall the contents of email messages presented to him during the hearing: "My emails, I would

have a computer, but has an assistant with a computer, so that when emails are sent to him "she would alert me and then I would look at it sometimes over her shoulder and say 'this needs to go to so and so in the retail area because it relates to a retail customer.'"[436] He said he did not maintain a file with emails from the Nielson lending relationship, but would instead forward emails from the Nielsons to Mr. Green or others in senior management.[437] He also testified that had no contact with loan files, and was never involved in processing loans or answering emails.[438]

Further questions that Ms. Miessner found to be inaccurately answered in this May 2010 response by Mr. Calcutt included his answer to Question 3 (concerning extensions of credit that "directly benefit someone other than the person named in the Note") – where the Bank's records established that the "Bedrock Loan was made for the direct benefit of all of the entities within the Waypoint Management credit."[439]

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scan them to who should receive them and then I would have my assistant send them on so this [Resp. Ex. 17] is refreshing my memory; obviously I received the email but then forwarded it on to Bill Green and probably to others at the Bank." Tr. at 1281 (Calcutt).

[436] Tr. at 1312 (Calcutt).

[437] *Id.*

[438] *Id.* at 1312-13 (Calcutt). Given evidence in the record including emails sent by Mr. Calcutt to others, I attribute no weight to Mr. Calcutt's claim that he was never involved in the answering of emails.

[439] Tr. at 746 (Miessner); see also EC Ex. 10 at 2, Acknowledgement of Pledge dated 11/25/09 granting the Bank a security interest in $400,000 in Pillay Trading Units naming Bedrock Holdings LLC as the borrower, and testimony by Ms. Miessner that "For Question

A detailed account of false or misleading statements attributed to senior bank officers is included in the 2011 ROE.[440] Drawing from this ROE, and from the 2010 ROE[441] a Visitation Report dated March 2, 2011 (based on an examination that began on February 22, 2011 reporting on conditions as of December 31, 2010),[442] and discussions between Examiners and Respondent and other Bank officers and employees held on September 14, 2011,[443] FDIC and Michigan Examiners found the following categories of misconduct attributed to Mr. Calcutt, Mr. Green, and Mr. Jackson:

A. Routing of Funds to Aid Concealment[444]

B. Missing Loan Documentation[445]

C. Office File Memoranda[446]

D. False Call Reports[447]

Number 3 to have been answered accurately, it would have said something along the lines of "A loan was made to Bedrock Holdings LLC, for the benefit of . . .", and then it would list the rest of the Waypoint Management and Nielson-related entities that received payments on their loans through the Bedrock Loan proceeds." Tr. at 748 (Miessner).

[440] EC Ex. 48 at 40.

[441] (Start date: 6/7/10; As of Date: 3/31/10).

[442] EC Ex. 38.

[443] Joint Ex. 11.

[444] Notice of Intention to Remove from Office and Prohibit from Further Participation, Notice of Assessment of Civil Money Penalties, Findings of Fact, Conclusions of Law, Order to Pay, and Notice of Hearing at ¶¶55-61.

[445] *Id.* at ¶¶62-65.

[446] *Id.* at ¶¶66-70.

[447] *Id.* at ¶¶71-73.

E. False Representations in November 2009 Letter to Bank's Regulators[448]

F. Officer's Questionnaires[449]

G. Temporary Sale of Nielson Loans[450]

H. Nielson Loans Excluded from External Loan Review[451]

I. Management's Response to August 2011 Examination[452]

J. Other Communication with Examiners[453]

Beyond these claims of concealment, Examiners also concluded Mr. Calcutt (and his subordinates) failed to follow Bank policy regarding obtaining loan approvals from the Bank's Board of Directors.[454]

P. Bank Management's Misrepresentations Presented in the Commitment Review for the 2009 Bedrock Loan

1. Misrepresentation Regarding "Working Capital" in the Bedrock Loan

As described in the Bank's Commitment Review for the Bedrock Loan, the purpose of the new $760,000 loan was to "[p]rovide for working capital requirements" for

[448] *Id.* at ¶¶74-78.

[449] *Id.* at ¶¶79-80.

[450] *Id.* at ¶¶81-88.

[451] *Id.* at ¶¶89-90.

[452] *Id.* at ¶¶91-92.

[453] *Id.* at ¶¶93-107.

[454] *Id.* at ¶¶27-38.

Bedrock Holdings LLC.[455] Bedrock Holdings LLC was owned by three trusts: Dana Nielson Perpetual Alaska Trust, Cori Nielson Perpetual Alaska Trust, and Keith Nielson Perpetual Alaska Trust.[456] Cash flow for Bedrock Holdings was supposed to be provided by Team Services, but, as Ms. Berden recounted, "Team Services [was] having a bad year in 2009," realizing only an actual net negative cash flow.[457]

Understanding that "working capital" means, generally, "your liquid assets, your cash, your receivables, net of your payables," Ms. Berden testified that while a "small portion of" the loan proceeds were intended for Bedrock's working capital, the "majority of the funds were disbursed out to other entities for their working capital."[458]

For his part, when asked whether he believed that "working capital" adequately described what the proceeds of the loan were to be used for, Mr. Calcutt equivocated, responding "Yes and no. They may have captured a portion of it, but no. I also say no, it did not capture the entire, didn't describe it entirely."[459]

James Gomez served as the FDIC's Examiner in Charge for the 2011 examination conducted jointly by the FDIC and Michigan Office of Financial and Insurance Services.[460] Through his testimony, Mr. Gomez identified

[455] Joint Ex. 6 at 1.

[456] Tr. at 110 (Berden).

[457] *Id.*

[458] *Id.* at 104. (Berden).

[459] *Id.* at 1307 (Calcutt).

[460] Without objection, Mr. Gomez qualified and testified as an expert witness – specifically, as a banking examination and supervision expert witness on the subjects of bank examination, prudent banking

features of the 2011 examination that gave rise to the charges now pending against Respondent.

In the 2011 ROE, Examiners stated that with the exception of Generations Development, on November 30, 2009, the majority of the 35 loans to the 20 Nielson Entities had reached 90 days past due and were placed on nonaccrual status.[461] This was notable in part because only 16 days earlier, Mr. Jackson signed a letter to the state regulators reporting that all of the Nielson loans cited in the Bank's formal response to the April 2009 Report were either "performing" loans or were in "renewal in process" status.[462] It was also notable because on November 30, 2009, at the request of Mr. Calcutt and Mr. Green, the Bank released $600,000 in collateral assets held by Pillay Trading LLC, and at that point "the funds were broken down into numerous denominations and moved in 61 separate transactions before being applied to the agreed upon loan accounts."[463]

The Nielson loans were placed back on accrual on December 1, 2009 because the Bank "recognized all previously reversed interest as income."[464] Two days later a new note was executed and on December 14, 2009, the Bank disbursed proceeds of the new $760,000 loan to one

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practices, including loan underwriting practices, standards of care and duties of directors to FDIC-insured financial institutions, FDIC supervisory and enforcement matters and actions. Tr. at 218 (Gomez). Credentials supporting this designation are set forth in the transcript of proceedings. Tr. at 187-219.

[461] EC Ex. 48 at 40.

[462] *Id.*

[463] *Id.*

[464] *Id.*

of the Nielson Entities, Bedrock Holdings LLC.[465]

The 2011 ROE then reports the following:

> Again, upon the request of Loan Officer Green and President and CEO Calcutt, with the knowledge of EVP Jackson, the funds were broken down into numerous denominations and moved in 54 separate transactions to place the funds in deposit accounts set up specifically for the purpose of funding monthly payments on all 36 loans. The Bedrock proceeds were first used to pay the December 1, 2009 payments with the remainder funding monthly payments through April 1, 2010.[466]

Mr. Gomez described this set of transactions as a straw loan – i.e., a loan "made to a borrower that's not used for the intended purpose or stated purpose."[467] The regulatory concerns about the Bedrock Loan include the inability for regulators to determine what the source of the loan's repayment will be (i.e., "if it's not an income-

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[465] *Id.*

[466] *Id.* at 41.

[467] Tr. at 270 (Gomez). See also testimony of FDIC Examiner O'Neill, when asked whether "working capital" includes the use of loan proceeds to make payments to other non-borrowing entities, after answering that it does not include such use, Mr. O'Neill stated "That would be a classic case of diversion. If you state one purpose on a loan proposal to the Board and then use it for an entirely different purpose . . . in that case, bringing other loans current or keeping them current . . . we actually review for that. It's to avoid the case of a shell game, essentially . . . if there's multiple entities involved and one loan is given to one entity, to then turn around and bring a whole slew of loans current, it's essentially a concealment effort," one that conceals "the true source of the payments." Tr. (2015) at 44 (O'Neill).

generating property to begin with and there is no inventory, there's no apparent way this loan is going to get repaid").[468]

This was true, in Mr. Gomez's opinion, notwithstanding that one of the Bedrock holdings was Team Services, an oil and gas services company that Ms. Berden described as "poised for an excellent 2010," which she said would, in turn, help with Bedrock's cash flow.[469] Presented with this report, Mr. Gomez responded that he could not confirm whether in fact Team Services could contribute to Bedrock's cash flow, stating "I'd like to see the proof. I mean, people can write things all the time."[470]

Along these same lines, FDIC Case Manager Ms. Miessner testified that based on her review of examination records leading up to the 2011 examination, she had specific questions about whether weaknesses relating to the Waypoint/Nielson Entities loans had been cleared up.[471] She testified that "previous Examinations had stated that management was allowing the Waypoint group, the Nielson group, to do equity pulls," which she stated "is where a borrower is allowed to take equity out of a property in the form of a loan and then do something with the proceeds that's other than what's stated in the purpose of the loan."[472]

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[468] Tr. at 271 (Gomez).

[469] *Id.* at 307 (Gomez); Resp. Ex. 48.

[470] Tr. at 309 (Gomez).

[471] *Id.* at 768 (Miessner); EC Ex. 25 at 2.

[472] Tr. at 768-69 (Miessner). See also testimony by Examiner Bird: an equity pull is "a situation where a borrower is adding additional leverage to a financial transaction to extract cash out of that financial transaction. . . . You would be adding debt to a transaction. That's

In addition to the work of Case Manager Ms. Miessner and EIC Gomez, as the FDIC Examiner charged with reviewing the Nielson Loan portfolio for the 2011 examination, Mr. O'Neill also participated in the 2011 exam. Mr. O'Neill explained that the distribution of proceeds from the Bedrock Loan to multiple Nielson Entities concealed the true source of the payments that brought those loans current, threatening the "integrity of the records."[473]

> If they had wanted to conceal that information because the true extent of the problems were worse for the borrowing entity itself did not have the cash flow or means to bring those payments in, bank giving out new funds of its own to then turn around and bring those loans current, there is a potential risk that we examine for is whether or not there is good money following bad.[474]

Mr. Gomez agreed with the premise that there is no regulation or other law that, to Mr. Gomez's knowledge, prohibits a bank from making a loan to pay principal and

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adding leverage, and the proceeds would go back out to the borrower. So you would add to your outstanding loans payable to the bank. And typically when you'll see an equity pull, it will be done with the same collateral and so your loan-to-value would be higher. Just signed as a cash-out kind of transaction." Tr. (2015) at 872 (Bird). When asked if Mr. Bird had seen this happen during the 2010 exam, he said no, because "I did not have the full characteristics of the Bedrock transaction." Tr. (2015) at 873 (Bird). Knowing now that the Bedrock transaction included the $760,000 loan and $600,000 Pillay transactions, Mr. Bird stated this would be an equity pull loan. Tr. (2015) at 873-74 (Bird).

[473] Tr. (2015) at 45 (O'Neill).

[474] *Id.*

interest payments for a few months while the borrower is then going to pick up the payments after those months.[475] Here, however, the outcome is different because of the way the Bedrock Loan was described – "the way the transaction was made had not [been] disclosed," and thus "tells a different story."[476]

As Mr. Gomez explained, while the loan document that Mr. Calcutt signed approving the Bedrock Loan indicated the purpose of the $760,000 loan was for "working capital," "we [know] now" that the purpose was to pay interest and principal on the Nielson Loans.[477]

Testimony from Bank board members persuasively established that neither Mr. Calcutt nor any other senior bank manager disclosed to the Bank's Board the true purpose of the Bedrock Loan. Former Board Members Bruce Byl and Ronald Swanson recalled approving the Bedrock Loan after reviewing the application for the loan in March

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[475] Tr. at 303 (Gomez).

[476] *Id.* at 304 (Gomez).

[477] *Id.* at 306 (Gomez); Joint Ex. 6 at 1. EC Ex. 133 is an FDIC-created illustration showing the November 2009 Bedrock Transaction Disbursement, including funds flowing from the Pillay collateral release and the new $760,000 Bedrock Loan. See also Testimony of FDIC Examiner O'Neill: working capital "generally [is] for purposes of, it could be seasonal or in some cases it's ongoing if a business has accounts receivable or inventory being financed, that's the classic accounts receivable financing." It does not, however, include the use of loan proceeds to make payments to other non-borrowing entities. Tr. (2015) at 43-45 (O'Neill). See also testimony by Examiner Bird, describing working capital as funds to be distributed only to Bedrock LLC, and would be used only for Bedrock's general business purposes, not used by any other entity – because "this request is discussing working capital for the Borrowing Entity." Tr. (2015) at 778 (Bird).

2010.[478]

Bruce Byl served on the Bank's Board from 2006 to 2012, having first served the Bank as a consultant, helping the Bank work on real estate projects.[479] Mr. Calcutt testified that Mr. Byl was on the board because Mr. Calcutt was a family member, and "I thought that the family should be represented other than [by] myself on the Board."[480] Mr. Byl testified that Mr. Calcutt had in the past sought out Mr. Byl to work on "opportunities he saw that he wanted more research done on, problem facilities that he needed to have resolved."[481] He testified that Mr. Calcutt ran the Board meetings as "the quarterback of that team."[482] He acknowledged that now he has no personal relationship with Mr. Calcutt, and that it has been many years since the two talked.[483]

Asked to describe Mr. Calcutt's style in running those meetings, Mr. Byl testified:

> Very business-like. He was professional. He, he would listen to, you know, our comments, our thoughts. I found him to be fair, honest, you know, a, a, a, a good person to be on the Board of. I thought he was doing the right things; and again

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[478] Tr. at 456, 484 (Swanson).

[479] *Id.* at 901, 908 (Byl).

[480] *Id.* at 1272 (Calcutt). Mr. Calcutt also testified that Mr. Byl is no longer on the Board and that he no longer has a relationship with Mr. Byl "because we discovered he embezzled over a quarter million dollars from the Bank, and he betrayed confidences of the Board." Tr. at 1272 (Calcutt).

[481] Tr. at 902 (Byl).

[482] *Id.* at 906 (Byl).

[483] *Id.* at 1045 (Byl).

> not having any prior bank board experience, I didn't have anything to compare it to, so I, I felt it was functioning well. I mean there were some things that I would have personally liked to see change but it wasn't my meeting.[484]

When asked whether Mr. Byl ever got the impression that Mr. Calcutt perceived questions by Board members to be a question of his authority, Mr. Byl responded, yes, explaining: "Well, Scrub was the brightest guy in the room, and it was hard to, hard to approach him or challenge him on something that you thought you might have a better, better knowledge of, better angle of, more information about. So I didn't very often."[485]

For his part, Mr. Calcutt testified that there was open discussion at board meetings, and denied that he tried to curtail any inquiry by any board member.[486]

He testified the meetings were conducted as follows:

> We had monthly board meetings, and before the board meeting there would be detailed materials sent out to each of the directors for a review before the meeting. And then quarterly we will embellish the monthly reporting with additional documents and so they had time to study them and bring them to the board meeting and discuss them. And obviously the CFO was at every board meeting to help discuss and address questions.[487]

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[484] *Id.* at 907 (Byl).

[485] *Id.* at 908 (Byl).

[486] *Id.* at 1271 (Calcutt).

[487] *Id.*

Although he testified that he knew of no instance where Mr. Calcutt expressed an intention to withhold information from the Bank's examiners, Mr. Byl said Mr. Calcutt had expressed some animosity about what he saw as overreaching by the examiners, telling Mr. Byl that "'This isn't a normal bank. We want to do some other things that are going to generate revenue outside of a normal bank,' and he was very frustrated that he was being challenged with those ideas and those thoughts and that direction."[488]

Mr. Byl testified that in preparing for Board meetings, if he had questions about loan applications, he would present the questions to whoever the loan officer was; and thereafter "you would form your own decision and you would email back what you thought, whether you were for or against" the proposed loan.[489] Although Mr. Calcutt testified that "[t]he directors had open access to anybody at the Bank anytime,"490[490] Mr. Bly testified that he contacted only two loan officers Scott Ashcroft and Dan Druskovich – but never Mr. Green, whom he described as "very elusive . . . you just never saw him."[491]

Board Member Swanson testified that upon reviewing the Bedrock application, he understood the purpose of the loan was to provide Bedrock LLC with working capital, which he understood would not include supporting vacant land, but would instead be "funds available to the business in their operation," in "a business that has accounts receivable and . . . accounts payable, and typically

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[488] *Id.* at 909-10 (Byl).

[489] *Id.* at 911 (Byl).

[490] *Id.* at 1291 (Calcutt).

[491] *Id.* at 912 (Byl).

their current asset liquidation is not timed right with when their payables are do, and so this is to take the peaks and valleys out of the flow of funds".[492]

Also in his review of the application, Mr. Swanson understood that there would be a release of $600,000 in the Bank's collateral interest in Pillay Trading Funds – although he stated he could not tell how the released funds were to be used.[493] Indeed, he testified that there was nothing in the loan application that would have indicated either the loan proceeds or the released collateral would be used for the benefit of any entity other than Bedrock Holdings LLC.[494]

Mr. Swanson also testified that he was not aware that at the time he and other Board members approved the loan the loan had in fact already closed, the $760,000 had been funded, and the Pillay collateral had been released.[495] Had this been brought to his attention, Mr.

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[492] *Id.* at 485, 549-50 (Swanson). See also testimony of Board Member Byl, who stated that while he did not recall reviewing the Bedrock Loan application, he believes he must have done so, because his initials are on the document and "typically something, a million dollars or in the million dollar area, I'm guessing those were forwarded to us for review and approval." Tr. at 915-16 (Byl); Resp. Ex. 36.5 (3/25/10 email from Byl to Hollands et al. re Bedrock Holdings and Generations Devl. "Both have been reviewed and approved."

[493] *Id.* at 486 (Swanson).

[494] *Id.* See also Examiner O'Neill's testimony, agreeing with the premise that a board member could be expected – upon seeing that $600,000 of Pillay collateral had been released by the Bank – to ask "Why are we releasing these funds," responded further that "the first one I would expect to ask would be Mr. Calcutt, who is also on this document as signing his initials, but I would expect the other board members as well to ask that question." Tr. (2015) at 643 (O'Neill).

[495] Tr. at 486-87 (Swanson).

Swanson stated he would have "contacted management and asked them why we were just seeing that loan now."[496] Elaborating, Mr. Swanson testified: "It would appear to me that the Term/Maturity column there [*i.e.* in the Bedrock Loan Commitment Review documentation] is not correct, that the loan should not have been funded or available for funding until the Board had approved it, which would have been March, so the nine-month number is not correct."[497]

Further, Mr. Swanson testified that he could recall no mention of the Bedrock Loan in any of the Board's meeting minutes for the last quarter of 2009.[498] He testified that although members of the Board were informed when the Nielson Entities first stopped paying on their credits,

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[496] *Id.* at 487 (Swanson).

[497] *Id.* at 533-34 (Swanson). See also testimony of Examiner O'Neill regarding the contents of the Commitment Review, noting "the extent of exposure that was created by granting the new loan and then compar[ing] it . . . to the state law requirement that there's a threshold upon which the full board has to vote on it and at least two-thirds of that Board has to vote in favor of it in order to comply. And then . . . the fact that although it's described to the Board of Directors as a new loan, in fact the loan was closed and fully disbursed three months earlier. No attempt to ratify. And then once again the concerns with working capital when in fact the purpose was to keep existing loans current." Tr. (2015) at 594-95 (O'Neill). When asked, given that the Review's report that this is a nine-month loan with a maturity of September 1, 2010, whether that disclosed the loan had been extended in 2009, Mr. O'Neill testified that this "doesn't tell me when the funds were already disbursed, sir. It simply says it's new and that this is the maturity date." The citation here is due to the fact that the loan proceeds were disbursed prior to receiving Board approval. Tr. (2015) at 641-42 (O'Neill).

[498] Tr. at 489 (Swanson).

there is no mention of this in the Bedrock Loan application – that is, the application does not disclose that the borrower had not paid on its loans since September 2009.[499]

To much the same effect, Board member George Kausler sent an email to Sharon July, one of the Bank's credit analysts, dated March 29, 2010, in which he reported that he would approve the Bedrock Holdings Loan under these conditions: "I would approve the renewal of the existing LOC and its release of collateral. However, given the request for the new loan I recommend we retain the collateral until cash flow is proven, not pro forma."[500] This suggests without ambiguity that Board Member Kausler had not been told the proceeds of the loan had already been disbursed and the collateral released.

Mr. Swanson testified that he and other Board members had not been told during the Bedrock Loan Application presentation that the combined funds ($760,000 and $600,000) were to be distributed among *multiple* entities other than Bedrock LLC that were controlled by the Nielson family.[501] He testified to the same effect regarding the Commercial Loan Special Request that the Board approved in December 2010, by which the Bedrock Loan, which matured on September 1, 2010, was to be extended to January 20, 2011.[502] In that Request, there was no mention of collateral being released, and

[499] *Id.* at 490 (Swanson).

[500] *Id.* at 1413 (Calcutt); EC Ex. 16.

[501] Tr. at 490; 497-98 (Swanson).

[502] *Id.* at 495 (Swanson); EC Ex. 30.

nothing describing how such a release would be utilized.[503]

Similarly, Mr. Byl testified that when he was presented with the Bedrock loan for Board approval, he was not aware that the loan, being approved in March 2010, had already been closed by the Bank and the loan proceeds distributed.[504] Further, he testified that when this was presented for his approval, he did not know that a large group of loans, including loans shown in the loan application, had stopped paying as of September 1, 2009, nor was he aware that the released collateral described in the application was to be used to bring current that large loan relationship that had stopped paying in September 2009.[505] Further, when presented with a chart showing the interrelated Nielson entities, Mr. Byl testified that he was not aware that there was this interrelationship that owed the Bank $38 million, nor that the $760,000 loan proceeds would be distributed for use as a reserve for all of

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[503] Tr. at 496 (Swanson).

[504] *Id.* at 1023-25 (Byl).

[505] *Id.* at 1025 (Byl). See also Mr. Byl's testimony, when presented with the Report of Examination from 2008, wherein the examiners in 2008 identify the Waypoint Management Relationship as an interrelated borrower group – Mr. Byl testified that he was not aware of the relationship until the meeting with examiners after the 2011 examination. Tr. at 1049-50, 1052-53 (Byl); Joint Ex. 1 at 43; and to the same effect regarding borrower concentrations that were described in the 2009 State Examination but which Mr. Byl had no recollection of ever reading. Tr. at 1054-55 (Byl); Joint Ex. 2 at 20. Explaining his lack of understanding of or appreciation for the significance of the information contained in the Reports of Examinations, Mr. Byl testified that "I obviously didn't read the complete examination because there were no red flags in 2008 or 2009, I would have read through the summary and maybe a little bit further but that was all because to me there was no reason to continue on." Tr. at 1057 (Byl).

those separate entities' loans.[506] Equally significant, Mr. Byl testified that at no time before the Bedrock loan application was presented to him did anyone at the Bank ever discuss the Nielson loans at any of the board meetings he attended, or with him separately as a board member.[507]

Mr. Byl described a similar lack of understanding regarding the Commercial Loan Special Request dated December 20, 2010, which extended the maturity on the Bedrock loans.[508] He testified that the Request was presented during the December 21, 2010 board meeting – something Mr. Byl described as "very atypical."[509] He said Mr. Calcutt was at that board meeting, and that throughout the approval process, Mr. Byl was unaware that going forward with the Request would mean the release of collateral held by the Bank, nor that the Bank's $34 million relationship with the Nielson entities had stopped paying on their loans as of September 2010, nor that the proceeds of $689,000 in released collateral would be used for a variety of entities not party to the Bedrock renewal.[510]

[506] Tr. at 1026-27 (Byl); EC Ex. 133.

[507] Tr. at 1026-27 (Byl). Mr. Byl acknowledged receiving a December 3, 2010 email from Mr. Jackson stating that the Bank "sent a demand letter to the Nielson family yesterday," but testified that at the time he did not know what the Nielson loans were and that while he was "concerned on behalf of the Bank, [ ] I had no idea how large this relationship was or what impact it really would have on the Bank." Tr. at 1027-28 (Byl).

[508] Tr. at 1025 (Byl); EC Ex. 30.

[509] Tr. at 1029 (Byl).

[510] *Id.* at 1029-32 (Byl).

2. Evaluating the Merits of Conflicting Testimony Regarding When the Bedrock Loan was Approved

Upon my review of the record, I reject as not supported by credible evidence Mr. Calcutt's testimony that the Bedrock Loan had been approved in December 2009.[511] Mr. Calcutt testified that while the Commitment Review (Long Form) for the Bedrock Holdings LLC Loan wasn't signed until March 2010, this loan did not follow normal procedure – it "would have been an exception," but that since he "never had any involvement in the processing of any loan, including this loan," nor in the "closing of any loan or disbursing of any loan," he "can't recall" why this write-up was not prepared in December 2009: "I certainly was made aware of it but I can't recall the reasons."[512] He testified he did not read the Review prior to signing it, that he "wasn't paying attention" to whether the write-up accurately stated the terms of the loan, that he did not know the stated purpose of the loan, and that he approved it "because the loan had already been made and we were moving down the road."[513]

In this respect the competing claims call for a determination of whether the true nature of the Nielson Entities' relationship with the Bank was explained to Board members, and whether the Board approved the Bedrock Loan in December 2009, as testified to by Mr. Calcutt. Finding neither to be the case, I rely first on my review of contemporaneous records identified above, including the Board packages provided by the Bank to its

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[511] See Tr. at 1305 (Calcutt).

[512] *Id.*

[513] *Id.* at 1306-07 (Calcutt).

Board members for the October through December Board meetings, which are silent regarding both questions; and testimony from Bank staff indicating no one other than Mr. Green or Mr. Calcutt would be present to address these two questions; along with testimony from Board Members Byl and Swanson, to the effect that no discussion on these questions was held before March 2010. Documentary evidence supports this finding, whereas Mr. Calcutt offered conclusory testimony that is not supported by contemporaneous documentation.

Mr. Calcutt has raised a factual question – whether he discussed with fellow Board members the true nature of the Bedrock Loan prior to March 2010 – averring that he is sure he did, notwithstanding testimony to the contrary from his colleagues on the Board. In broad terms, once the record presents such a conflict, the core tests include corroboration, inherent believability, internal consistency and reliability of other parts of the evidence, clouded or clear recollection, and (in very limited circumstances) witness demeanor.

Here, Board minutes would have been the normal source for corroboration to support Mr. Calcutt's factual claim, but those minutes are silent with respect to the Bedrock Loan prior to March 2010. Inasmuch as Mr. Calcutt was actively participating in the key Board meetings and clearly was managing how the Bedrock loan was to be used, he had both the incentive and the opportunity to ensure these minutes reflected the true course of this transaction. Silence in this instance erodes Mr. Calcutt's credibility.

Next, I find the testimony from Board Members Byl and Swanson to be inherently believable, inasmuch as there was little or no evidence that suggested a motive to lie on their part, versus evidence in the record that Mr. Calcutt was repeatedly willing to testify in a way that deflected responsibility off of him and onto any subordinate he could point a finger at.

There was a lack of internal consistency, wholly attributable to Mr. Calcutt's testimony, where in one moment he acknowledges an active role as the Bank's principle negotiator with the Nielson family and in the next moment he has no role in responding to emails or reading Call Reports. Throughout the evidence-gathering part of this action, documentation and witness testimony other than that offered by Mr. Calcutt consistently showed that Mr. Calcutt and others under his supervision withheld this vital information from both the other members of the Board and the Bank's regulators. From the record as a whole, I found Mr. Calcutt's testimony on this point to be materially inconsistent and thus unreliable, where the same cannot be said of the testimony of Mr. Byl or Mr. Swanson.

Next, I found no evidence that recollections by either Mr. Byl or Mr. Swanson had been clouded by time – this may be due in part to the fact that both gave almost exactly the same sworn testimony in 2015, when events presumably were fairly fresh in their minds. In contrast, Mr. Calcutt testified he was not personally involved in writing up the Bedrock Loan application and cannot recall now why the application was funded before it was signed by the Bank's Board members. I found the recollection testimony of both Board members to be sufficiently clear and consistent that when they reported not being advised about the Nielson relationship and the Bedrock Loan, the testimony was credible and reliable.

Last, I found nothing remarkable in the demeanor of any of the witnesses in this enforcement action that would support or take away from reliance on their testimony. I did, however, find Mr. Calcutt evasive in response to some questions, notably regarding who would be presenting information to members of the Board during Board meetings; and found the responses of Mr. Byl and Mr. Swanson relatively free of traits that would lead one to question how candidly and thoroughly the witness was answering while on the stand.

3. Findings of Fact Regarding Respondent's Failure to Inform the Board Prior to Disbursing the Bedrock Loan Funds:

Upon these factors, I find preponderant and persuasive evidence exists that establishes that Mr. Calcutt did not secure Board approval of the Bedrock loan until March 2010, and obtained that approval without disclosing to members of the Board the true nature of the Nielson Entities' relationship with the Bank. His testimony to the effect that made these disclosures is in my view entitled to no weight.

a. Failure to Fully Disclose the Sources of Funding for Bedrock Loan Service

Another concern addressed by Mr. Gomez during the 2011 examination was that the loan's published purpose was to supply Bedrock Holdings LLC with working capital – but the proceeds were distributed to multiple Nielson Entity loans to keep those loans current.[514] This use does not establish a source for repayment of the Bedrock Loan,

[514] Tr. at 270 (Gomez).

adding to the risk of the loan.[515] As Ms. Gomez explained:

> Well, several of the entities, they were land loans. They weren't income-producing, [so] where is the cash flow going to come from? The cash flow will have to come from other Nielson Entities or the sale of land. And when you are lending in that type of situation and you are relying on other entities to repay a loan, you will - I'll go back to the lack of a global cash flow analysis: You don't know if any of those other entities can pay back and how, and you don't want to rely on the liquidation of collateral to sell your, to repay your loan. Now you're in a bad situation.[516]

Mr. Gomez explained that the loan documentation presented to the Bank's Board that supported the Bedrock Loan transaction identified new collateral taken in conjunction with the $760,000 loan.[517] The Commitment Review supporting the Bedrock Loan reflected two forms of collateral: a "Second [Real Estate Mortgage, or REM] on 121 acres located at 60 US-31 S, Traverse City MI" and a "First REM on a 1 acre lot on East Shore Road, Traverse City, MI, List Price $330M".[518] In Mr. Gomez's opinion, however, the Review relied upon an outdated collateral analysis, as the collateral's appraisal was over a year old.[519] Notwithstanding this, however, Mr. Gomez did not dispute that the LTV analysis the Bank presented

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[515] *Id.*

[516] *Id.* at 272 (Gomez).

[517] *Id.* at 311 (Gomez).

[518] *Id.* at 32-13 (Gomez); Joint Ex. 6 at 1.

[519] Tr. at 312 (Gomez).

to its examiners was not criticized in the 2010 ROE.[520]

Also of concern to the regulators, according to Mr. Gomez, was the fact that, from the outset and throughout the terms of the loans, the Bank did not secure personal guarantees in conjunction with the multiple Nielson Entities loans.[521] He testified that this is of particular concern in loans secured by land that is intended to be developed but has not yet been developed.[522]

Mr. Calcutt testified that the Bank acquired no personal guarantees from the Nielson Entities because when "the relationship came to us from a prior bank, there were no guarantees at the time. So there was a history of no guarantees."[523] He denied that the lack of a personal guaranty would be seen as an exception to the Bank's loan policy at the time the Bedrock loan was issue.[524]

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[520] *Id.* at 312-13 (Gomez). See also testimony of Examiner Bird, to the effect that he could not tell, by looking at the Commitment Review, the extent of the role Ian Hollands, rather than Mr. Green, played in preparing the form. Tr. (2015) at 894 (Bird); EC Ex. (2015) 20 at 15-21.

[521] Tr. at 273-74 (Gomez).

[522] See also testimony of Examiner O'Neill regarding the collateral of the Nielson Entities, when asked "They were secured loans, were they not?" Mr. O'Neill responded "They were very under-secured loans" and that the debt "proved to be remarkably short in terms of collateral and multiple of millions of dollars in losses in shortfall of that collateral." Tr. (2015) at 619 (O'Neill). See also testimony of Mr. Calcutt upon examining Mark Smith's October 25, 2011 email to James Gomez and Lisa Thompson regarding 6/30/11 Safety and Soundness Exam Open Issues, where Mr. Calcutt observed that "there were concerns from legal counsel about how well secured we were on those Pillay funds." Tr. at 1418 (Calcutt); Resp. Ex. 174 at 3.

[523] Tr. at 1275 (Calcutt).

[524] *Id.* at 1375 (Calcutt).

The Bank's loan policy does not, however, support Mr. Calcutt's testimony on this point, as it provides that loans lacking personal guarantees "are to be regarded as an exception to the institution's policy and must be treated accordingly as provided for under the loan approval authority section of this policy."[525] Mr. Calcutt's answer also directly contradicts the loan documentation – which expressly stated in the section headed "Exceptions to Normal Underwriting Guidelines" "No personal guarantees."[526] Elaborating on this answer, Mr. Calcutt testified that while not an exception, "it would have been unusual. It is not an exception in the sense that we did have other loans where there were no guarantees, but it was unusual, yes."[527] Accordingly, no weight is given to Mr. Calcutt's factual claim that loans lacking personal guarantees need not be regarded as exceptional at the Bank. His answer also calls into question whether Mr. Calcutt has been fully candid with this Tribunal.

Mr. Calcutt added that he did not believe guarantees would have improved the position of the Bank, although he offered no basis for this belief[528] – and from the record there is no apparent basis in fact, logic, or banking practice that gives credence to or support for this belief.[529] His testimony on this point materially calls into question whether Mr. Calcutt has the requisite skill and knowledge

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[525] Tr. at 1375-76 (Calcutt); EC Ex. 86 at 5.

[526] Joint Ex. 6 at 1.

[527] Tr. at 1375 (Calcutt).

[528] *Id.* at 1275 (Calcutt).

[529] See also testimony of Mr. Jackson, that without personal guarantees, the Bank had no legal recourse against Keith Nielson, Cori Nielson, Melvin Nielson, or Dal Nielson. Tr. (2015) at 1666 (Jackson).

to provide regulated banking services in any environment protected under the FDI Act.

Mr. Gomez acknowledged that the Entity Loans had been in place for several years, and could not say whether Examiners had ever criticized the Bank for not securing guarantees for these loans.[530] He also could not say whether the individual stand-alone LLCs had indicated at the outset of their relationships with the Bank that they would not offer personal guarantees.[531]

What was clear, however, was that for these loans, until the land is sold, there would be no source of income. Requiring personal guarantees on this kind of loan, Mr. Gomez explained, prevents the borrowers from walking away from the loan without any obligation to repay the loan.[532] A personal guaranty, he stated, "makes [the borrower] have some skin in the game."[533]

Related to this concern is the premise, as stated by Mr. Gomez, that if one of the Nielson Entities were to come into a windfall, the Bank would nonetheless not be able to collect from such windfall to make payments to satisfy any of the other debts.[534] Further, by servicing the multiple loans with proceeds from the Bedrock Loan, the need arises to determine the financial condition of each of the multiple accounts *receiving* these loan proceeds. That need was not met here, as the Bank did not call for anyone

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[530] Tr. at 290-91 (Gomez).

[531] *Id.* at 291-92 (Gomez).

[532] *Id.* at 273 (Gomez).

[533] *Id.*

[534] *Id.* at 273-74 (Gomez).

from either Bedrock or the other Nielson Entities to obtain current collateral values of the Nielson Entities prior to the Bedrock Loan disbursements to these Entities.[535]

According to Mr. Gomez, there were two problems in this respect: first, when new loan money was disbursed to the multiple accounts, if over a certain amount, there would be a need to "get an appraisal or at least [an] updated evaluation" related to the property.[536] Second, adverse economic conditions in force at the relevant time led, according to Mr. Gomez, to "big decreases, changes in the value of real estate" requiring updated collateral values.[537]

The Bank's Director of Global Risk, Mark Smith, confirmed the negative impact on appraised values between 2008 and 2011. Mr. Smith identified instances where examiners cited the Bank for apparent appraisal violations – for outdated appraisals at the time the Nielson Loans were renewed.[538] For example, one loan, benefitting AuSable LLC, had been renewed on December 22, 2010 but AuSable's most recent appraisal was in October 2007.[539] According to Mr. Smith, Examiners at this time required appraisals to be within one year of when the loan was renewed.[540]

Mr. Smith explained that in the process of the Bank's

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[535] EC Ex. 48 at 40.

[536] Tr. at 274 (Gomez).

[537] *Id.*

[538] *Id.* at 422 (Smith).

[539] *Id.*, citing EC Ex. 54 at 11-12.

[540] Tr. at 422 (Smith).

attempts to settle with the Nielson Entities, disputes between the Examiners and the Bank's officers arose regarding the FAS 114 analysis – i.e., the analysis required under Financial Accounting Standard (FAS) 114, that applies generally accepted accounting principles (GAAP) when calculating the Bank's reportable allowance for loan and lease losses (ALLL).[541] He identified a spreadsheet that reflected the FAS 114 analysis he received from the Bank's Examiners, showing the Examiners' analysis of the ALLL losses attributable to the Nielson Entities that would be realized under terms of a proposed settlement that the Bank had presented to the Nielsons, versus the estimated losses that the Bank itself had calculated.[542] He explained, however, that the Bank's estimated losses were based on "the most current appraisals that we had at the time," adding that, "[i]n general terms, a lot of [the Bank's appraisals] were outdated."[543]

That the appraisals were outdated is sufficiently established by the record. Mr. Smith identified, without contradiction, the Examiners' list of loans that had been renewed in December 2010 using appraisals of the Entities' assets dating back to 2001 through early 2008,[544] under conditions where the Examiners called for appraisals that were no older than one year prior to the loan renewal.[545] The Bedrock Loan, for example, was renewed

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[541] *Id.* at 419 (Smith).

[542] Tr. at 417 (Smith); EC Ex. 75.

[543] Tr. at 418 (Smith).

[544] *Id.* at 421-22(Smith); EC Ex. 54 at 11-12.

[545] Tr. at 422 (Smith).

on December 22, 2010 based on appraisals from November 2007 and October 2008.[546] Examiners further noted that there had been no appraisal at all for one of the Bedrock properties (the one-acre lot identified as collateral for the loan).[547]

The resulting dispute between the Examiners' analysis and the analysis advanced by the Bank reflected the Examiners' determination that the losses related to the Nielson Entities amounted to $7.3 million, whereas the Bank contended the ALLL would be only $3.8 million – a difference of $3.5 million.[548] The stale appraisals were of concern, according to Mr. Smith, because at the time, "real estate values were declining, so data appraisals would have made the real estate values higher than they should have been; and when we ultimately obtained current appraisals, I believe in early 2012, the values had decreased quite a bit from these 2007 and 2008 appraisals."[549] Mr. Calcutt, however, considered the $3.5 million difference "absolutely unwarranted."[550]

Mr. Gomez testified that Examiners expected the Bank to take appropriate measures to assess the level of risk associated with the Nielson Entities loan portfolio: the Bank needed to secure and should have secured from the borrowers financial statements for the companies, as

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[546] *Id.*; EC Ex. 54 at 11.

[547] Tr. at 422 (Smith); EC Ex. 54 at 11.

[548] Tr. at 421 (Smith); EC Ex. 54 at 14. See also testimony from Examiner O'Neill regarding the Bank's "global settlement offer with the Nielsons" that ultimately fell through. Tr. (2015) at 743 (O'Neill); Resp. Ex. (2015) 159.

[549] Tr. at 423 (Smith).

[550] *Id.* at 1337 (Calcutt).

well as updated collateral analyses.[551]

This perspective did not vary when Mr. Gomez was presented with the proposition, on cross examination, that $760,000 was roughly one-tenth of one percent of the Bank's overall loan portfolio at that time.[552] Mr. Gomez expressed the concern that the proceeds of the Bedrock Loan "were used to impact 47 percent of capital of the Bank,"[553] referring to the total Nielson Entities Loan portfolio that benefitted from the Bedrock Loan. Even if $760,000 was modest in relation to the Bank's overall loan portfolio, when the Bedrock Loan "impacts so many others," he could not view the loan "all by itself."[554]

Mr. Gomez testified that this was particularly true given that by September 2009 the borrowers (through both Ms. Berden and Cori Nielson) had expressed their intention *not* to pay back the amounts due on their loans.[555] At the very minimum, Mr. Gomez opined, once the borrowers made that position known in September 2009, the portfolio of loans needed, at a minimum, to be graded as substandard, and the Bank needed to be prepared to take back the collateral associated with the

[551] *Id.* at 278 (Gomez).

[552] *Id.* at 310 (Gomez).

[553] *Id.*

[554] *Id.* at 310-11 (Gomez). See also EC Ex. 79 (Call Report Restatements Proposed by the Bank through December 31, 2011); and testimony of Ms. Miessner: "The Nielson credits represented approximately 50 percent of the Bank's capital. And so 50 percent of the Bank's capital in loans would indicate a significantly higher risk profile."

[555] Tr. at 277 (Gomez).

various Nielson Entities, do an assessment of that collateral, and then write off any shortfall.[556]

Mr. Gomez agreed that when dealing with a difficult or declining real estate market, or a recession, banks can give concessions, but only upon the borrower demonstrating both the "ability and willingness" to pay.[557] Preponderant evidence in the record establishes that by September 2009, Mr. Calcutt was on notice that the Nielson Entities' ability and willingness to pay had been called into question in a manner that was material to Mr. Calcutt's fiduciary obligations to the Bank.

b. Material Misrepresentations in Respondent's Responses to Questions Presented to the Bank's Officers in September 2011

As noted above, discussions between Examiners and Mr. Calcutt and other Bank officers and employees led to Examiner determinations that Mr. Calcutt had not been fully candid during a meeting held on September 14, 2011. That meeting followed a meeting Lisa Thompson, Michigan's lead examiner, had with Mr. Calcutt on September 7, 2011 (which is memorialized in an email Ms. Thompson sent to Gary Thielsen later that day).[558]

During the September 7, 2011 meeting, Ms. Thompson discussed directly with Mr. Calcutt her concerns about the Nielson loans – noting that the Bank had not yet

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[556] *Id.*

[557] *Id.* at 278 (Gomez).

[558] Resp. Ex. 100.1. See also testimony of Examiner O'Neill regarding the process the examiners followed when reducing their hand-written notes about the September 14, 2011 meeting. Tr. (2015) at 718-22 (O'Neill); Resp. Ex. 105

put those loans on a non-accrual basis based on "a judgment call" by the Bank's management that the Nielsons have had a "20-year relationship" with the Bank, that the Nielson family has "substantial resources," and that – according to Scrub Calcutt – "we would get paid and on we would go."[559] There is in the record substantial reliable evidence that through Ms. Thompson, Mr. Calcutt knew by not later than September 7, 2011, that the Bank's examiners were looking for information about how the Bank was managing the Nielson Entity Loans.

Leading up to the September 14, 2011 meeting, FDIC Case Manager Anne Miessner[560] asked EIC Gomez to seek additional information from the Bank regarding the

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[559] Tr. (2015) at 722-24 (O'Neill); Resp. Ex. (2015) 100.1.

[560] Ms. Miessner was commissioned as an Examiner in 2007, has extensive training regarding regulatory guidance and rules, and policy statements. Her formal post-graduate education includes attendance at courses on financial analysis, call reports, asset liability management, loan analysis, examination management, bank risk identification, and all coursework required to sit for the examination required of all commissioned examiners. She also has experience as an FDIC instructor in the Examination Management School where she helped design and teach Case Manager training, and helped updated the Applications portion of the FDIC Case Manager's Procedures Manual. She served as a Commissioned Examiner in between 100 and 150 bank examinations, and was Examiner in Charge in fourteen examinations. Although Respondent objected to Ms. Miessner's testimony for reasons stated in his Motion in Limine (having to do with claims of bias on Ms. Miessner's part), Respondent did not object to finding her qualified as a banking examination regulation and supervision expert witness on the subjects of FDIC bank supervision, regulatory requirements and guidance, prudent banking practices, standards of care and duties of directors to FDIC-insured financial institutions, FDIC supervisory and enforcement matters and actions, violations of banking laws and regulations, and the imposition of civil money penalties. Tr. at 684-724 (Miessner).

use of the funds of the December 2009 Bedrock Loan.[561] Specifically, Ms. Miessner asked whether Mr. Calcutt had gone on record with the Examiners affirmatively stating that there was no more correspondence relating to the Nielson Entities loans – asking this after Mr. Gomez advised her that earlier that day (September 7, 2011), Mr. Gomez had explained to Mr. Calcutt and others at the Bank why the Examiners needed all of the Bedrock Holding Company's materials.[562]

Among the defensive claims is one that depends on Mr. Calcutt being surprised about the scope of what was discussed during the September 14, 2011 meeting. During the hearing, responding on cross-examination to the question "[P]rior to the meeting of September 14th, you were very careful not to alert Mr. Calcutt about your interest in the Bedrock Loan, were you not?", Mr. Gomez responded "I guess asking for transaction information regarding specifically the Bedrock Loan, I don't know how that's very hidden; and we were asking for documents regarding the Bedrock Loan, I'm not sure how that's hidden, either."[563]

Mr. Calcutt testified during the second hearing that the first notice that he received that there was going to be a discussion about the Bedrock Loan at the September 14, 2011 meeting was through Mr. Smith's email, sent at 10:58 a.m., relating to the meeting that was set to begin at 3

[561] Resp. Ex. 98.1.

[562] *Id.*

[563] Tr. at 326 (Gomez). See also testimony of FDIC Examiner O'Neill, referring to EC Ex. (2015) 110 (9/14/11 email from Mark Smith to Mr. Calcutt and others, identifying topics that would be discussed during the upcoming meeting), Tr. (2015) at 194.

p.m.[564] The record, however, does not support this statement, which I find to be false, although not on a point material to this enforcement action. Even if it were true, however, by Mr. Calcutt's own testimony had the email been his first notice that the Bedrock Loan was going to be discussed, he would have deflected the message. When asked what occurred during the four hours between the time he got the message and the start of the meeting, Mr. Calcutt testified that "I don't know what occurred."[565]

Elaborating on his lack of involvement, Mr. Calcutt testified:

> Again, as I said, I would have turned this e-mail over to Bill Green and others saying this loan's in foreclosure. I mean we're beyond this. It's a loan that represents one-tenth of one percent of our loan portfolio; he'll have to answer these questions. I don't know the answers to these questions. I don't have access to loan files.[566]

From the record, notably from the contents of the September 14, 2011 email from Mark Smith, then the Bank's Director of Global Risk,[567] it appears that going into the meeting, *all* the participants in the September 14, 2011 meeting understood that the Examiners wanted to discuss directly with Mr. Calcutt details concerning the Bedrock Loan, including Mr. Calcutt's understanding as to how the $760,000 loan was used, how complete the Bank's documentation is with respect to correspondence

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[564] Tr. at 1335 (Calcutt); EC Ex. 110.

[565] Tr. at 1335 (Calcutt).

[566] *Id.*

[567] *Id.* at 385 (Smith).

between the Bank and the Nielsons, how the Pillay funds were used (and Mr. Calcutt's knowledge regarding the Bank's release of those funds as loan collateral), and Mr. Calcutt's understanding of what the source of funds was that brought the Nielson Entities' loans current in December 2010.[568] Mr. Smith added that he told FDIC Examiner O'Neill that "we would like to further discuss our position on the restoration of the Nielson loans to accrual status back in December 2010."[569]

Mr. Calcutt's advance knowledge of the topics to be discussed during the September 14, 2011 meeting also is evidenced by an email message dated September 13, 2011, from Mr. Green to Mr. Calcutt and others.[570] In this message, Mr. Green copied Mr. Smith's September 13, 2011 email to Mr. Green and others – describing in significant detail the Bank's management of the Nielson-related entities, specifically with respect to the loans' being placed into non-accrual status during October 2010.[571]

Through this memo, Mr. Smith raised with Mr. Calcutt the *same* points that were to be raised by the

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[568] ED Ex. 110 (email sent at 10:58 a.m. on 9/14/11 from Mark Smith to Mr. Calcutt, Mike Doherty, Tom Levi, Bill Green and Dick Jackson, recounting Mr. Smith's conversation with the FDIC's Dennis O'Neill, in anticipation of the meeting set for 3 p.m. later that day). See also testimony of Examiner O'Neill regarding the time of the meeting and the advance time – roughly between 11 a.m. and 3 p.m. Tr. (2015) at 712-15 (O'Neill); and Mr. Jackson, who testified that he did not recall there being any conversation in which he participated after the receipt of the email. Tr. (2015) at 1642 (Jackson).

[569] ED Ex. 110.

[570] Resp. Ex. 60.

[571] Tr. at 429 (Smith); Resp. Ex. 60.2.

Examiners during the September 14, 2011 meeting, regarding the possibility that the Bank falsified the December 31, 2010 and March 31, 2011 Call Reports "by not classifying these loans as nonaccrual and by recording interest income related to these loans on those reports."[572] While Mr. Calcutt may have been unaware of the agenda for the September 14, 2011 meeting, he clearly had been fully briefed the day before, on the subjects that were raised during that meeting.[573]

Indeed, Mr. Calcutt appeared to be well up to the task, during the September 14, 2011 meeting.[574] Consistent with what the participants understood would be the case, the September 14, 2011 meeting gave Mr. Calcutt the opportunity to describe his understanding of how the $760,000 Bedrock Loan proceeds were to be used. According to Mr. O'Neill, at no time did anyone from the Bank say that the proceeds were used to bring other loans current.[575] Instead, Mr. Calcutt told Mr. O'Neill that Bedrock had purchased Team Services, which had been a

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[572] Tr. at 429-30 (Smith); Resp. Ex. 60.

[573] Testifying to the same effect, Mr. Jackson likewise stated that at the time of the September 14, 2011 meeting, he did not know, nor did other members of senior management know, that they were being investigated by the FDIC for possible removal violation actions. Tr. (2015) at 1649 (Jackson).

[574] See testimony of Mr. Jackson, where he recalled what Mr. Calcutt's response was at the meeting on September 14, 2011, when asked what the proceeds of the Bedrock Loan were used for, he responded "I believe he stated it was working capital." Tr. (2015) at 1645 (Jackson).

[575] Tr. (2015) at 49 (O'Neill). See also testimony by Mr. O'Neill regarding information gathered from correspondence provided by Ms. Nielson: "The correspondence which we received directly from the Borrower and between the Borrower and bank officials demonstrated

Bedrock customer; and that "Bedrock then needed working capital, which was what the loan was for."[576] According to Mr. O'Neill, it was only by securing imaged copies of the disbursement checks to see where the proceeds went to that Mr. O'Neill could ascertain how the funds actually were disbursed.[577]

The record establishes without doubt that the only

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that Mr. Calcutt knew that the proceeds in the loan were to keep existing loans current." Tr. (2015) at 589 (O'Neill).

[576] Joint Ex. 11 at 3. Note that through testimony, Examiner O'Neill clarified that at page 4 of Joint Ex. (2015) 11, at subparagraph (f), that although "the focus of much of what was my work in December of 2009 and the new funds were disbursed. There is a separate question that was asked to be part of this series of questions," and those questions related to 2010, as stated. Tr. (2015) at 729 (O'Neill). See also Tr. (2015) at 46 (O'Neill): in the first week or two of August 2011, "I observed a meeting in which Bob Bush posed the question to Bank management and received a response that it was working capital. I was also asking the question myself in a subsequent meeting in September, I believe it was September 14, [2011] in which it was provided in writing as to what the purpose was."

[577] Tr. (2015) at 50 (O'Neill) "Not all recipients were Bank customers: There were entities that were not borrowing at all at the Bank. Alaska Perpetual Trust entities, entities that we would otherwise have no knowledge about that had been created, checking accounts created to hold these funds to pass through, so it became something of a visual spider web where I would not know to go to the next step until I had actually gotten to that statement." Tr. (2015) at 51, 53 (O'Neill); Joint Ex. 13 (2015) (flowchart of Bedrock Loan proceeds from initial disbursement to ultimate use concluding "Of the $760,000 in loan proceeds, $541,661 was promptly transferred to other Nielson Entities."). See also testimony by Mr. O'Neill that prior to the September 14, 2011 meeting, examiners had "already established through the actual tracing of bank records that the proceeds were used primarily to bring existing loans current and not in any fashion for working capital for Team Services or Bedrock." Tr. (2015) at 587 (O'Neill).

thing Mr. Calcutt was unaware of prior to that meeting was the fact that Ms. Nielson had provided to the Bank's examiners her copies of correspondence between herself and Mr. Calcutt directly discussing the Bedrock Loan proposal.[578] From the record now before me, I find the answers Mr. Calcutt gave to examiners during the September 14, 2011 meeting were material, knowing, and willful misrepresentations by Mr. Calcutt regarding his knowledge of the purpose for the Bedrock Loan proceeds.[579] For the foregoing reasons, notwithstanding Mr. Calcutt's testimony that his answers were not intended to conceal the details of a Bedrock Loan that he remembered full well, I reject as false Mr. Calcutt's testimony that at the time he received Mr. Smith's September 14, 2011 email (FDIC Ex. 110) he had no independent recollection of the Bedrock Loan transaction.[580]

Similarly, in response to Mr. O'Neill's question whether Mr. Calcutt had any correspondence either to or from the Nielsons regarding their proposed use of the $760,000 loan proceeds that were disbursed in December

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[578] See Tr. at 1341 (Calcutt).

[579] The parties have stipulated, subject to certain reserved rights, to the use of the following testimony in the transcript from the hearing held in September 2015 of FDIC Examiners: a) Dennis P. O'Neill, as set forth in Volume I, pages 10 -209; Volume III, pages 584 – 692; and Volume IV, pages 702 – 757; and b) Charles H. Bird, Volume IV, pages 758 - 916, including all admitted exhibits. See Joint Ex. 17 (Joint Stipulation Regarding Testimony of FDIC Examiners O'Neill and Bird), dated July 29, 2019; and Joint Ex. 18 (Joint Stipulation Regarding Testimony of Richard Jackson), September 30, 2019.

[580] Tr. at 1336, 1339 (Calcutt). See also EC Ex. 67, Mr. Calcutt's memo to the file recalling the Nielson Loans "were discussed in many Board meetings going back years. (See 2009 loan concentration reports handed out at Board meetings.)"

2009, Mr. Calcutt stated he did not recall any such correspondence, and that if there had been such correspondence "[i]t would be in the credit files if any, because all the other officers here are copied on whatever I would have."[581] From the record now before me, I find this to have been a material, knowing, and willful misrepresentation by Mr. Calcutt regarding his knowledge of relevant correspondence between the Nielsons (and Ms. Berden acting on behalf of the Nielson Entities) related to the proposed use of the $760,000 Bedrock Loan proceeds.

Similarly, in response to Mr. O'Neill's question about Mr. Calcutt's understanding of when the Pillay funds were released as Bank collateral and the purposes those funds were put to, Mr. Calcutt stated "I thought we still had them."[582] When Mr. O'Neill noted that the Bank Board's approval of the 2009 Bedrock Loan referred to a $600,000 release of Pillay Funds, and asked about the December 2010 release of $687,000 in Pillay collateral, Mr.

[581] Joint Ex. 11 at 3; Tr. (2015) at 195 (O'Neill); Joint Ex. (2015) 11 at 3. See also testimony from Mr. O'Neill regarding Respondent's answer to the question "Does the CEO have correspondence to or from the Nielsons regarding their proposed use of the $760,000 in loan proceeds disbursed in December 2009?" where Mr. O'Neill determined Mr. Calcutt knowingly and falsely responded "No, I don't recall any." Tr. (2015) at 590 (O'Neill), basing that determination on correspondence between Mr. Calcutt and Ms. Nielson found in EC Ex. (2015) 3 at the pages noted above, demonstrating that he had such knowledge. Tr. (2015) at 590 (O'Neill).

[582] Joint Ex. 11 at 4; Tr. (2015) at 591-92 (O'Neill) "By the time this meeting had been held and his response was recorded, the Pillay funds had already been released. In fact, that was one of the conditions for granting the new loan to Bedrock, long, long before this." Tr. (2015) at 592 (O'Neill).

Calcutt responded only "The numbers are so close maybe we are talking about the same thing."[583] The record reflects that the Bank under Mr. Calcutt's express direction released $600,000 in Pillay collateral in December 2009 and $689,000 in December 2010.[584] Again, from the record now before me, I find Mr. Calcutt's statements were material, knowing, and willful misrepresentations regarding his knowledge of the two stages of release of the Pillay Funds collateral.

Similarly, in response to Mr. O'Neill's question "Where does the CEO state that the funds came from to bring all the Neilson loans current in December 2010," Mr. Calcutt responded "Their vast resources between oil, gas, and rentals."[585] From the record before me, I find this statement to be a willful, knowing, and material misrepresentation by Mr. Calcutt regarding his knowledge of the source of funds used to bring the Nielson loans current in December 2010.

c. Missing Loan Documentation

The 2011 ROE identified significant documentation lapses relating to the Nielson Entities loan portfolio.[586]

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[583] Joint Ex. 11 at 4.

[584] Tr. at 623-24 (Smith); EC Ex. 67.

[585] Tr. (2015) at 205 (O'Neill); Joint Ex. 11 at 4. See also testimony of Mr. O'Neill, opining that Mr. Calcutt's answer was false because the examiners already had "examined and have copies of bank documents indicating it was new bank funds being advanced to the Borrower which brought the loans current. And this is December 2010. Again, December of 2009 was when the new Bedrock loans were done." Tr. (2015) at 593 (O'Neill).

[586] EC Ex. 48 at 41-42 (ROE p. 38-39).

The record reflects that the loan files for the Nielson Entity loans "did not contain any evidence of, or reference to, the release of" Pillay Trading LLC units that had been serving as collateral for three of the Entity loans.[587] Further, the record reflects the release of these funds was not approved by the Bank's Board of Directors before its release – indeed, substantial evidence establishes the Board was not even made aware of the release prior to or at the time of the release.[588]

According to 2011 by EIC Mr. Gomez, because of this flat organizational structure, and because Mr. Calcutt would in this structure serve as the Bank's senior lender, Mr. Calcutt would have the overall responsibility for credit administration.[589] Not included in the senior lender duties, according to Mr. Gomez, would be actually putting documents into loan files – those duties would fall to Mr. Green, as the lending officer for the Nielson Entities, and Mike Doherty, as the Credit Administrator.[590] Echoing the perspective given by Ms. Miessner regarding Mr. Calcutt's obligations regarding placing emails he sent and received into the proper Bank folders, Mr. Gomez testified that with respect to the emails found in the Nielson folio (identified as FDIC Exhibit 3 – *i.e.*, the folio of email records retained by Cori Nielson and sent by her to the

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[587] *Id.* at 41.

[588] *Id.*

[589] Tr. at 297 (Gomez). See also Examiner O'Neill's testimony that under this organizational structure, he would expect Mr. Calcutt would have his attention pulled in many directions, and would expect Mr. Calcutt to give that attention "towards those of the highest risk." Tr. (2015) at 622 (O'Neill).

[590] Tr. at 297-98(Gomez).

FDIC) – it would have been Mr. Calcutt's *direct* responsibility to ensure those exchanges were found in the appropriate Bank files.[591]

It should be noted that for reasons that appear to be directly related to the withholding of material information from the Bank's Examiners on this point, draft Examiner findings from the August 1, 2011 examination included a statement concerning the Board's presumptive understanding and knowledge of the disbursement of the 2009 Bedrock Loan several months before the Loan was actually presented for Board approval.[592]

In the draft Report, the Examiners state the premise, regarding a line item in the report pertaining to a "Lending Limit Violation," that a two-thirds approval of the Bank's Board would be required on any loan "exceeding

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[591] *Id.* at 298 (Gomez).

[592] See testimony of Examiner O'Neill upon review of Resp. Exs. (2015) 22 and 23, agreeing with the premise that board members or examiners could be expected to ask "why have our delinquencies jumped from $17 million to $57 million" based on the contents of the Board packages for November 24, 2009 and December 17, 2009. Tr. (2015) at 627-28 (O'Neill). When asked about the premise that this documentation shows there was no concealment regarding delinquencies in these reporting periods, Mr. O'Neill disagreed, testifying that in order to understand the data, the reader would need to know more about the relationship of the borrowers to the Bank. Examiners or board members presented with this information – upon learning that the data concerned Nielson-related debt, would be expected to ask about the change, but only "if they knew it was Nielson debt" and not just " a block of home loans that had gone 31 days that month. You're building a presumption in there that they asked and found out it was the Nielsons. I don't see a detail delinquency report that lists the Nielsons' loans individually." Tr. (2015) at 633-34 (O'Neill).

15% capital and surplus."[593] The draft Report stated that the line item "is in reference to the Bedrock Holdings loan, dispersed [*sic*] December 2009 and Board approved March 2010."[594]

The Report responded to this line item with the following explanation:

> This was a documentation oversight by management. A memo from loan officer Green was provided to the examination teams while on-site regarding the circumstances surrounding this oversight. The 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. It has always been Bank policy that all loans which require board approval are indeed approved by the Board prior to the loan being disbursed.[595]

[593] EC Ex. 52 at 1. See also Tr. (2015), testimony by Examiner O'Neill at 40 "When a loan reaches over fifteen percent of the common stock and surplus of the capital of the Bank, under state law here in Michigan, that loan has to go to the Board of Directors, for at least two-thirds of the Board has to vote approval of it."

[594] EC Ex. 52 at 1.

[595] *Id.* at 2. See also testimony by Board Member Bruce Byl establishing that the Bank's Commercial Loan Policy, as it existed in October 2009, required (under Michigan Section 487.3432, State Bank Act of 1996, that "any loans where the total aggregate exposure is between 15 and 25 percent of the Bank's Regulator Capital, require a 2/3rd majority approval from the Board. The total aggregate exposure is not to exceed 25% of the Bank's Regulatory Capital." Tr. at 1043 (Byl); EC Ex. 86 at 2.

d. Findings of Fact Regarding Missing Loan Documentation

Preponderant evidence in the record, including Board member testimony and the absence of any reference to this matter in the Board's meeting minutes for the months between September 2009 and March 2010,[596] establishes that the explanation supplied to the Examiners by Mr. Green that led the Examiners to reach this conclusion failed to fully disclose the material circumstances that are documented herein, relating to actions taken by Mr. Calcutt and others, that withheld from the Bank's Board of Directors salient and material information regarding the Bedrock loan and the 2009 disbursement of the loan proceeds. For these reasons, I find unsupported by preponderant evidence Respondent's factual claim that

[596] Including Resp. Ex. 22 (Scorecard, included in Board Report, November 24, 2009); Resp. Ex. 23 (Scorecard, included in Board Report, December 17, 2009); and Resp. Ex. 24 (12/3/09 email from Bill Green to Ian Hollands, stating that the "Nielson loans we need to get approved"). As Mr. Gomez testified, Scorecard entries, presented in this context, identified the percentages of delinquent loans and non-performing assets, but the Board meeting minutes reflect no discussion of the delinquent loan percentages for November or December. In this way, Mr. Gomez opined, the reporters are "minimizing the need or the desire to actually look at the reports. If they are providing a summary of a big spreadsheet and by reading this short narrative, the belief is there's nothing in the spreadsheet to read, that would cause a concern." Tr. at 352 (Gomez). Also in the record is Mr. Green's account, presented in September 2011 to Mr. Smith stating: "The new loan of $760,000 was extended in 12/09. It had been agreed to following several meetings between the bank and borrower. It was verbally approved at those meetings (after discussions at the bank with approving group). I had been tied up with several other loan re quests at year end so the approval followed the verbal ok. The actual approval was probably completed in 3/ 10." EC Ex. 55; Tr. at 446 (Smith).

the Board "'"verbally approved the [Bedrock Loan] Transaction in late 2009."[597]

This finding is not contradicted by Mr. Calcutt's testimony regarding disclosures made to members of the Bank's Board through the November 24, 2009 Board Report.[598] Included in that Report is a "scorecard" which, according to Mr. Calcutt, would reveal trends and "key numbers" for the Board's consideration.[599] Asked who would present this score card during Board meetings, Mr. Calcutt avoided answering the question, responding instead that the accounting department would prepare the scorecard, and "our comptroller, our CFO [and] our Classified Assets Committee would be aware" of it, and "other people in the Bank . . . would be aware of these numbers also," but did not identify anyone who would discuss the scorecard with members of the Board during a Board meeting.[600] Pressed on the point, when asked again "did someone in particular present the scorecard at the Board meetings?" Mr. Calcutt responded "We would just, we would look for trends in and pick up numbers, and our CFO would certainly make that clear on any significant changes he might point that out. Or if he didn't I would."[601] There is, however, no evidence that this was

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[597] Respondent's Post-Hearing Brief at 7.

[598] Resp. Ex. 22.

[599] Tr. at 1290 (Calcutt).

[600] *Id.* at 1291 (Calcutt).

[601] *Id.*; Resp. Ex. 22 at 2-4. Mr. Jackson testified that "The scorecard was really kind of a high-level overview of the Bank's performance. It touched on a number of different items that we felt to be of importance to Board members. It's talking about net revenues, financial performance. Talking about loan portfolio sizes, delinquencies,

done with respect to the November 24, 2009 Board Report.

According to Mr. Calcutt, the November 24, 2009 Board Report and Reports from December 17, 2009 included data that revealed "what was transpiring with the Nielsons" and disclosed the delinquent portfolio loans and non-performing assets month by month".[602] According to Mr. Calcutt, data included in these Reports reflected that by December 2009, delinquencies "went down from the $59 million in the previous month and the $17 million the month before" to roughly $20 million.[603] This showed, according to Mr. Calcutt, "a big change in the delinquencies."[604] There was, however, nothing in the two reports that describe the steps Mr. Calcutt had taken to precipitate this big change.

Although the Reports and Board Minutes for October through December 2009 were silent regarding the release of the Pillay collateral and the $760,000 Bedrock Loan, Mr. Calcutt testified that he recalled discussing with the Board in December 2009 what led to the delinquencies being resolved:

> Q. Do you recall discussing with the Board what it was that had occurred that resulted in these delinquencies being resolved?
>
> A. Well, the Bedrock Loan had been closed. And that would have been discussed. If that's what

nonperforming assets. Growth levels and other key ratios." Tr. (2015) at 1609 (Jackson).

[602] Tr. at 1292-93 (Calcutt); Resp. Exs. 22 and 23.

[603] Tr. at 1292-93 (Calcutt).

[604] *Id.* at 1293 (Calcutt).

> your question is, the Bedrock Loan would have been discussed at the Board and received approval.
>
> Q. Okay. I want to ask you, is this the first occasion that, here in the period of November, December 2009 that any board member would have learned about the nature of the Nielson relationship and the size of that relationship?
>
> A. No, absolutely, because each, all the board members approved of the Nielson Loans. Each was individually underwritten and each board member would have approved those loans.[605]

Given the substantial evidence establishing that the Board members were not told about the Nielson Entities loan relationship and did not approve the Bedrock Loan until March 2010, I reject as false Mr. Calcutt's claim that the Bedrock Loan had been discussed and approved at any meeting in 2009. To the contrary, preponderant evidence establishes that Respondent and other senior Bank managers violated Bank policy by disbursing Bedrock Loan proceeds before seeking or securing approval of the Bank's Board of Directors, and thereafter misled the Bank's Examiners in this regard.[606]

Mr. Calcutt's argument – that each Board member had "a duty or an oath" to review the Reports of Examinations going back to 2006 or 2007, and would thereby

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[605] *Id.* at 1294 (Calcutt); see also EC Ex. 101 (Board Minutes for August 20, 2009, September 22, 2009, October 22, 2009, November 24, 2009, and December 17, 2009); Tr. (2015) 1611 (Jackson).

[606] See also testimony of Mr. Jackson, confirming that Bank policy required the Bank's Board of Directors to approve the Bedrock Loan renewal transaction. Tr. (2015) at 1669 (Jackson).

know of the true nature of the Nielson Entities loan portfolio – is unavailing here.[607] Preponderant evidence, including the above-referenced testimony of Board members Byl and Swanson, establishes that Board members had not been advised of the true nature of the Nielson loan portfolio – by Mr. Calcutt, by Examiners, or by any Bank employee – until after 2009. Also unavailing is Mr. Calcutt's claim that it was "impossible" that Board members in 2009 lacked full knowledge of the Nielson relationship because, according to Mr. Calcutt, "The CFO is there. I am there. This all would have been explained and there would have been an approval process undertaken."[608] Preponderant evidence establishes no Board approval was sought or given until March 2010.

e. Failure to Fully Disclose the Effect of the Release of Pillay Trading Collateral

Another significant feature of the disclosures made in the Bedrock Loan Commitment Review concerned the effect the transaction would have on collateral securing the Loan. After the release of the $600,000 Pillay Trading LLC proceeds, there would be approximately $400,000 remaining from Pillay to serve as collateral.[609]

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[607] See Tr. at 1294 (Calcutt): "Secondly, these loans were in every Report of Examination, as I said, going back to, I can't recall exactly, 2006 or '07; and each director reviewed the Exam Reports, was required to; they had a duty to or an oath that they signed that they reviewed the Report of Examination. So not only would they approve each of the loans, they would have seen these loans every year, not to mention just discussions in general about the Nielsons that would have been at the Board level or any discussions they may have had with individuals in the Bank." Tr. at 1294 (Calcutt).

[608] Tr. at 1295 (Calcutt).

[609] *Id.* at 106 (Berden); Joint Ex. 6 at 1.

f. Failure to Timely Obtain Financial Statements from the Recipients of Pillay Disbursements and Bedrock Loan Proceeds

Another significant feature of the Bedrock Loan transaction concerns the state of the Bank's information regarding the recipients of the loan proceeds: According to Ms. Berden, when the $600,000 in Pillay funds was released and used to make current the Nielson Entity Loans, it was Ms. Berden's understanding that the Bank lacked current financial statements for fifteen Nielson Entities identified in the email Mr. Green sent to her on January 13, 2010.[610]

An example of this was shown in the North Park LLC account. According to Ms. Berden, the Bank did not typically require financial information when gathering loan documents, but instead Mr. Green would contact Ms. Berden saying "that they are getting ready for Examiners to come again and he's going to be needing some financial statements" from her.[611]

One such request came in the form of an email from Mr. Green to Ms. Berden dated June 2, 2010, in which Mr.

[610] Tr. at 106-07 (Berden); Resp. Ex. 29.1-2. See also testimony of Mr. Jackson to the effect that Mr. Green's January 13, 2010 email to Ms. Berden seeking financial statements from fifteen Nielson Entities suggested that at that time Mr. Green did not have these statements. Tr. (2015) at 1622 (Jackson). He testified that "we wanted to get these [Nielson Entities Loans] renewed by the end of the year," although prudent bankers "generally" would want to have financial statements, global cash flow analyses, and current appraisals before approving these loans. Tr. (2015) at 1622-23 (Jackson).

[611] Tr. at 107-08 (Berden).

Green requests "the 12/31/09 financials and the most recent interim financial on North Park."[612] Ms. Berden explained North Park was one of the Entities that had insufficient cash flow, and that the Nielson Entities had been trying to sell North Park, but that the "real estate market there was still pretty rough".[613] Notwithstanding these negative attributes, when North Park received the partial proceeds from the Bedrock Loan, there were, according to Ms. Berden, no limitations on how North Park used the proceeds of the loan.[614]

g. Transfer of Loans to Affiliate Banks in May 2010

Noting that Examiners were due to arrive at the Bank in 30 days, Mr. Green advised Ms. Berden in a May 10, 2010 email message that the Bank intended to sell some of the Nielson Entity loans to affiliate banks – State Savings Bank of Frankfort was to buy two loans, and Central State Bank was to buy four loans.[615] (Mr. Calcutt was the Chairman of the Board for both Central State and State Savings and for both banks' holding companies, and was the principal shareholder of the parent company of those banks.[616])

Ms. Berden testified that this news was of concern to her, because "we didn't know who [State Savings Bank of Frankfort] was or who our contacts would be or what

[612] Tr. at 108 (Berden); EC Ex. 3 at 27.

[613] Tr. at 108-09 (Berden).

[614] *Id.* at 100 (Berden).

[615] EC Ex. 3 at 140-41.

[616] Tr. at 884 (Miessner); Tr. (2015) at 167 (O'Neill). See also Examiner O'Neill's opinion that Mr. Calcutt was "a dominant policy-maker in those two banks." Tr. (2015) at 623 (O'Neill).

would happen when the loans matured [on] September 1st of 2010."[617] Responding to these concerns, Ms. Berden said Mr. Green assured her that he and Mr. Calcutt would continue to be "our points of contact and that we would work directly with them when it came time for renewals in September."[618] She said the same was true regarding the loans being sold to Central State Bank.[619]

Ms. Berden testified that when the Bank sold these loans, it did so at a value discount – which struck her as odd.[620] In response to questions by Ms. Berden about who owned State Savings and Central State Bank, Mr. Green wrote that while he knew the affiliate banks have "some common ownership" with Northwestern, they were privately held and as such he had "no idea what the exact ownership is".[621] Contradicting Ms. Berden's testimony, he wrote that the Bank did not sell the loans at a discount, but that the purchasing banks "may have the right to ask us to buy them back."[622]

Mr. Jackson testified that "[w]e sold loans or participations to the affiliates quite often and, in turn, we would purchase participations or loans from the affiliates, so it was a common practice."[623] He denied, however, that the

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[617] Tr. at 113 (Berden).

[618] *Id.*

[619] *Id.* at 114 (Berden).

[620] *Id.* at 118 (Berden).

[621] EC Ex. 3 at 146.

[622] *Id.*

[623] Tr. (2015) at 1622 (Jackson). A loan "participation" would "be a sale of a portion of a loan. A whole loan sale would be a sale of the entire loan." These were loan sales, not loan participations. Tr. (2015) at 1624-25 (Jackson). See Resp. Exs. 42-43 (Central State Bank Loan

timing of the sale had any bearing on the fact that there was an examination by the FDIC pending.[624] "The sales were in an effort to reduce our exposure," meaning the Bank's exposure due to the "outstanding balances of loans that we had with the Nielson relationship."[625]

Elaborating on this point, Mr. Jackson testified:

> There had been discussions from both the FDIC and the State of Michigan that questioned the unit borrowing requirements and whether or not we were in compliance with those, and I believe the FDIC may have felt we had a unit borrowing issue, and they deferred to the State in 2009 to review that, and I believe the State concluded that we did not have a unit borrowing issue, but that's really the only regulatory concerns that I was aware of.[626]

When asked why he thought it would be a good idea

Purchase Agreements); Resp. Exs. 44-45 (State Savings Bank Loan Purchase Agreements). Despite the timing of these transactions, Mr. Jackson testified that "this was an opportunity for Northwesten to reduce its exposure to the Borrowers," and were not sham sales. Tr. (2015) at 1629-30 (Jackson). The Bank repurchased these loans even though they were non-performing – "Borrowers had once again stopped making payments and requested additional concessions before they would again renew them," after Mr. Jackson "was contacted by president of one of the affiliate banks who asked what the status was of the September payment, and I indicated to them that the relationship had soured. We were continuing to negotiate a settlement with the Borrowers on that and that if they'd like, I would repurchase the loans." Tr. (2015) at 1629-30 (Jackson).

[624] Tr. (2015) at 1622 (Jackson).

[625] *Id.*

[626] *Id.* at 1623 (Jackson).

to reduce the Bank's exposure to the overall Nielson debt, Mr. Jackson testified that "it was a large concentration in, you know, one group of borrowers and it's always good to reduce that if you can. It represented a significant part of our capital."[627]

FDIC Case Manager Ms. Miessner was asked about Respondent's efforts regarding the sale and repurchase of these loans – specifically about her opinion that Respondent's conduct was misleading in regard to these transactions.[628] She agreed that one way for the Bank to come into compliance with its lending limit would be to sell debt like these loans, that is, to refinance the debt to a different bank, providing the transactions were "true sales."[629] She agreed that the record includes a July 10, 2009 memo from Mr. Green to Mr. Calcutt suggesting that as part of an "action plan" to "immediately reduce loan exposure," the North Park LLC loan of $1.8 million and the $1.07 Waypoint Acquisitions credit "and others could also be participated in 100% of the loan amount."[630] According to Ms. Miessner, what Mr. Green was proposing was not a loan sale – even at 100 percent, "participating them out [is] different than selling them."[631] She said "we know in this case" the Bank did not truly sell these loans.[632]

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[627] *Id.*

[628] *Id.* at 849-50 (Miessner).

[629] *Id.* at 850, 852 (Miessner).

[630] Resp. Ex. 206 at 3.

[631] Tr. at 853 (Miessner).

[632] *Id.* Per the 2011 ROE at Bates page 27 (i.e., page 24-25 of the Report), "Sections 23A and 23B of the Federal Reserve Act contain

Later on, however, in May 2010, the Bank did sell some of these loans to Central State and State Savings Bank.[633] Ms. Miessner determined that Mr. Calcutt intentionally concealed information about these transactions because "the Bank sold those loans right before the Examination started and then bought them back right after the examiners left."[634] She opined that it was "obvious" based on the timing of the sales that Mr. Calcutt did not have any intention of leaving them actually sold, "which means that as of the Call Report date they still should have been reported as assets out of the Bank, and management did not disclose to the examiners that they had just sold participations in their largest relationship which

restrictions on transactions between member banks and their affiliates. Sections 23A and 23B are made applicable to insured nonmember banks by Section 18(j) of the FDI Act. Northwestern Bank, Central State Bank, and State Savings Bank are controlled through the common ownership of the Calcutt family. Accordingly, the three banks meet the definition of affiliate in Section 23A(b)(1(C)(i) and 23A(b)(3)(A)(i)." See also testimony of Examiner O'Neill regarding his recommendation that a charge under Section 23A be pursued. Tr. (2015) at 605 (O'Neill); EC Ex. (2015) 90.

[633] Tr. at 855, 858-59 (Miessner); Resp. Ex. 42, 44. Mr. Jackson testified that EC Ex. 42, his message to Ms. Meissner dated May 12, 2011 regarding "3/31 performance questions" was written "in conjunction with a pending shareholder dividend request that we had submitted to the Federal Reserve for Northwestern Bank". Tr. (2015) at 1636 (Jackson). See also testimony by Examiner Bird, reporting that an email dated May 17, 2010 from Mr. Green to Autumn Berden disclosing that "Central State Bank has been reviewing some of the loans and has purchased 3 loans from NRJ . . . 1 loan from Sunny . . . and 1 loan from Waypoint" was not provided during his 2010 examination, which began on June 7, 2010. Tr. (2015) at 803-04 (Bird).

[634] Tr. at 855 (Miessner).

they knew we would be reviewing while on-site."[635]

Mr. Calcutt testified that Mr. Green suggested the Bank sell the North Park $1.8 million loan and the Waypoint $1.07 million loan – doing so in a memo dated July 10, 2009.[636] He said such a transaction was "common":

> It was a common occurrence for Northwestern and the affiliate banks because they were always looking for additional loans to sell and participations in loans, and sometimes they would have loan customers that would exceed their lending limits and we would participate when we buy a participation.[637]

Although Mr. Jackson testified that both he and Mr. Calcutt made the decision to approve the loan sales,[638] Mr. Calcutt could not recall these two loan sales, nor did he recall any particular reason why the loans were sold at that particular time.[639] He did recall the affiliate banks were "eager to buy participations" in these two loans, because "they were looking for additional revenue," but

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[635] *Id.* at 856 (Miessner). See also testimony of Examiner O'Neill, testifying that the 2010 Call Report "needed to be amended" with respect to the non-accrual status of the Nielson Loans, stating the failure to report that status "was such a huge omission, being the largest single borrowing relationship in the Bank that it should have been disclosed as on non-accrual status and had such an impact on anyone attempting to use the Call Reports, it was so material that it amounted to the filing of false Call Reports." Tr. (2015) at 661 (O'Neill).

[636] Tr. at 1316 (Calcutt); Resp. Ex. 206 at 3.

[637] *Id.* at 1317 (Calcutt).

[638] Tr. (2015) at 1693 (Jackson).

[639] Tr. at 1317 (Calcutt).

offered no evidence to support this testimony.[640] He denied that the loans were sold at a time when the loans were not performing – "We couldn't and wouldn't."[641] He denied these were sham loans, testifying that he did not intend to repurchase the loans at the time he sold them, "because we thought these loans would perform."[642] Mr. Calcutt has offered, however, no factual basis for this thinking.

Mr. Calcutt could not, moreover, explain why Ms. Berden understood Mr. Green to have told her she would continue to work with him, because, according to Mr. Calcutt, Ms. Berden "would have to work with the CEOs of those two banks."[643] Mr. Calcutt denied having any role with the loans after the sale to the two banks, and could not recall who made the decision to repurchase the loans, other than to say "It wouldn't have been me."[644] He admitted the loans were delinquent when Northwestern repurchased them, explaining that "it just made more sense administratively for Northwestern to deal with this issue than to have multiple parties dealing with it."[645] Mr. Calcutt offered no evidence to support this claim.

Mr. Jackson's memory was better than Mr. Calcutt's on this point. Mr. Jackson testified that the Bank repurchased the two loans "to make it more efficient in part to have all of them under one roof so we would not have to consult with . . . two other banks in this case, to get their

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[640] *Id*. at 1318 (Calcutt).

[641] *Id.* at 1319 (Calcutt).

[642] *Id.* at 1319 (Calcutt).

[643] *Id.*

[644] *Id.* at 1319-20 (Calcutt).

[645] *Id.* at 1320 (Calcutt).

concurrence as far as decisions, administrative decisions on how to manage the accounts in the future."[646]

In their 2011 ROE, examiners identified as a violation of the Federal Reserve Act the participation loans purchased from an affiliate bank.[647] Mr. O'Neill testified that the examiners were concerned when it was shown that the Bank purchased participations in what were clearly troubled loans (i.e., loans to Nielson entities that had only recently been sold to the Bank's affiliates, under Mr. Calcutt's direction). Mr. O'Neill explained that the Bank was being cited for repurchasing the loans shortly after the 2011 examination was completed.

As Mr. O'Neill explained the matter, there was evidence of:

> a rather lengthy history of problems being admitted to by the Borrower and their inability to pay and the Borrower stating how short the collateral would be or the equity would be in the properties. And all the series of problems and correspondence already being well documented, nonetheless, Northwestern Bank bought those loans back. And that's the purchase of a low quality asset from an affiliate.[648]

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[646] *Id.* (2015) at 1694 (Jackson).

[647] ED Ex. (2015) 48 at 27-29.

[648] Tr. (2015) at 163 (O'Neill). See also Examiner O'Neill's testimony that when the loans were repurchased on September 29, 2011, the group of loans were low quality as a whole because, in part, Mr. Calcutt acknowledged that they were low quality at the time they were repurchased, and because they "had payments being provided to them by the new funds that were being given from the Bedrock Loan. If

Mr. O'Neill described the transactions – both selling the participations and then repurchasing them – as "an act of concealment, in my experience, by the management of the Bank that sold them before the Exam and then repurchased them after the Examiners had left."[649] Further, Mr. O'Neill opined that Mr. Calcutt had, and breached, his fiduciary responsibility to tell the Board at State Savings Bank "the full extent of the problems that he was aware of based, among other things, [on] the correspondence that we have been reviewing here today".[650]

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you want to call that renegotiated" as that term is used in the definition of a low-quality asset includes an asset "whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor." Tr. (2015) at 672-75 and 678-86 (O'Neill); Resp. (2015) Exs. 90 at 6 and 157 at 1-2; EC Ex. (2015) 48 at 28 (26 of the ROE). Put more bluntly, Mr. Bush editorialized that if "I were Frankfort I would want to get rid of this garbage." Resp. (2015) Ex. 157 at 1. As Mr. O'Neill elaborated on the point, "the loans were 29 days past due and past maturity at the time of repurchase and subsequently were placed on non-accrual on November 30, 2010. As of the date of repurchase, Northwestern Bank management had already engaged in correspondence and negotiations for restructuring all of these loans based on cash flow problems, vacancies and other evidence of financial distress." Tr. (2015) at 687 (O'Neill). See also testimony of Examiner Bird regarding the 29 day delinquency status of the Nielson Entity loans: "I had inquired about some past dues that occurred in the timeframe that you're talking about." Although unable to recall whether the response was provided by Mr. Green, Mr. Jackson, or Mr. Doherty, Mr. Bird testified that "I was told that they were administrative past dues, that loans had matured and that they were waiting for all parties to get together for signatures and closing." There was, however, "never a communication that the payments had stopped." Tr. (2015) at 886-87 (Bird).

[649] Tr. (2015) at 168 (O'Neill).

[650] *Id.* See also testimony of Examiner Bird regarding the sale and repurchase of these loans: "In my experience, a transaction such as

Asked what facts led her to conclude that Mr. Calcutt intended to have the loans returned to the Bank immediately following the examination, Ms. Miessner testified thus:

> So we were not aware of this sale or repurchase until during the 2011 Exam, and they told us that they bought them back because of the deteriorating credit quality of the Nielson credits, but yet they still didn't identify them internally as problem credits in 2010 when they bought them back. So their statements contradict each other as far as -- it was contradictory to what their actions would have done.[651]

Q. The Distressed State of the Nielson Entities Loan Portfolio in 2010

The $760,000 Bedrock Loan and the first release of Pillay Funds collateral permitted the Nielson Entities to bring current each of their loans – but only through September 1, 2010.[652] On October 4, 2010, Mr. Green sent an email message to Ms. Berden, reporting that all Nielson Entity loans, other than those associated with Immanuel LLC (which had filed for relief in bankruptcy) were "matured and all are due".[653] In this message, Mr. Green

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this, a sale just before the exam and a purchase a few months after the exam, would be highly questionable and dubious as far as the legitimacy of the initial sale." Tr. (2015) at 849 (Bird).

[651] Tr. at 857 (Miessner).

[652] Excepting Immanuel LLC's loan, which had been included in that company's bankruptcy.

[653] EC Ex. 3 at 148. See also testimony of William Calcutt, Esq., who worked with Fred Bimber, Esq. challenging the Immanuel LLC Chapter 11 bankruptcy, that the Bank and Immanuel's other major

stated that the Bank "may agree to use the Pillay funds held as collateral to make the monthly payments on loans which Cori indicates cannot be made either directly or indirectly by its owners or from other sources."[654]

Ms. Berden confirmed this, testifying that most of the loans to Nielson Entities had matured on September 1, 2010, and were "due in full."[655] Describing the circumstances in 2010 as similar to those in previous fall, Ms. Berden testified that the Nielson Entities "didn't have the cash to pay those loans in full" so "we stopped making payments on any of the loans, including the ones that were matured and the ones that were not yet matured."[656] She also confirmed the contents of the email message dated October 19, 2010, in which she told Mr. Green that the Nielson Entities "simply don't have access to enough cash to continue making payments on the specified properties without running out of cash in the near future, which would put them and the bank in the same spot."[657]

Responding to Mr. Green's suggestion that the remaining Pillay Trading funds again be used to service these loans, Ms. Berden stated: "it doesn't make sense for these entities to borrow Pillay's cash to make loan payments. That cash would only cover a short period of time, and then the entities and the bank would be in the same

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creditor, Oleson Foundation, discovered "there were a number of fraudulent transfers of I think about 20 properties by Immanuel." Tr. at 1143 (W. Calcutt).

654 EC Ex. 3 at 148.

655 Tr. at 126 (Berden).

656 *Id.*

657 EC Ex. 3 at 151.

boat at that time."[658]

Beyond rejecting Mr. Green's suggestion regarding the use of Pillay collateral, Ms. Berden countered his proposal with a proposal that the Bank offer "either a period of time with no payments, or there's a proposal in here about PIK interest", where PIK was described as having the loans "accrue interest and increase the principle balance.[659] She testified that she also expressed an interest in short sales of the properties – "trying to unload the properties as quickly as possible still in a depressed real estate market, but knowing that if we needed to sell them quickly we would need to drastically lower prices," provided the Bank included deficiency waivers as part of the deal.[660]

Ms. Berden testified that Mr. Green rejected these proposals in an undated memo that referred back to his email message of October 4, 2010 and Ms. Berden's responsive email dated October 12, 2010.[661] According to Ms. Berden, the Bank "didn't like any of our suggestions. They weren't planning to do any new loans. They didn't want to accept any deeds-in-lieu. We were kind of at a

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[658] *Id.*

[659] Tr. at 129 (Berden); EC Ex. 3 at 151.

[660] Tr. at 129 (Berden). See also testimony of Mr. Doherty, reflecting that the Nielsons "wanted permission to do short sales and have the Bank absorb any losses that would incur. . . . And they just expected to walk away from it, not contribute any of their own resources that they had. Some of the millions." Thus, Mr. Doherty agreed that if a property that was collateral for a loan was sold and the sale price was below that what was owed on the loan so that the Bank wasn't repaid in full, the Nielsons were asking the Bank to just absorb the difference. Tr. at 1209-10 (Doherty).

[661] Tr. at 129-30 (Berden); Resp. Ex. 51.

standstill."[662]

That standstill appears to have remained in effect through most of the last quarter of 2010. In an email message to Ms. Berden dated December 6, 2010, Mr. Green proposed to have the Nielson Entities "utilize the Pillay funds to help you make payments if we can extend the maturity date to 4/15/2011," allowing the "deposit accounts [to be] funded through the payment period and all property taxes remain current."[663]

There is evidence that Cori Nielson offered a "2 month renewal until January 31, 2011," informed in part by Ms. Nielson's observation that "maturity dates don't seem all that critical to the Bank, and it only becomes urgent when there are deadlines for quarter-end reporting."[664] Ms. Berden explained (in an email to Mr. Green dated December 6, 2010) that she sought the shorter two month renewal, rather than the period suggested by Mr. Green, only because "your group doesn't want to work out the details for short sales and deficiency waivers, saying those are 'for later'".[665]

By mid-December, it appeared negotiations were likely to result in a plan that once again depleted Pillay Trading funds for use in servicing the outstanding Nielson Entity loans. In an email message dated December 15, 2010, Ms. Berden presented a proposal where $686,646.07 would be released from Pillay and used to pay the Nielson

[662] *Id.* at 130 (Berden).

[663] EC Ex. 3 at 162.

[664] *Id.* at 165-66.

[665] EC Ex. 3 at 162; Tr. at 1004 (Nielson) (stating that a short sale is when "the Bank approves releasing its collateral for a sale to a third party that results in less proceeds than is owed the Bank.")

Entity loans directly.[666] The proposal, however, would only "get loan payments current up to and including payments . . . due on January 1, 2011," in some cases covering principle and interest, and in others covering interest only.[667] There is no evidence in the record that the individual Nielson Entity loans had demonstrated there was sufficient cash available to continue to service these loans, at least not without relying on cash from other Nielson Entities.[668]

Proceeding in this fashion, the Bank and Ms. Berden executed revised loan documents that, at Ms. Berden's request, included the release of "Bernard's guaranty of $400,000 on 067406662" followed by the release of "the remaining $289,779.11 from Bernard's guaranty on

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[666] EC Ex. 3 at 170.

[667] Tr. at 134-35 (Berden); EC Ex. 3 at 170.

[668] See also testimony by Examiner O'Neill regarding the failure of Bank management to fully disclose the terms of the proposal regarding Pillay collateral: Asked with respect to the Commitment Review for the Bedrock Loan (EC Ex. (2015) 51 at 160) whether the explanation for the purpose of the loan was unusual, Mr. O'Neill answered that there was no description of the use to which the Pillay funds would be used, which, he opined, meant that the Board members were not being told why the funds were being released. He testified that using released funds to make payments on several unrelated loans or loans not identified in the Commitment Review "usually a red flag that the underlying cash flow from operations is insufficient to be paying these loans. It would also raise into question the stated purpose as working capital because if in fact we are having to release collateral to make payments, well, that's not an accounts receivable, not inventory, the normal type of things dealing with a working capital loan." Tr. (2015) at 599 (O'Neill); EC Ex. (2015) 51 at 160. Note that Joint Ex. (2015) 6 is a copy of the Commitment Review Mr. O'Neill refers to as EC Ex. (2015) 51 at 160, without the notes he attached to the Review.

067406690."[669] In this context, Bernard was "the entity that was holding the Pillay units," and the guaranty had been for the Bank's benefit as security for the two loans identified in the email to Mr. Green.[670] Upon completion, total indebtedness of the Nielson Entities in December 2010 was $34.2 million, and the 2010 Pillay disbursement to the Entities' loans was just under $690,000.[671] The Bank issued the agreed-upon releases on August 5, 2011.[672]

Ultimately, after a July 31 2012 $30,000 charge-off against the $760,000 Bedrock Loan,[673] and loan losses against the Nielson Loans of at least $6.44 million,[674] the Bank secured an order in foreclosure against the Bedrock collateral.[675] In the order, Notes shown as being owed to the Bank as of April 18, 2012, totaled more than $8.2 million.[676] By stipulation entered on November 4, 2013, the deficiency owed by Bedrock to the Bank was $1,023,557.56.[677] According to Ms. Berden, to date, the amounts Bedrock owed to the Bank have never been fully

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[669] EC Ex. 3 at 177.

[670] Tr. at 136-37 (Berden).

[671] *Id.* at 140 (Berden); EC Ex. 147.

[672] Tr. at 142-43 (Berden); EC Ex. 53.

[673] EC Ex. 81 at 70.

[674] EC Ex. 48 (2011 ROE) at 43, 52, 83-93, and 124.

[675] Tr. at 146 (Berden); EC Ex. 183.

[676] Resp. Ex. 183.004.

[677] EC Ex. 129. See also testimony of Mr. Bimber: following the foreclosure action against Bedrock Holdings LLC, who set the "money that the Bank never actually collected from any source" at $1.8 million. Tr. at 381-82 (Bimber).

paid.[678]

R. Impact of the Bank's Failure to Document and Disclose the Status of the Nielson Entity Loans

Following the 2010 examination, FDIC Examiner in Charge James Russell met with Mr. Calcutt and Mr. Jackson to conduct an exit conference and record the initial reactions of the Bank's managers.[679] Meeting with the managers was the Michigan Regional Supervisor for OFIR, Al Clark, and the FDIC's Case Manager, Anne Miessner.[680]

Included in the 2010 exit meeting was a discussion about the regulators' concern regarding Waypoint/Nielson-entity loans that were maintained as interest-only loans (rather than loans amortizing principal and interest), where the loans were for the benefit of income-producing property.[681] Ms. Miessner testified that at this time, the regulators were not aware of the nature, scope, and details of the Bedrock Loan transaction, which had occurred in late 2009.[682] During the exit conference, when the regulators raised questions about this concern, Bank management offered no response and did not disclose the terms of the Bedrock Loan transaction.[683]

During the 2010 exit conference, regulators discussed with Mr. Calcutt the potential finding that the Bank's composite rating and its Earnings rating was going to be

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[678] Tr. at 147-48 (Berden).

[679] EC Ex. 22.

[680] *Id.*

[681] Tr. at 758 (Miessner).

[682] *Id.*

[683] *Id.* at 759-60 (Miessner); EC Ex. 22 at 3.

adversely affected based on the findings in the ROE.[684] According to Ms. Miessner, Mr. Calcutt objected:

> So during the exit meeting, Mr. Calcutt and Mr. Jackson were talking about how their performance was better than other banks' performance and that given the economic downturn, that they thought that we should, you know, that our ratings should be different than what they were based on the fact that they were performing better than other banks given the economic downturn, which of course now we know that the performance numbers that they were using to present to us to argue that case were falsified and in fact when they were adjusted appropriately they were performing lower than those banks that they were trying to say they were performing better than.[685]

To the same effect, when the Bank through Mr. Jackson offered a written response to the concerns raised by EIC Russell, no mention was made of the nature of the Bedrock Loan or the fact that the loan proceeds had been disbursed without Board approval – instead, Mr. Jackson wrote that "[t]he Board is well informed of all activities of the Bank and all major decisions are reviewed and discussed openly with the Board."[686] Although beyond the scope of this recommended decision (because it concerns only Mr. Jackson), preponderant evidence set forth above makes it plain that this was a material misrepresentation by Mr. Jackson of conditions related to the Board's

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[684] Tr. at 821 (Miessner).

[685] *Id.* at 822-23 (Miessner).

[686] EC Ex. 23 at 9.

knowledge and approval of the Bedrock Loan.

Mr. Gomez explained that the 2011 Examination established the Bank's management had "actively concealed the accurate condition of [the Nielson Entities credit] relationship from regulators and from the Board through the failure to maintain complete loan files and through false or misleading verbal and written statements."[687] He identified a series of documentation lapses – notably with respect to the use loan proceeds were to be put to, and the source of payments in service to the loans.[688] "When a loan is made, you want to know what the proceeds are being used for. Is it to buy land? Is it to buy equipment? You don't want the borrower using the proceeds to buy something or engage in something that the Bank would consider . . . inappropriate activity."[689]

Specifically with respect to the Bedrock Loan, Mr. Gomez stated the regulators' concern was "where is the actual source for repayment going to be?"[690] The borrower lacked income-generating property, it lacked inventory, and there was no apparent source for repayment.[691] Equally of concern to Mr. Gomez were the absence of personal guarantees by the borrowers, and the lack of current and complete financial information from the borrower.[692] Without this information, the Bank held off "identifying troubled debt restructures," such that "the Bank's financial overall condition is not being

[687] Tr. at 270 (Gomez); EC Ex. 48 at 40.

[688] Tr. at 270 (Gomez).

[689] *Id.*

[690] *Id.* at 271 (Gomez).

[691] *Id.*

[692] *Id.* at 279 (Gomez).

properly recognized" in Call Reports.[693]

Mr. Gomez offered his expert opinion that the $760,000 Bedrock Loan transaction was an imprudent banking practice, one that was contrary to the generally accepted standards of safe and sound banking operations.[694] Specifically, he opined that using "proceeds on loans to make current and keep current other notes," while lacking current appraisals, financial reports, and title searches, exposed the Bank to those risks arising when a borrower hides the true condition of the loans. By failing to properly identify the condition of the loans and by using the release of collateral to keep other loans current, the Bank through Mr. Calcutt engaged in practices that were contrary to generally accepted standards of safe and sound banking operations.[695]

Mr. Gomez also expressed an opinion regarding that part of the Bedrock transaction that involved acquiring a second mortgage. This feature, in his opinion, could not alleviate the regulators' concern about the release of the Pillay collateral.[696] He explained that there were no updated appraisals to support the second mortgage, so the regulators "don't know what the current values are."[697] Further, while the instrument securing the loan was spoken of as though it was a second mortgage, there had been no title search, and as a result this may have been other than a second mortgage, possibly third or fourth in line –

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[693] *Id.* at 280-81 (Gomez).

[694] *Id.* at 283-84 (Gomez).

[695] *Id.* at 285-86 (Gomez).

[696] *Id.* at 286 (Gomez).

[697] *Id.*

because no one had examined for prior liens.[698] There was, indeed, testimony establishing that upon foreclosure in 2012 of the $760,000 promissory note secured by the Bedrock properties, the Order of Foreclosure reflected the presence of five secured mortgages, and the Bank sustained a deficiency in the amount of $1.8 million.[699]

Further, and here specifically referring to Mr. Calcutt's decision to permit the release of the Pillay collateral, the decision created "a temporary mask over a bigger problem because there's no continued source of where all these payments are going to come from."[700] The Bank "essentially [did] the same action twice. Once in 2009, and again in 2010, to try to keep the hiding of this condition going, which is not a prudent practice, especially

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[698] *Id.* at 286-87 (Gomez). See also testimony from William Calcutt regarding the Bank's security interest in the Pillay Fund, that "at some point I looked at the loan documents or loan documentation. I suspect that it was in late 2010 I will guess, and I think that's when I first saw the Security Agreement. I think it was a Pledge Agreement. . . . Just going through it, I saw it, and I said 'What, what's this? Do they have a valid security interest in these Pillay Trading Units?' which were membership interests in another LLC . . . . I thought it was really problematic, and at some point I'm guessing I wrote an email or memorandum about it because the problem I had was the description I didn't think was sufficient perhaps under Article 9 or Article 8 of the U.C.C." Upon his review, William Calcutt found this ambiguity "very troublesome and I think I advised the Bank to say this may not be enforceable. We may not have a security interest in these Pillay Trading Units." Tr. at 1152-53 (W. Calcutt). To the same effect, see testimony of Mr. Jackson that, based on William Calcutt's legal opinion, he had particular concerns that the Bank was unable to perfect its security interest in the Pillay collateral. Tr. (2015) at 1664 (Jackson).

[699] Tr. at 380-81 (Bimber); Resp. Ex. 183.

[700] Tr. at 287 (Gomez).

due to the . . . amount of the loans and [the] amount of the capital that it represented."[701]

Presented with the Nielson's notice that the entities were going to cease making payments in September 2010, Mr. Calcutt concluded only that "here we go again, more posturing, more negotiating."[702]

Mr. Jackson was asked "if you didn't feel that they were being forthright with you about their ability to pay the loans, why do you feel that they had any credibility with respect to negotiating with you for paying the loans at any point in time?"[703]

He answered thus:

> No, we had a relationship with the Nielson family for years and years and years. It went back to another bank, and there was a very good relationship and a history of, you know, dealing with these things honorably and this was just totally contrary to the relationship that we had or the experience or the expectations that we had with them. We thought we had new young management that had come in to take the company over. We felt as though they were kind of flexing their muscles, pushing their limits to see how much they could get away with with the lender. Again, we felt that they were posturing, that they had the

[701] *Id.* But see the testimony of William Calcutt, expressing the opinion that, given the uncertainty over whether the Bank had a perfected security interest in the Pillay Fund Trading Units, "I was of the opinion that if you get any money for this Pillay Trading Units it's like getting something for nothing." Tr. at 1154 (W. Calcutt).

[702] Tr. at 1320-21 (Calcutt).

[703] Tr. (2015) at 1687 (Jackson).

> ability. And that if we would take the time to work with them in good faith, you know, we could get over this and get them to see the light and come back and do what they had committed to do for us.[704]

S. Regulator Concerns Regarding Respondent's Role in Bank Management

Mr. Gomez described the Bank's organizational structure as "very flat," in that "[e]ssentially everyone reported" to Mr. Calcutt.[705] He agreed that this was an "odd" structure, and agreed with the premise that this meant Mr. Calcutt was responsible for far more aspects of the Bank, rather than having vice presidents be responsible for some of these duties.[706]

Mr. Calcutt confirmed that he "wore several hats" but rather than agree that he served as the focal point of the

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[704] *Id.* at 1687-88 (Jackson).

[705] Tr. at 296 (Gomez). See also testimony of Mark Smith, at Tr. 391: "My observation was that it was a very flat organization, meaning that there was (*sic*) a lot of direct reports directly to Scrub. It may not have been . . . documented that way, but it seemed like all of senior management, which was a great number of individuals, all reported directly to Scrub." See also testimony of Ms. Miessner describing as "very unusual" for only the two top executives – i.e., Mr. Calcutt and Mr. Jackson – to participate in Examiners' exit meetings, but that was the case for the exit meeting following Michigan's examination in 2009. Tr. at 735-36 (Miessner). See also testimony of Examiner O'Neill noting that the Bank did not have a Chief Lending Officer and regarding examiner criticism prior to and during the 2011 examination that "Normally by the time a bank reaches the size of Northwestern Bank, it is unsustainable to have a CEO and president also wearing the hat of a senior lender. The task to each deserves its own undivided attention." Tr. (2015) at 608 (O'Neill).

[706] Tr. at 296 (Gomez).

Bank's management described the Bank as having a "very decentralized organization".[707] In his testimony, however, Mr. Calcutt acknowledged having "at least 20" people directly reporting to him – a convergent structure that does not suggest decentralization of management within the Bank.[708]

Also of concern with respect to the Bank's organization was Mr. Calcutt's apparent reluctance to acknowledge that he had all of these senior managers directly reporting to him. When asked whether Bill Green was one of the employees who reported directly to him – a question that called for a yes or no answer, Mr. Calcutt deflected, answering "He reported to the Senior Loan Committee. He reported to Credit Administration. He would have reporting responsibility to a number of people."[709] This answer was neither complete nor true, as it withheld from the record the truth – that Mr. Green did, in fact, report directly to Mr. Calcutt. So determined was Mr. Calcutt's effort to mislead this Tribunal during his current testimony that the only way a true and complete answer could be secured from Mr. Calcutt was for Enforcement Counsel to refer Mr. Calcutt to his sworn testimony from the hearing conducted in 2015, and upon seeing what he testified to in 2015, Mr. Calcutt now "clarified" his testimony by directly acknowledged that Mr. Green reported to him.[710]

Similarly, when asked "who was overall responsible for regulatory compliance," rather than acknowledge his

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[707] *Id.* at 1263 (Calcutt).

[708] *Id.*at 1360-61 (Calcutt).

[709] *Id.* at 1362 (Calcutt).

[710] *Id.*, and Tr. (2015) 1818 (Calcutt).

own responsibility as the Bank's CEO and President, Mr. Calcutt testified, fatuously in my opinion, that overall responsibility for compliance was with a committee that evaluated the Bank's classified assets, as well as "a number of people in the Commercial area. Credit Administration, the individual lenders. And obviously we had a security department, internal audit department, compliance department".[711] The term "overall responsibility" should have required no definition or interpretation: as the Bank's CEO and its President, "overall" responsibility was placed with him. To the same effect, where uncontroverted evidence established that when the $760,000 loan funds were disbursed to it, the Bank had no current financial statements for Bedrock Holdings, I find unavailing Mr. Calcutt's assertion that responsibility for advancing this loan was with the Bank's Credit Administration department, and not with him.[712]

Also of concern is testimony by Mr. Calcutt that the Bank's Board of Directors gave "verbal approval" of the

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[711] Tr. at 1270 (Calcutt). According to Mr. Jackson, "Typically, what would happen is the loan review would be approved or rejected by the Senior Loan Committee. If it were approved and it required a higher level of approval, following the Senior Loan Committee it would go back to the Credit Administration Department. The Credit Administration Department would put the loan review form out on the secure website and notify the independent directors that there was a loan available to be reviewed and ask them to take a look at it and provide their responses, approval, questions, or disapproval back to the Credit Administration Department." Tr. (2015) at 1607 (Jackson). Mr. Jackson testified that with respect to the Bedrock Loan approval through November and December 2009, these normal policies were not followed. *Id.*

[712] Tr. at 1380-81 (Calcutt).

2009 loan to Bedrock before the $760,000 had been disbursed.[713] The record reflects that there are no notes to that effect, "other than the ultimate write-up which was signed off on by the Board and the Senior Loan Committee."[714] Board Minutes from December 17, 2009, and testimony by Board Members Byl and Swanson noted above, constitute preponderant, credible, reliable, and substantial evidence that no such Board approval had been given prior to the disbursement of these funds.[715] Mr. Jackson expressly testified that any verbal discussion took place before the loan was approved, "it's not documented" in December 2009; nor was there any documentation showing the Board's approval of money being disbursed out of the Bank in December 2009.[716] Given the nature of his testimony, including his statement that he could not remember the conversation when the Board members were informed, I give little weight to Mr. Jackson's testimony that the Bank's Board of Directors had been well-informed "through verbal discussions that we were having ongoing conversations with the Nielsons."[717]

Given that the parties have stipulated that the Bank funded the Bedrock Holdings Loan on or about December 14, 2009, and given that the December Board meeting was held on December 17, 2009, even Mr. Calcutt's assertion that the Board gave its "verbal approval" on December 17, 2009, indicates the funds were paid out through Mr.

[713] *Id.* at 1377-78 (Calcutt).

[714] *Id.* at 1377-78 (Calcutt).

[715] EC Ex. 101 at 16-18.

[716] Tr. (2015) at 1670-71 (Jackson).

[717] *Id.* at 1673 (Jackson).

Calcutt's direct approval, *before* the Board gave its approval.[718]

Further, Mr. Calcutt's cause is not aided by his admission that when the actual Bedrock Loan documentation was presented for Board approval in March 2010, while he signed or initialed it, he did not read it, "because the loan was already made."[719] He agreed that by not reading the documentation, he would not know whether the sources of repayment shown in the documentation were accurate, nor would he know if the net income attributed to the Borrower could service the debt.[720] Nor is his cause aided by testimony that he could recall no instance of the Board of Directors ever turning down a loan that had been presented by management, nor by his statement that he was never involved in processing or closing loans, or disbursing funds.[721]

Of further concern is Mr. Calcutt's testimony that he did not agree with the premise that as a Bank Director and as its CEO that he cannot delegate responsibilities of the greater authority he held in those capacities.[722] As Mr. Jackson opined, as Board Chairman Mr. Calcutt is ultimately responsible for keeping the Board informed.[723]

When shown the State of Michigan Examination from April 13, 2009, which bears his signature, Mr. Calcutt

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[718] Tr. at 1378-80 (Calcutt).

[719] *Id.* at 1383 (Calcutt).

[720] *Id.* at 1389-90 (Calcutt).

[721] *Id.* at 1444 (Calcutt).

[722] *Id.* at 1354 (Calcutt).

[723] Tr. (2015) at 1678 (Jackson).

agreed that he could not delegate his responsibility to personally review the contents of the Report.[724] Somewhat troubling was Mr. Calcutt's response to the question "Is it your normal practice to sign loan approval requests without reading them carefully?"[725] Where "no" would seem to be the only suitable answer, Mr. Calcutt responded: "It would depend. Typically I would read them, yes. But in this situation where the loan was already closed, there was no reason for me to review it."[726] Similarly, when asked whether he was familiar with Financial Institution Letters that the FDIC issues from time to time, Mr. Calcutt said simply, "no."[727]

Testimony by Board Member Swanson established that in the ordinary course of the Board operations, when Board members were asked to approve loans, if questions arose the Board member would not discuss the questions during board meetings but would instead contact either Sharon July or Ian Hollands, both of whom were credit analysts at the Bank.[728] The analyst would then respond to the Board members' questions, with the understanding

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[724] Tr. at 1355 (Calcutt); Joint Ex. 2.

[725] *Id.* at 1384 (Calcutt).

[726] *Id.*

[727] Tr. at 1418 (Calcutt); e.g., Policy Statement on Prudent Commercial Real Estate Loan Workouts, at EC Ex. 150, which Mr. stated "I don't recall reading it. It doesn't mean I didn't". Tr. at 1418 (Calcutt).

[728] Tr. at 456, 484, 492, 517 (Swanson). See also testimony of Mr. Hollands Tr. at 1135-37(Hollands); EC Ex. 119 (email from Mr. Swanson asking, inter alia, whether "corporate financial statements for f/y/e 2009 for [Blue Ridge Holdings, Moxie, and AuSable] be received and reviewed by loan officer prior to finalization or renewal?"), and EC Ex. 120 (email from Mr. Swanson asking Mr. Hollands or Ms. July to address in further detail, inter alia, the lack of personal guarantees on the Frontier Energy LLC loan).

that prior to responding he or she would have forwarded the question to Mr. Calcutt and possibly Dick Jackson; after which either Ms. July or Mr. Hollands would reply to the members' question by email.[729]

Testimony from Ian Hollands provided details about his responsibilities at the Bank and his interaction with Board members.[730] Serving as a credit analyst at the Bank between 1999 and 2004, he was promoted to credit manager in 2004.[731] As credit manager during the relevant time period, Mr. Hollands reported to Mike Doherty and was both performing credit work and supervising and training analysts.[732] He explained that the credit analyst would look at financial statements and balance sheets, prepare cash flow statements, examine prior financial performance and collateral – all relating to the proposed loan.[733] This information would then be presented through a credit write-up.[734]

Mr. Hollands testified about performing these duties with respect to the Nielson Entities, which he said was the Bank's "largest overall relationship" and was also "the most complicated relationship we had."[735] He said he worked directly with Mr. Green as the Bank's lender for

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[729] Tr. at 492-93 (Swanson).

[730] *Id.* at 1080 (Hollands).

[731] *Id.*

[732] *Id.* at 1081 (Hollands).

[733] *Id.* at 1082 (Hollands).

[734] *Id.*

[735] *Id.* at 1084 (Hollands).

the Nielsons throughout the relevant period.[736]

Mr. Hollands identified a series of emails between himself and Mr. Green regarding Mr. Green's direction that the Nielson loans "need to get approved."[737] Between December 3, 2009 and January 4, 2010, as the Bank was preparing for an external loan review that ordinarily would take about two weeks of his time, Mr. Hollands alerted Mr. Green to the fact that the Nielson renewals "will get pulled come next exam, so it would be good to get moving on them now so we can have everything done before they get here."[738] He explained that apart from the external loan review, the Bank's regulatory examiners would look at these loans – the Nielson loans in particular, because as he already stated, they "were the largest relationship the Bank had so they got pulled every year."[739]

In an email he sent on January 13, 2010, when he had yet to receive from Mr. Green the financial information he needed to prepare for the external loan review and the examiner's review, Mr. Hollands reminded Mr. Green that "we still need to get together to talk about on what we need to do with respect to what happened on all of the Nielson loans."[740] Mr. Hollands testified that his concern

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[736] *Id.* at 1085 (Hollands): "The lender is the face to the customer. They are the ones talking to the customer, getting the deals, talking about their business. The lender then portrays that information to us."

[737] Tr. at 1085 (Hollands); Resp. Ex. 24.

[738] Tr. at 1087 (Hollands); Resp. Ex. 25.

[739] Tr. at 1088 (Hollands).

[740] *Id.* at 1089 (Hollands); Resp. Ex. 26. See also Resp. Ex. 27, in which Mr. Green provided to Mr. Hollands a list of fifteen Nielson loans that were the subject of Mr. Hollands' emails to Mr. Green.

about this was that the loans "had already been renewed on the [Bank's operating] system," but that "we needed to get the approvals done."[741] Also of concern to Mr. Hollands was the fact that the borrowers had not yet provided financial statements the Bank needed to provide to its reviewers and examiners.[742]

Mr. Hollands identified the Board Information Sheet reflecting the February 8, 2010 application for Immanuel LLC, seeking to "renew an existing loan that matured 9/1/09 for another 12 months."[743] He testified that this was an example of one of the loans that was approved in 2009 but that he only started writing an application for in 2010.[744] Mr. Hollands said it was his understanding that the loans had been extended because they were already on the Bank's books, but he did not know how that extension or approval process had occurred.[745] He stated that the document he prepared was used "to obtain approval," but these loans had already been approved and booked prior to year-end 2009.[746]

Mr. Hollands added that although he knew what the term "ratification" meant, "that wasn't common language

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[741] Tr. at 1089 (Hollands).

[742] *Id.* at 1095-96 (Hollands); see also Resp. Ex. 29, 1/14/10 email from Ms. Berden for Generations Management responding to Mr. Green's 1/13/10 request for financial statements from the entities, in which Ms. Berden is unable to produce the December 31, 2009 statements but supplies instead statements from December 31, 2008.

[743] Tr. at 1100-01 (Hollands); Resp. Ex. 32 at 1.

[744] Tr. at 1101-02 (Hollands). See also to the same effect Resp. Ex. 33 (Blueridge Holdings).

[745] *Id.* at 1102 (Hollands).

[746] *Id.*

for us to use" and was not a term he would use for a loan write-up.[747] For his part, Mr. Doherty testified that when Mr. Hollands brought to his attention that there was no loan write-up for the Bedrock loan, Mr. Doherty "told him we immediately needed to get a new write-up done and have it ratified."[748] Nothing in the loan write-up, however, reflects that the purpose of the Bedrock Review document was to ratify any prior action of the Senior Loan Committee or any other entity at the Bank.

Mr. Hollands also identified the Commitment Loan Review Form that was presented to the Board as the credit write-up for the Bedrock loan.[749] He said he prepared this Review starting on March 16, 2010, explaining that Mr. Green told him the purpose of the loan was that "we were restructuring this as a line of credit and the assumption is that that would be for working capital requirements" because "ninety-nine percent of line of credits are for working capital requirements, so we make that assumption unless we are told otherwise."[750]

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[747] *Id.* at 1103-04 (Hollands).

[748] *Id.* at 1198 (Doherty).

[749] *Id.* at 1104-05 (Hollands); Joint Ex. 6 (which is the same as the withdrawn Resp. Ex. 35).

[750] Tr. at 1106 -07 (Hollands). See also testimony by Mr. Doherty that "unless the lender would specify to the analyst working on the write-up anything different, it was always put as "working capital" on lines of credit." It would, according to Mr. Doherty, be presented this way "unless the lender [here Mr. Green] would specifically notify the analyst and put in the write-up that it's for other purposes." Tr. at 1203, 1235 (Doherty). Mr. Doherty added, however, that because the definition of working capital is "very vague," proceeds from the loan could be "used for distributions," and "if the owner took distributions, that's still working capital to the borrower." Tr. at1237 (Doherty). He confirmed however, that if proceeds are distributed to an entity that was

Mr. Hollands testified that he was not aware that the actual purpose of the $760,000 loan was to make payments on the Nielson-related entities going forward into 2010, nor did he know how the released collateral was to be used.[751] Upon completing the Review, Mr. Hollands then sent it to Mr. Green, who would then present it to the Bank's Senior Loan Committee, which included Mr. Calcutt, Mr. Jackson, Mr. Teachout, and Mr. Doherty.[752]

Mr. Calcutt explained the role of the Senior Loan Committee:

> We were just one step in the process for approving loans. Any loan under an individual commercial lender's loan authority could be approved by that lender without the Senior Loan Committee. When the loan amount exceeded their loan authority, then it would go to the Senior Loan Committee; and if it exceeded the Senior Loan Committee, then it would go on to the Board of Directors. We had very low loan authorities for a bank our size. So the Senior Loan Committee saw a lot of loans and so did the Board of Directors.[753]

Mr. Doherty testified that he started working at the Bank around 2002, after working for the Farmers Home Administration for 10-plus years, with terms of service in other commercial settings, leading to his service as the

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not a Bedrock owner, it would not qualify as working capital. Tr. at 1255 (Doherty).

[751] Tr. at 1125 (Hollands).

[752] *Id.* at 1109, 1123-24 (Hollands); Tr. at 1193 (Doherty).

[753] *Id.* at 1284 (Calcutt).

Bank's Commercial Loan Officer.[754] Reporting directly to Mr. Calcutt, Mr. Doherty supervised the Bank's Credit Administration Department – Mr. Hollands and Mona Alpers.[755] He testified that when the Nielson loans (including the Bedrock loan) were under negotiation for renewal and payments, Mr. Green was the person engaged in those negotiations.[756] He added that given the size of the Nielson relationship, the members of the Senior Loan Committee would have discussed the Nielson delinquencies in October 2009.[757] He could not, however, recall whether the Bedrock loan was proposed to cure the Nielson delinquencies.[758]

Mr. Hollands testified that although Board members did from time to time contact him with questions about write-ups regarding loans being presented for approval, those requests were infrequent: "I can probably count on one hand the amount of times the Board of Directors would come back with questions," but when that happened, Mr. Swanson was the member who most often would ask him questions.[759]

Mr. Swanson testified that although he believed he could contact Mr. Green directly (and could do so without having to go through Mr. Calcutt), if he did so no other Board member would be informed about the question or

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[754] *Id.* at 1186 (Doherty).

[755] *Id.*

[756] *Id.* at 1190 (Doherty).

[757] *Id.* at 1192 (Doherty); Resp. Exs. 18 and 20.

[758] Tr. at 1194 (Doherty).

[759] *Id.* at 1109-11 (Hollands).

the information provided in response.[760] Further, according to Mr. Swanson, loan presentations generally did not occur during Board meetings – it would be an unusual occurrence for Board members to actually be present for such presentations.[761]

The lack of Board discussions regarding Bank loans led Mr. Swanson at one point to suggest that there be a loan officer's presentation regarding loans and that the presentations be held during board meetings, explaining that he had "an interest in learning more about that credit than what was just in the Loan Presentation Sheet."[762] Although Mr. Calcutt told Mr. Swanson the Bank managers "would give it some thought," he never heard about the proposal again.[763]

Similarly, Mr. Swanson described the limited disclosure provided to Board members with respect to regulatory actions. Upon the Bank's receipt of the regulators' Reports of Examinations, Mr. Swanson would not be provided with his own copy – instead, he was told that the Report "had been received by the Bank and was available for our review because we also had to sign that report."[764] This meant Mr. Swanson had to "go to Traverse City and request a conference room where I could

[760] *Id.* at 493, 517 (Swanson).

[761] *Id.* at 494 (Swanson).

[762] *Id.* at 502 (Swanson).

[763] *Id.* at 502-03 (Swanson).

[764] Tr. at 505 (Swanson). See also testimony from Board Member Byl to the same effect, that while Mr. Calcutt would make the Board members aware of upcoming examinations, this would be in the form of "in passing or in a meeting we may have that 'Oh, by the way, the Examination is here.'" Tr. at 1036 (Byl). Mr. Byl described actually meeting

look at the Report in detail," but could do so only on site.[765] He added that the Board members offered "no real comment" about the Reports, and played no role in shaping the Bank's response to the Reports – having not received the draft responses until after the final response had been sent to the Examiners.[766]

Mr. Swanson stated that he felt that he served as an independent member of the Bank's Board, exercising what he believed to be his responsibilities to the Bank as an independent board member throughout his tenure there.[767] Nevertheless, Mr. Swanson testified that "Scrub was very open about his adversarial relationship with the Bank Examiners," and ultimately, he (Mr. Swanson) resigned from the Bank's Board (in December 2011) having become "frustrated with the lack of progress on resolving the issues between Bank management and the regulators."[768]

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with examiners, but those meetings occurred after the 2011 Examination. Tr. at 1037-38 (Byl).

[765] Tr. at 505-06 (Swanson).

[766] *Id.* at 507 (Swanson). See also testimony from Board Member Byl indicating that Board members would not know if other board members had questions about the loans, and didn't know there was a process by which he could ask questions of the credit analyst, Ian Hollands. Tr. at 913 (Byl).

[767] Tr. at 516 (Swanson).

[768] *Id.* at 509-10 (Swanson). See also testimony of Board Member Bruce Byl, to the effect that he knew of no loan application that was ever declined, and that Mr. Calcutt hated anyone who questioned his authority at the bank. Tr. at 909, 913 (Byl). Mr. Byl testified that "I felt that we were making decisions in silence. There was no opportunity to discuss. We were never encouraged to discuss this between us." Tr. at 914 (Byl).

T. Concerns Regarding Limited Loan Presentations to the Board

The record also reflects that under Mr. Calcutt's direction, loan presentations before the Bank's Board of Directors did not include in-depth discussions regarding the proposed loans. According to the Bank's Director of Global Risk, Mark Smith, Board meetings were "relatively brief," and loans "weren't discussed at board meetings."[769] Instead, the "regular practice at Northwestern [was] to approve the loans via email with the Board members separately."[770]

This, in Mr. Smith's experience, was not customary in banks smaller than Northwestern – where typically loans "would be reviewed by the board members in person, all together, and discussed."[771] For banks the size of Northwestern and bigger, "you typically see a board-level committee discuss those, those new loan deals, or loans, in person also."[772] He added that while the Bank had a senior management level loan committee, he was not aware that the committee ever appeared before the Board, except through email transmissions.[773]

Mr. Gomez noted that the Bedrock Loan was funded by the Bank, with Mr. Calcutt's knowledge and approval, in December 2008, but the Loan was not actually presented to the Board for its approval until March 2009.[774]

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[769] *Id.* at 393 (Smith).

[770] *Id.*

[771] *Id.*

[772] *Id.* at 393-94 (Smith).

[773] *Id.* at 394 (Smith).

[774] *Id.* at 289 (Gomez).

Mr. Gomez stated the evidence demonstrated that Mr. Calcutt failed to seek approval of the Bank's Board of Directors before completing the loan, thereby (in Mr. Gomez's opinion) breaching the fiduciary duty of candor, behaving in a self-serving way (protecting his bonus and dividends), and failing to abide by the responsibilities he owed to the Board to disclose what was happening with the Bedrock Loan transactions.[775]

Referring specifically to dividends paid under conditions affected by Respondent's failure to disclose material circumstances pertaining to the Nielson Entities loan portfolio, Ms. Miessner noted that the Bank paid a $463,000 shareholders dividend during the second quarter of 2011.[776] She said regulator approval of that dividend was based on insufficient information, as the information the Bank provided to the FDIC in support of the dividend "did not disclose the fact that on April 20, 2011 the Bank had placed the Nielson loans on non-accrual and reversed all of the income that they had . . . accrued throughout 2011 to that point."[777] She added that under these circumstances, the Bank paid the dividend without disclosing that the Nielson loans were no longer performing and therefore should not have been incurring interest."[778] Ms. Miessner testified that as a result, with earnings overstated, because a portion of the capital calculation reflects current period retained earnings, "the capital numbers

[775] *Id.* at 288 (Gomez).

[776] *Id.* at (Miessner); EC Ex. 48 at 65.

[777] *Id.* at 785 (Miessner). See also testimony of Mr. Jackson, confirming that the loans went on nonaccrual status in April 2011. Tr. (2015) at 1703 (Jackson).

[778] Tr. at 785-86 (Miessner).

were overstated. The earnings numbers were overstated. And then the asset quality was misrepresented as well."[779]

By concealing from the FDIC the true state of the Nielson loan portfolio, the Bank paid a dividend that, according to Ms. Miessner, "exceeded year-to-date earnings and also violated the provisions in the Section 39 Compliance Plan that required Tier 1 capital to be 8.5 percent in conjunction with the asset growth plan, and [the provision that] the ALLL that was supposed to make the ALLL adequate and make sure that the Tier 1 capital doesn't go below 8.5 percent."[780]

U. Respondent's Impact on the Bank's Call Reporting

According to Ms. Miessner, with respect to asset quality metrics, banks must use Call Reports to disclose "the number of days [a loan is] past due, whether or not a loan is on nonaccrual, and whether or not the loan is a troubled restructured debt and, of course, chargeoffs."[781] She said the Bank's CFO, Tom Levi, prepared the Bank's Call Reports, and that while she did not know what Mr. Calcutt's actual role was in preparing these reports, "Mr.

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[779] *Id.* at 786 (Miessner). See also testimony by Examiner O'Neill describing examiner concerns during the 2011 examination that by the Nielsons withholding payments, their actions threatened the overall financial health of the Bank, inasmuch as "they were the single largest borrowing relationship at Northwestern Bank. Their default would have had a very material impact on the institution." Tr. (2015) at 620 (O'Neill).

[780] *Id.* at 786-87 (Miessner); EC Ex. 105 at 9: "Following discussion [during the March 2011 Board meeting] a shareholder dividend in the amount of $462,950, representing approximately 9.87 of net income, was approved, the same amount paid since 2007."

[781] *Id.* at 861 (Miessner).

Calcutt is ultimately responsible for the information that's in the Call Reports".[782]

Notwithstanding Mr. Calcutt's testimony that he had "no involvement" in deciding what should or should not be reported in the Bank's Call Reports, and that the reports were "simply presented to me for signature,"[783] Mr. Calcutt had an affirmative obligation to certify the accuracy of those reports.

Testifying in 2019, Mr. Calcutt revised his answer to the question regarding his involvement in processing Call Reports, after stating he had "no involvement in the Call Reports," adding that "I had a CFO; I had a comptroller, and I had some very experienced people."[784] In testimony from neither hearing, however, is there any evidence that Mr. Calcutt actually consulted with those experienced people or took any steps to ensure that the information presented in the Reports was accurate.

1. Findings of Fact Regarding Respondent's Impact on the Bank's Call Reporting

Preponderant evidence establishes that Mr. Calcutt

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[782] *Id.* at 861-62 (Miessner) and transcript from the prior hearing at 1356-57 (Miessner). Also drawn from the witness's testimony at the prior hearing was her answer, in the affirmative, to the question whether her opinion would change if Mr. Calcutt "had absolutely no input into the decision as to what the contents of the classifications of the Bank were going to be in the Call Reports." Prior hearing testimony at 1450 (Miessner); and that she did not know what role Mr. Calcutt played in preparing answers to the examiners' questionnaires, testifying now that "I don't know his process. The process doesn't really matter, though, because it asks the question and he did not answer the question truthfully." Tr. at 865 (Miessner).

[783] Tr. at 1757 (Calcutt).

[784] *Id.* at 1424 (Calcutt).

was actively involved in the review of the Bank's Call Reports, and was aware of the contents of those reports throughout the relevant reporting period.[785] The record reflects that Mr. Calcutt was adamantly opposed to the idea that the Bank's 2010 Call Reports needed to be restated.[786] The opposition was presented in the written response from Mr. Calcutt to Examiners following the Bank's receipt of the draft 2011 Report of Examination.[787] In responding to the Examiner's draft findings that there was a need to restate the 12/31/10, 3/31/11, and 6/30/11 Call Reports due to false or misleading reports of information, the Bank's response was "Management strongly disagrees with this violation" and refers the Examiners to the Bank's "memo dated 9/13/11 related to the restoration of loans to accrual status pertaining to the Nielson relationship loans."[788]

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[785] *Id.* at 861-62, 865 (Miessner).

[786] *Id.* at 336 (Gomez).

[787] EC Ex. 53 at 3.

[788] EC Ex. 53 at 3. See also, EC Ex. 22 (7/26/10 File memo from Al Clark, FDIC Michigan Territory Field Supervisor re: July 23, 2010 Management Exit Meeting, Management Responses regarding Mr. Clark's and Ms. Miessner's observations during the exit meeting, when asked "How did Mr. Scrub Calcutt seem to respond to the FDIC's guidance or positions that were proposed during the exit meeting?" Ms. Miessner responded, "He disagreed with most of our recommendations. He disagreed with most of the apparent violations. And he disagreed with our analysis of the Bank's deteriorating financial condition", describing the FDIC's reference to the Examiners' interest rate risk analysis – i.e. the regulatory policy statement that sets forth what appropriate risk management practices are regarding interest rate risk – as "a bunch of crap." Tr. 754-55 (Miessner); Resp. Ex. 84 at 6 (7/30/10 email from EVP Jackson to Ms. Miessner reiterating "we strongly object to the findings and recommendations that

Mr. Calcutt testified that while he knew generally what kind of information is contained in Call Reports, the reports were prepared by "our accounting people," adding "I had nothing to do with the preparation of Call Reports. Had no input in them, never offered any input."[789] He testified, unconvincingly in my view, that he never reviewed information in the Bank's Call Reports, leaving preparation of the reports to the Bank's comptroller and her staff, adding that he had nothing to do with the 2009 Call Report.[790] But whether or not Mr. Calcutt actually read the Call Reports he signed, he had a fiduciary duty to the Bank to do so, and as such breached that duty by not familiarizing himself with what he was signing.

Elaborating on this point, Mr. Calcutt testified that on those occasions where he actually signed a Call Report, even though by doing so he was certifying that he had examined the income reported and that the Report was

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were presented" during the Exit meeting; and Mr. Calcutt's testimony that the adjustments reflected "an insignificant amount, less than one-third of one percent adjustment in our Capital Ratio," Tr. at 1347 (Calcutt), and Resp. Ex. 182, Bank's Comments Regarding Exam Report for 6/30/11 Examination: "Even without Restatement the total net effect of all the Examination adjustments on reported Capital ad December 31, 2011 is a reduction of approximately 2.8M, which would reduce the reported Tier 1 Capital Ratio by only about 30 basis points. The impact on December 31, 2011 is much smaller than the impact on June 30, 2011 because many of the Examination adjustments were recorded in the third and fourth quarter of 2011."

[789] Tr. at 1300 (Calcutt).

[790] at 1300-01 (Calcutt). See also Mr. Calcutt's further testimony that "I had no involvement in preparing [Call Reports], reviewing them, and I may have signed one, again relying on other people, once in a blue moon, but I had not involvement in the Call Reports." *Id.* at 1337 (Calcutt).

prepared in conformance with the Report's Instructions, "[i]t would be no different if this were JPMorgan or Northwestern Bank; any director signing a report of condition like this would be relying on a team of people, the CFO, the comptroller, a number of accounting people in signing this."[791] Mr. Calcutt has offered no legal support for the proposition that if the Call Report concerned JPMorgan and its signer failed to read the Report before submitting it, such failure would somehow not constitute a breach of fiduciary duties owed to the institution.

Under Mr. Calcutt's direction, Mr. Smith participated in making the Bank's response to Examiners' determination that the December 31 2010 Call Report be restated: Mr. Smith testified that the examiners contended that the Nielson Loans should have stayed on the Bank's books in non-accrual status, dating back to the fourth quarter of 2010. Bank management, however, had determined to end the Loans' non-accrual status in April 2011, whereas the examiners determined the non-accrual status should have remained unchanged, and that the Loans "should never had been put back on an accrual basis of accounting."[792] Key to the disagreement was Mr. Calcutt's position that "the Nielsons had brought all their loans current and . . . had showed or had the ability to repay so [the loan] should be moved back to accrual status."[793]

At issue, from the examiners' perspective, were the circumstances known to the Bank's management relating to whether the Nielson Entities had *documented the capacity to repay loans* that had been renewed at the end of

[791] *Id.* at 1358 (Calcutt); EC Ex. 132.

[792] *Id.* at 427 (Smith).

[793] *Id.* at 582 (Smith).

2010.[794] Mr. Smith testified that senior Bank management members had directed him to look into whether the Bank could restore the Nielson Loan portfolio in 2011 in the same way the portfolio was restored to accrual status in 2010.[795]

In resisting the examiners' direction to restate the Bank's 12/31/10 Call Report, Mr. Smith testified that – acting under Mr. Calcutt's direction – he questioned whether it was "really necessary to restate the fourth quarter" report.[796] Mr. Smith's first point was that the minimal nature of any accounting error would make a restatement of the Report unwarranted. He had reasoned that "taking the loans from an accrual basis to non-accrual would have reduced income by about $250,000 which, after taxes, [would be] $165,000, which we thought for a bank our size was not significant or material to have to restate the Call Report."[797] The examiners, on the other hand,

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[794] *Id.* at 429 (Smith).

[795] *Id.*

[796] Tr. at 428 (Smith).

[797] *Id.*; see also testimony by Examiner O'Neill recalling "there was an argument by Mark Smith that the income that would have been foregone on the credits being placed on non-accrual would not have been large enough in relation to the total income, and the response very much made clear by those Regulators present, including myself, was that the principal balance of the Nielson relationship was so large that anyone attempting to follow trends would not have seen the large bump up in principal of things put on non-accrual as a form of red flag about asset quality concerns. So, yes. It had importance beyond the earnings foregone. That's my recollection of, at least my contribution to this, and there were others that ultimately contributed to the final examination findings that are presented in our Report of Examination on this topic." Tr. (2015) at 734-35 (O'Neill).

regarded the correction to be material.[798] Ultimately, amended Call Reports for the quarters ending December 31, 2009 through December 2011 were filed on July 10, 2012, and an amended Call Report for the quarter ending March 31, 2012, was filed on July 26, 2012, all as had been directed by the examiners.[799]

In support of the Bank's position and in response to the request from senior Bank management (including Mr. Calcutt), Mr. Smith produced a memorandum drawing guidance from Federal Financial Institutions Examination Council (FFIEC) Guidance (at FFIEC 031 and 041) that the Examiners had provided to the Bank, which stated:

> As a general rule, a nonaccrual asset may be restored to accrual status when (1) none of its principal and interest is due and unpaid, and the bank expects repayment of the remaining contractual principal and interest, or (2) when it otherwise becomes well secured and in the process of collection.[800]

Also included in Mr. Smith's memo to Bank management was this FFIEC Guidance:

> [F]or purpose of meeting the first test, the bank must have received payment of the past due principal and interest unless, as discussed below . . .

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[798] Tr. at 428 (Smith).

[799] *Id.* at 598-599 (Smith); EC Exs. 78, 79. See also Mr. Doherty's testimony that he did not recall whether anyone from the FDIC instructed the Bank to classify the Nielson loans, but does not believe the Bank's examiners had instructed the Bank to classify the loans before the Bank did so. Tr. at 1212-13 (Doherty).

[800] Tr. at 429-31;(Smith); Resp. Ex. 60.2.

> the borrower has resumed paying the full amount of the scheduled contractual interest and principal payments on a loan that is past due and in nonaccrual status, even though the loan has not been brought fully current, and the following two criteria are met. These criteria are, first, that all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within a reasonable period, and, second, that there is a sustained period of repayment performance (generally a minimum of six months) by the borrower in accordance with the contractual terms involving payments of cash or cash equivalents. A loan that meets these two criteria may be restored to accrual status but must continue to be disclosed as past due in Schedule RC-N until it has been brought fully current or until it later must be placed in nonaccrual status.[801]

Mr. Smith testified that senior Bank management had taken the position that it was "justifiable to restore the Nielson Loans back to accrual status after they went non-accrual in the fourth quarter of 2010."[802] He agreed that the test, stated above, is whether the Bank "expects repayment of the remaining contractual principal and interest."[803] He explained, however, that Management's position was in conflict with the examiners' position because the examiners felt the Nielsons "hadn't shown us a sustained period of repayment." He added that the Nielsons "made one payment and brought the loans all current

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[801] Resp. Ex. 60.2-60.3.

[802] Tr. at 431 (Smith).

[803] *Id.* at 648 (Smith).

and immediately moved them to accrual status without showing six months of payments first."[804]

During examination on behalf of Respondent, Mr. Smith agreed that the question then at issue was whether circumstances were such that the Bank expected repayment.[805] When presented with the factual premise that the borrower negotiated to pay down the debt with liquidation of some of the Pillay assets, Mr. Smith agreed that this one instance did not mean the Bank did not expect full repayment.[806] He added, however:

> Well, if you're extending credit for them to make their own loan payments and lead management to believe they are struggling to fulfill or expect repayment of all remaining contractual principal and interest, then yes, I think management should have a concern or doubt their ability to do that.[807]

Elaborating further on this point, when presented with the premise that Cori Nielson had written to Bank management and stated "If you will work with us through this recession/depression, it must end eventually, and it would be our intention to pay Northwestern fully 100 percent cash back," Mr. Smith was asked "would that have ameliorated your concern about whether management expected repayment in full?"[808] Mr. Smith responded:

> No. Their history of loan payments didn't show

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[804] *Id.* at 432 (Smith); Resp. Ex. 60.3.

[805] *Id.* at 649 (Smith).

[806] *Id.*

[807] *Id.* at 649 (Smith).

[808] *Id.* at 652 (Smith).

> that they intended to pay off on their own. They only repaid us the end of 2009 through early 2011 with release of Pillay funds and funding of loans from us to repay their loans.[809]

Bank management's written response to regulators, which Mr. Smith gathered by talking with Mr. Calcutt, Mr. Doherty, Bill Green, and Dick Jackson, [810] was premised on senior management's representations to Mr. Smith that "the Bank expects repayment of the remaining contractual principal and interest, which I was told was true by senior management."[811] Further, Mr. Smith said that while he did not perform an independent analysis regarding the expectation of repayment by the Nielson Entities, he relied not only on the representations of Mr. Calcutt and others, but also on guidance from a CPA Mr. Smith reached out to – Kelly Bebow, a Principal at Rehmann, the Bank's external auditors.[812]

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[809] *Id.* at 653 (Smith). See also testimony of Examiner O'Neill, who was asked, based on Resp. Ex. (2015) 122 at 2, whether he would have taken consolation about the good faith of the borrower. Mr. O'Neill testified that he would not take consolation in this: "Actually it would be in a long line of traditions in any prudent banking that you would not look to this to be anything other than a recovery prospect. You would charge it off at a point in time when it is probable to be a loss, particularly if they are defaulted and you are starting to look for things like collateral with it releasing it, or by August 2011 there were already foreclosure proceedings, you are already looking to collateral at that point. At that point there is specific guidance that we have that says, no, you recognize the loss." Tr. (2015) at 654-54 (O'Neill).

[810] Tr. at 429-30 (Smith).

[811] *Id.* at 432 (Smith).

[812] *Id.* at 433 (Smith).

Without telling Ms. Bebow who the loan client was, Mr. Smith gave her details about the loans, and asked for her understanding of the above-cited FFIEC Guidance in the context described above.[813] Upon his presentation of the relevant facts as he saw them, Ms. Bebow told Mr. Smith that she interpreted the FFIEC Guidance on "Restoration to Accrual Status" to provide that "if all principal and interest is brought current and we expected full repayment of remaining principal and interest, we may restore the credit to accrual status."[814]

In his testimony, Mr. Smith agreed with the premise that because Immanuel LLC was in bankruptcy, there was no intent by the borrower to bring Immanuel current, so that would be an exception to his September 13, 2011 memo to Mr. Calcutt.[815] He also agreed with the premise that new, material concerns about his analysis arose when he became aware of correspondence by Cori Nielson, sent to the Bank prior to December 31, 2010, where Ms. Nielson indicated she could no longer make payments on these loans.[816]

Mr. Smith testified that he became aware of the existence of (but apparently not the contents of) correspondence from Ms. Nielson through a response sent

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[813] *Id.*

[814] *Id.*; Resp. Ex. 60.3. In her September 1, 2011 email to Mr. Smith, Ms. Bebow elaborated: "It appears that the 6 months criteria is ONLY for those instances where the borrower has resumed paying but is not fully current. I will say, however, that in practice the bright line test of at least 6 months of consistent payment is generally followed. (Also, you will not find any such bright lines in GAAP.)" Resp. Ex. 66.1.

[815] Tr. at 435 (Smith).

[816] *Id.* at 435.

to him on September 13, 2011, by Mr. Green, copied to Mr. Calcutt.[817] In it, Mr. Green wrote in response to Mr. Smith's request for input, to help Mr. Smith prepare to meet with the Examiners the next day.[818] In this email message, Mr. Green wrote: "I have no additional input. I would expect that the examiners may refer to two issues. One is that Cori Nielson had sent letters to the bank prior to 12/31/10 where she indicated she could no longer make payments."[819] Mr. Green apparently considered this to be less than significant, as he followed that statement with the statement that Ms. Nielson "had done this (verbally) on a prior occasion but then continued to make payments."[820]

The other issue was with respect to the Immanuel bankruptcy, where Mr. Green acknowledged that because there was no intent by Immanuel to repay, that loan would not fall within the scope of Mr. Smith's analysis.[821]

Mr. Smith testified regarding the context of this message:

> So [Mr. Green is] telling me even though the Examiners may say, "Well, the Nielsons say they don't have the ability to pay and won't repay," he was leading me to believe that they, this is more, this is them: They've said this in the past but they always continue to pay.[822]

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[817] *Id.* at 434-35; Resp. Ex. 178.

[818] Resp. Ex. 178.

[819] *Id.*

[820] *Id.*

[821] *Id.*

[822] Tr. at 435-36 (Smith).

At the time (*i.e.*, prior to the September 14, 2011 meeting with the examiners), Mr. Smith had seen none of the Nielson folio of correspondence between Cori Nielson (and Ms. Berden) and Mr. Calcutt and other Bank managers, and had seen no letters in the loan file reflecting statements, past or present, by anyone on behalf of the Nielson Entities, concerning an unwillingness or inability to repay these loans.[823]

Mr. Smith acknowledged that there were concerns about whether the Bank's security interest in the Pillay collateral was properly perfected; and agreed with the premise that it would be reasonable, under such circumstances, for the Bank to let the Nielsons use the collateral to pay down their debt, in both 2009 and 2010.[824] He also stated, however, that at the time of writing his memo to Mr. Calcutt he was unaware of how the Nielson Entity loans had been brought current in December 2010, and particularly was not aware of the role releasing the Pillay collateral played in bringing those loans current.[825] He testified that had he known about these details, he "would have come to a different conclusion – that they shouldn't have been moved back to accrual status" – "[b]ecause the customer[s] themselves hadn't shown the ability to repay on the loans without our release of collateral that they were paying on the loans."[826]

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[823] *Id.* at 436 (Smith).

[824] *Id.* at 645-46.

[825] *Id.* at 441 (Smith).

[826] *Id.* See also testimony from Examiner O'Neill who noted that in the September 13, 2011 analysis, Mr. Smith advanced the premise that in December 2010, "the Bank had no reason not to expect repayment" from the Nielson related entities, and in support of this premise noted that "Frontier Energy, a Nielson related entity, had recently

Elaborating, Mr. Smith testified:

> So in this instance, they were paying down on the loans but our collateral balance was less, so really . . . you're in the same situation; and they aren't showing the ability to bring in external money to pay on those loans.
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> . . .
>
> You kind of have . . . using collateral from one loan and then repaying on multiple loans, so those additional loans, those loans themselves don't show the ability to repay. Those entities themselves don't show the ability to pay on those separate loans, so it leads you to believe that it's really just one large entity that you're lending to, not multiple entities.[827]

Knowing now what he did not know when he wrote the memo preceding the September 14, 2011 meeting with the examiners, Mr. Smith testified that he no longer agrees with the conclusion in his memo, and offered the opinion that the loans described in the memo should not have been returned to accrual status "because the Nielsons had

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received a $10 million lawsuit settlement" which was believed to be unencumbered. Mr. O'Neill explained that through this analysis, the Bank was presuming the commingling of these funds: "In other words, whether Frontier Energy gets some sort of windfall, how does that help Bedrock? How does that help NRJ? It had been the Bank's representation to us all along that these are separate entities, that we shouldn't be lumping them together into one borrower. That was inappropriate." Tr. (2015) at 665 (O'Neill). See also testimony of Mr. Jackson, confirming that he did not know if Frontier had any obligation whatsoever to send the $10 million in funds to any other Nielson Entity. Tr. (2015) at 1666 (Jackson).

[827] Tr. at 442-43 (Smith).

brought 'em current . . . through the release of collateral and through the extension of credit by . . . the Bank."[828] He added that this change of opinion was based solely on what he learned regarding the use of the Pillay collateral – and that he did not learn about the Bedrock Loan's role in servicing the Nielson loans until January 2012.[829]

To much the same effect, Mr. Smith testified that the Bank's more formal response to examiners, in the form of a memo to Mr. Gomez and Ms. Thompson dated December 13, 2011, was "basically the same" as the Bank's response to the draft Report of Examination, and again, was the product of a collaboration with Mr. Calcutt and other members of the Bank's senior management team.[830] Here again, Mr. Smith noted that the response – which gave a four-point argument that the Nielson Entities "had the wherewithal to pay on the loans" came directly from Mr. Calcutt, Mr. Jackson, and Mr. Doherty.[831]

Mr. Calcutt testified to the same effect – recalling his email message to Mr. Green dated September 22, 2009, in which Mr. Calcutt forwarded Ms. Nielson's September 21, 2009 email in which she stated her intention to "pay Northwestern fully 100% cash back."[832] According to Mr. Calcutt, "knowing that they had significant financial resources, we expected them to repay their loans. With interest."[833]

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[828] *Id.* at 445 (Smith).

[829] *Id.* at 445-47 (Smith); EC Ex. 55.

[830] Tr. at 584-85 (Smith); EC Ex. 60.

[831] Tr. at 587 (Smith).

[832] Tr. at 1283 (Calcutt); Resp. Ex. 17 at 2.

[833] Tr. at 1283 (Calcutt).

While testifying that Mr. Calcutt never told him to withhold information from the Examiners,[834] Mr. Smith testified that "I believe [Bank] management knew the Nielsons were experiencing financial difficulty and it wasn't just posturing. [That they] had extended credit and a release of collateral so the customer could make payments on their loans is really the definition of an entity experiencing financial difficulty."[835]

Mr. Smith began inquiring about the Bedrock Loan transaction in a January 9, 2012 email message he sent to Mr. Green and other senior Bank managers.[836] He did so in response to an email inquiry by the FDIC's Case Manager Miessner dated December 15, 2011.[837] In her email to Mr. Smith, Ms. Miessner noted that Mr. Green had "provided a memo to examiners re: failure to document Nielson loan approval in Dec 2009."[838] She told Mr. Smith that she hadn't seen Mr. Green's memo and asked Mr. Smith to provide her with a copy.[839] Mr. Smith provided a copy of the memo, which is not dated,[840] but which provided Mr. Green's version of the circumstances surrounding the Bedrock Loan.[841]

Mr. Smith testified that he sought input from Mr.

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[834] *Id.* at 639 (Smith).

[835] *Id.* at 583 (Smith).

[836] *Id.* at 448 (Smith); EC Ex. 55.

[837] Tr. at 446 (Smith); EC Ex. 55.

[838] EC Ex. 55-002.

[839] *Id.*

[840] Mr. Smith testified Mr. Green's memo was prepared "probably in September 2011." Tr. at 446 (Smith)

[841] EC Ex. 55-001.

Green after the Bank's examiners had asked for an explanation for why the approval of the loan had not occurred until three or four months after the loan funds were disbursed.[842] In accounting for the length of time from when "the new loan of $760,000 was extended in 12/09," to the time of the loan's "actual approval" in March 2010, Mr. Green made no mention of approval by the Bank's Board of Directors during this period, but instead wrote that the loan had been "verbally approved" at meetings "between the bank and the borrower" after "discussions at the bank with the approving group," inferring that the delay was because he had been "tied up with several other loan requests at year end so the approval followed the verbal ok."[843]

Mr. Green added that the Bedrock Loan "was for working capital purposes" but stated "I cannot say exactly how the borrower or members used the money."[844] He added that disbursement "mostly would have been in the Team Services business but they may have disbursed funds to members as they are allowed to do. Members

[842] Tr. at 446 (Smith).

[843] EC Ex. 55-001.

[844] *Id.* See also testimony by Examiner O'Neill stating that examiners had "demonstrated through the tracing of bank records that the $760,000 was largely used for the purpose of keeping existing loans current, not for working capital" and upon that premise opining that Mr. Green's response here was not a true statement, nor was his statement that he "cannot say exactly how the Borrower or members used the money" because Mr. Green "was intimately involved in how the funds were disbursed, how restricted deposit accounts were created and the arrangements in which those restricted deposit accounts were used to continually make monthly loan payments on existing loans." Tr. (2015) at 600-01 (O'Neill); EC Ex. (2015) 55.

could do many things with it including invest in other borrowers they have an ownership in."[845] There is in the record, however, no evidence that proceeds of the Bedrock Loan mostly went to the Team Services business.

Mr. Smith also identified a January 19, 2012 letter from Mr. Calcutt to David K. Mangian, Assistant Regional Director for the FDIC.[846] Mr. Smith testified that working with his brother, attorney Bill Calcutt, Respondent Scrub Calcutt provided these responses to the FDIC's questions about the 2009 Bedrock Loan.[847]

In the attachment accompanying this letter, Scrub Calcutt stated that "some of the proceeds [from the Bedrock Loan] were used for loans with Other Entities" and before the 2009 Bedrock Loan "a partial release of the pledged Pillay Units was granted by Northwestern, with the understanding that the funds, as a result of that partial release, would be used by Bedrock to cover principal or interest payments on Bedrock loans and loans to some of the Other Entities" (where "Other Entities" was described as outstanding loans Northwestern had with "various entities managed by Waypoint Management or other (entity) managers that were managed by all or some of the managers of Waypoint Management.")[848]

Upon reviewing this explanation, Mr. Smith testified:

> After reading this and, and further analysis, that included this and I'm aware of the proceeds of the 2009 loan and the release of the Pillay Collateral,

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[845] EC Ex. 55-001.

[846] Tr. at 566 (Smith); EC Ex. 64.

[847] Tr. at 567 (Smith).

[848] EC Ex. 64 at 3.

> my conclusion would have been not to put it back to accrual status from the fourth quarter 2009 forward. To leave it in non-accrual status, I mean, from fourth quarter 2009 forward.[849]

Mr. Smith testified that it was clear to him during the 2011 Examination that an examiner had begun tracing the Bedrock Loan proceeds from December 2009, along with the release of the Pillay funds.[850] He testified that "I was aware or I assumed that's what the Examiner was doing, based on the deposit histories and the loan histories that he requested to look at the timeframes that he was looking at."[851] This raised concerns with Mr. Smith, and he in turn raised the matter during "regular meetings" with Mr. Calcutt and other senior Bank managers.[852]

One of those concerns involved a lending limit violation: In the August 1, 2011 draft Examination Findings, examiners wrote that there was a lending limit violation: "2/3 Board approval required on loan exceeding 15% capital and surplus. (State Law) This is in reference to the Bedrock Holdings loan, dispersed [sic] December 2009 and Board approved March 2010."[853]

Upon consulting with Mr. Calcutt and other senior Bank managers, Mr. Smith responded to the examiners by writing that "this was a documentation oversight by management."[854] He said that this answer came from his

[849] Tr. at 568 (Smith).

[850] *Id.* at 572 (Smith).

[851] *Id.*

[852] *Id.* at 573 (Smith).

[853] EC Ex. 52 at 1.

[854] *Id.* at 2.

understanding of the circumstances as Mr. Green had explained them, in the memo attributing the delay in obtaining Board approval to the fact that (Mr. Green) had "been tied up with several other loan requests at year end".[855] With respect to the claim that the Bank's Board "was fully aware of this loan prior to disbursement of the loan," Mr. Smith said he had been told this "by Scrub Calcutt, Dick Jackson, Mike Doherty, and Bill Green, most likely," while "we would have all been sitting around the table discussing our response to these, and this is the response that management wanted drafted."[856]

When presented with a copy of the Bank's Management Responses to the draft summary of Examination Findings for the August 1, 2011 examination, Mr. Calcutt denied recognizing it, notwithstanding that it bore his signature under the certification that each person signing the Responses "attests to the responses contained therein".[857] Mr. Calcutt refused to agree to the premise that he cannot delegate his responsibilities when signing the Responses, testifying that "I would sign this, but I would be relying just as any other institution would be on other people for the appropriate response."[858]

Mr. Doherty testified on this point, agreeing that Mr. Calcutt was on the Senior Loan Committee that had before it the Bedrock loan, and agreed that the removal of the Nielson loans from the Delinquency Report in November 2009 also would have been discussed by the Senior

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[855] Tr. at 580; EC Ex. 55 at 1.

[856] Tr. at 580-81 (Smith).

[857] *Id.* at 1359; EC Ex. 52 at 17.

[858] Tr. at 1360 (Calcutt).

Loan Committee members.[859] He further agreed that there would at this time have been some urgency in trying to cure delinquencies prior to the year end, and agreed that from the records presented to him – that there was the new $760,000 loan, and that as of the November 30, 2009 Delinquency Report it reflected that the Nielson loans were no longer delinquent – this indicated to Mr. Doherty that the Senior Loan Committee had approved the $760,000 loan.[860]

As noted above, following the 2011 Examination, the FDIC provided a draft summary of Examination Findings dated August 1, 2011, which included a description of violations found during the exam along with a record of the Bank's response thus far, asked for responses from Bank management in those cases where issues were noted and no response had yet been supplied by the Bank, and asked the Bank managers to note "any responses you feel are inaccurate."[861] Mr. Smith was tasked in November 2011 with providing the responses sought by the FDIC.[862]

The result was presented as an exhibit during the hearing, and bears the signature of Mr. Calcutt, the Bank's Executive Vice President, Richard Jackson, the Bank's Chief Financial Officer, Thomas Levi, its Vice President, Credit Administration, Mike Doherty, and Mr. Smith, as the Director of Global Risk.[863] From this record, preponderant evidence establishes that Respondent fully participated in making the Bank's response to the FDIC,

[859] *Id.* at 1192 (Doherty); Resp. Exs. 18, 19 and 20.

[860] Tr. at 1194-95 (Doherty).

[861] EC Ex. 52 at 1.

[862] Tr. at 578, 579 (Smith).

[863] EC Ex. 52 at 17.

and that he was fully aware of the contents of that response, as it had been sent at his direction.

Testimony from Board member Ronald Swanson provided additional evidence regarding the nature of the disclosures by senior Bank managers regarding the renewal of the Bedrock Loan as that loan became due on January 20, 2011. Mr. Swanson was presented with a copy of a Commercial Loan Special Request dated December 20, 2010.[864] After reviewing the document during the hearing, Mr. Swanson said he did not recognize it, and although the Request indicates it was approved at a Board meeting, Mr. Swanson did not recall it.[865] After reviewing it, he agreed with the premise that the Request makes no reference to Bank collateral (specifically the Pillay collateral) being released, nor does the Request reveal how the released collateral would be used.[866]

After being presented with a chart showing the distribution of proceeds from the 2009 Bedrock Loan (identifying each of the Nielson Entities and how the proceeds were distributed to them[867]), Mr. Swanson testified that, with respect to the original Bedrock Loan, he could recall no time when he had been advised by the Bank's management that the $600,000 collateral release of the Pillay funds would be used to service current multiple Nielson Entity loan accounts, or that the $760,000 loan proceeds were to be held in reserve to make future loan

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[864] EC Ex. 30.

[865] Tr. at 494 (Swanson); EC Ex. 30.

[866] Tr. at 495 (Swanson); EC Ex. 30. See also testimony of Mr. Jackson, confirming that the request does not include reference to the release of the Pillay collateral. Tr. (2015) at 1691 (Jackson).

[867] Tr. at 497-989; EC Ex. 133.

payment not only for the Bedrock account but numerous other Nielson-controlled entities.[868]

Mr. Swanson also testified regarding Concentration Reports, which he described as a listing in the Bank's loan portfolio designed to show concentrations in a particular industry or commercial real estate credit type.[869] He explained that the Bank assembled these reports at his request, because he wanted to see what concentrations there might be within the Bank's commercial loan portfolio.[870] He sought Concentration Reports because "it seemed to me that there was a large portion of the portfolio, given the presentation sheets I was looking at, that were related to real estate, and I wanted to see if our portfolio percentage was high in relation to the total portfolio in commercial real estate."[871]

Mr. Swanson testified that the Bank's Chief Financial Officer, Tom Levi, attended each Board meeting and occasionally would comment with respect to the Report's "Score Card," which was "a snapshot of some of the highlights in the deposit and lending area as related to each

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[868] Tr. at 496-97 (Swanson).

[869] *Id.* at 498-99 (Swanson).

[870] *Id.* at 499 (Swanson).

[871] *Id.* at 501 (Swanson). Mr. Swanson's concerns appear to have been well-founded. In the Board's response to the 2011 Joint ROE, the Bank wrote that its adversely classified assets "were significantly impacted by the addition of the Nielson-managed entity loans during the most recent exam period. The addition of these loans approximately doubled the Bank's adversely classified assets. Aside from this unique concentration, non-performing loans have not grown as significantly as it would appear." EC Ex. 76 at 3.

month's activity."[872] He then identified the Bank's Commercial Loan Delinquency Report.[873] He noted that the Loan Delinquency Report reflected current delinquent loans in the Bank's commercial portfolio, but stated that there was nothing in that report that indicated a relationship among the multiple Neilson Entities listed.[874]

Mr. Swanson stated that by November 2009, if not before, he became aware that the Nielson aggregate debt was very substantial, in the $40 million range.[875] He said the matter came up not as "a question that I had, but Scrub Calcutt explained that this [i.e., the October 31, 2009 Commercial Loan Delinquency Report] is largely the Nielson credits."[876]

Mr. Swanson described further discussion about these delinquencies thus:

> At that point, I addressed both Scrub Calcutt and Tom Levi about the unit borrowings regulations in Michigan, about the Examiners' accepting or passing, if you will, their term on those credits. I don't recall beyond that. But they both responded that the Bank Examiners had passed on those credits and so that they were not considered under the unit rules.[877]

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[872] Tr. at 519-20 (Swanson).

[873] *Id.* at 500 (Swanson); Resp. Ex. 18.

[874] Tr at 500 (Swanson); Resp. Ex. 18.

[875] Tr. at 523 (Swanson); Resp. Ex. 18.

[876] Tr. at 524 (Swanson); Resp. Ex. 18.

[877] Tr. at 527 (Swanson). See also testimony of Examiner O'Neill on the unit borrowing rule: "The unit borrowing rule or the part of the loan to one borrower law under Michigan law has to do with the total

Preponderant evidence as set forth above establishes the response by Mr. Calcutt to Mr. Swanson's questions here was misleading, and that, when given, Respondent knew his answers to Mr. Swanson would be material to the performance of Mr. Swanson's role as a member of the Bank's Board of Directors, and that the answers were misleading.

While mindful of Respondent's factual claim that "the cause and cure of the $40 million jump was clearly discussed,"[878] I find preponderant evidence establishes the Board members were not told of the relationship among these borrowers – making it impossible in 2009 for the Board members to fully understand the regulatory impact of the aggregated debt.

There also is testimony that one of the steps taken by the Bank's Board of Directors after it became clear that regulators were questioning the Nielson loan relationship generally was to "do the independent loan review of the Nielson relationship" – here accomplished by retaining

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relationship of interrelated borrowers and whether or not there is sufficient basis for grouping those together and calling them essentially a loan to one borrower. In the case of the Bedrock loans, there is an absolute limit of 25 percent of common stock in surplus and then there is a 15 percent threshold which above you can go if you take the loan prior to it being granted to September 17, 2015 the full Board and get at least two-thirds of that Board's voting in favor of it." Tr. (2015) at 637 (O'Neill). In Mr. O'Neill's opinion, from his review of communications from the Nielson borrowers and Autumn Berden, Mr. Green set up the flow of money to the Nielson Entities "in such a way to make it untraceable" except through tracing "the disbursement of the loans through checking account images to the ultimate loan payments" which, according to Mr. O'Neill, was information that was not maintained in the Bank's loan files. Tr. (2015) at 638-39 (O'Neill).

[878] Respondent's Post-Hearing Brief at 7.

the regional CPA firm of Plante & Moran for this purpose.[879] Initiated during a meeting of a special committee created by the Bank's Board of Directors in January 2012, Mr. Smith explained that the review was to examine the Nielson relationship and determine if there were other relationships similar to that the Bank had with the Nielson family.[880]

The independent loan review, completed in August 2012, concluded that "the length of time between the [Bedrock] loan closing (12/3/09) and Board approval (3/16/10), 103 days, as inconsistent with stated Bank policy and based upon our experience with similar financial institutions, highly irregular."[881] The review also concluded that the "use of the term 'working capital' to describe the Bedrock loan was not accurate."[882] The review found that "[g]iven that the loan officer, Bill Green, and Scrub Calcutt were aware of how loan proceeds were to be used, the use of 'working capital' to describe the loan can be viewed as being vague."[883]

2. Findings of Fact Regarding Respondent's Knowledge that the Purpose Stated in the Bedrock Loan Application was Misleading

Preponderant evidence as set forth above establishes that Respondent knew the description of the purpose of the Bedrock Loan was not only vague, it was also misleading, as it failed to fully disclose material information known to Respondent relating to the true

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[879] Tr. at 588 (Smith).
[880] *Id.* at 589 (Smith).
[881] EC Ex. 77 at 12.
[882] *Id.* at 13.
[883] *Id.*

purpose of the Bedrock Loan.

The Bank in 2012 entered into a Consent Order, following FDIC Examiners' 2011 findings of a "pattern of noncompliance with laws and regulations, noncompliance with Interagency Policy Statements, and disregard for regulatory recommendations over an extended period."[884] Also following the 2011 ROE, the Bank commissioned a management study, performed by FinPro, designed to "look at the structure of the Bank and also specifically senior management of the Bank," to determine whether or not management was "able to fulfil their capacity as the senior management, and also the structure of the Bank, whether it made sense for a bank of the size that we were."[885]

The FinPro management study was in addition to the work of an external loan reviewer, described by Mr. Smith as "an independent, fresh set of eyes outside of your Credit Administration team that goes in and reviews the credit and determines what they think the credit should be rated at, whether it's a good loan, substandard loan, and so on."[886] Mr. Smith added, however, that the Bank's examiners had expressed concern that this reviewer (JWM Consulting Services, Inc.) had not included the Nielson loan portfolio in its review, because, according to Mr. Smith, "I believe they had been instructed not to look at them because I was told the Examiners look at them every year, so no sense in paying JWM to look at them

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[884] Tr. at (Smith); EC Ex. 70.

[885] Tr. at 594-95 (Smith); EC Exs. 83-84.

[886] Tr. at 601-02 (Smith).

also."[887]

Mr. Smith explained that given the way the multiple Nielson Entities were interrelated, and given how the Bank maintained the accounts, where individual loans were not aggregated in the Bank's records, unless the examiners knew the Nielsons, it would not be apparent to anyone doing a loan review (either an external review or a review by regulators) that there was a relationship among these borrowers.[888] He testified that the impact of this on risks attributable to these accounts would be that if one of the accounts is struggling, "it could pull them all down, and if it pulls them all down at the time there's $35 million in loans out to the Nielson relationship, that would have been a major hit to the Bank for all of them to go bad at the same time."[889]

The record reflects that the process by which senior Bank managers, including Mr. Calcutt, facilitated the servicing of the Nielson loans through advancing new funds to keep the loans current violated Bank policy.[890] In the Material Weaknesses section of the Management Report Regarding Internal Controls and Compliance with Designated Laws and Regulations that Mr. Smith drafted (with input from the Bank's external audit firm, Rehmann), the

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[887] *Id.* at 603-04 (Smith); EC Ex. 89. See also testimony of Mr. Hollands, stating the Nielson loans were excluded from credit review "because they were reviewed by Examiners every year." Tr. at 1113-14 (Hollands). To the same effect, Mr. Doherty testified the Bank "would exclude them because they were getting reviewed by Examiners during their exams." Tr. at 1215 (Doherty).

[888] Tr. at 605 (Smith).

[889] *Id.* at 606 (Smith).

[890] *Id.* at 608-09 (Smith); EC Ex. 61 at 2.

findings (which were approved by both Mr. Calcutt and the Bank's Chief Financial Officer, Thomas Levi) include the following, concerning two loans that were not related to the Nielson Entities:

> Two loans were noted to be past due as of September 30, 2011, and became current on or before December 31, 2011 as a result of the Bank advancing new funds to keep the loans current or off the past due loan listing. While in both situations the Bank obtained additional collateral, it is against the Bank's policies and procedures to advance funds to keep loans off the books.[891]

Mr. Smith agreed that during the hearing conducted in 2015 in this administrative enforcement action, when he was asked about the Bank's policies in this regard, he testified that the language about advancing loans to keep funds current came into effect as part of the Bank's Section 39 compliance plan, which would indicate the policy was not in place before the 2010 Exam.[892]

3. Findings Related to the Costs Associated with Respondent's Misrepresentations

> There is in the foregoing record preponderant evidence that because Respondent and other senior Bank managers had misrepresented the condition of the Bank to its Board of Directors and to Bank's regulators, the Bank needed to hire and pay for a third-party consulting firm to investigate the handling of

[891] Tr. at 608-09 (Smith); EC Ex. 61 at 2.

[892] Tr. at 634-35 (Smith). Mr. Smith also testified that while these two loans were not related to the Nielson Entities, the auditors discovered the reported loans while doing a test "to define other instances similar to the Nielson relationship where loans were extended to keep them off the past due listings." Tr. at 610 (Smith).

the Nielson relationship.

V. Costs Associated with Respondent's Misconduct

As noted above, amended Call Reports were filed for the last quarter of 2009, and each quarter of 2010 and 2011, and included what Mr. Smith described as material restatements.[893] Summarized, these amendments reflected a $2.8 million negative adjustment to the Bank's net income.[894] The Bank's external auditors, Rehmann, agreed with the conclusion that the Call Reports needed to be restated, and upon receiving updated appraisals, the result was an increase in losses that "resulted in more of an impact on retained earnings."[895] This was not, however, the only cost associated with Respondent's course of conduct.

Mr. Smith completed a study of the costs the Bank had incurred "as a result of our issues with the FDIC".[896]

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[893] Tr. at 599-600 (Smith); EC Exs. 78-79.

[894] Tr. at 600 (Smith); EC Ex. 79. See also EC Ex. 148 at 44-45: The Bank's Consolidated Financial Statements, prepared by Rehmann for years ending in 2011 and 2010 reported a total of $5.3 million in restated retained earnings. But see testimony of William Calcutt that during the Immanuel bankruptcy litigation, while it at first appeared the Bank would be "about a million three short", "if the alleged transfers of those properties could be brought in, we estimated the value of [approximately 20 fraudulent transfers by Immanuel] were over two million which would have made the Bank whole." He added that at the time it was estimated the properties were worth $2.2 million or more, "more than sufficient to cover that $1.3 [million] shortfall." Tr. at 1143, 1146, 1151, 1165 (W. Calcutt); Resp. Exs. 17 (confidential settlement discussions email dated 9/22/09) and 70 (Settlement agreement in the Immanuel bankruptcy proceeding)

[895] Tr. at 625-26 (Smith).

[896] *Id.* at 611 (Smith); EC Ex.116.

Included were the costs of officer legal fees that had been paid by the Bank, legal consulting fees, increased audit fees, and FDIC assessments that would increase "as a result of our CAMELS ratings" change.[897] The total increased cost associated with these issues was shown as $2.29 million.[898] Further, the Bank, through Mr. Levi and as reviewed by Mr. Smith, recalculated the bonus that Mr. Calcutt was entitled to, taking into account the effects of the Bank's restated Call Reports.[899] In this context, restatement was warranted because the Bank had claimed it had received interest payments on the Nielson loans, and while the Bank had in fact received the money, it was not able to claim the money as interest income.[900] Nevertheless, after restatement the Bank was still profitable each year, with $1.8589 million in profits in 2009, $2.619 million in 2010, and $4.2 million in 2011.[901]

Mr. Calcutt testified that he followed the bonus formula of his predecessor, which had been 5.5 percent, "but

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[897] Tr. at 611-13 (Smith); EC Ex 116.

[898] EC Ex. 116 at 2.

[899] Tr. at 616-18 (Smith); EC Ex. 117.

[900] Tr. at 662-63 (Smith).

[901] *Id.* at 664 (Smith). (Tier I Capital was estimated after restatements but before auditor adjustments at 7.62 in 2009, 7.44 in 2010, and 8.67 in 2011. Per the Bank's Section 39 Plan, it was required to have capital of 8.5 percent after 2010. Tr. at 665-66 (Smith). See also EC Ex. 79 (Call Report Restatements Proposed by the Bank through December 31, 2011); testimony of Ms. Miessner: "the amount of interest that the Bank was earning on the Nielson credits was about – in 2009 was 30 percent of net income before tax based on what they reported originally at 2009. So a 30 percent decrease in their earnings, especially in a situation where they were in 2009 where earnings were already declining, that 30 percent reduction to earnings was very significant given their earnings profile or their earnings performance at that time." Tr. at 801 (Miessner).

then I reduced it when the Great Recession came. Reduced my salary. I was the only employee in the Bank to reduce my salary and I reduced my bonus percentage" to four percent.[902] And even at that, according to Mr. Calcutt, he was "underpaid" and is "still owed the money."[903]

According to Mr. Smith, Mr. Calcutt was entitled to a bonus based on Bank income of four percent.[904] Due to the Bank's restated Call Reports, CFO Levi found that under the original reports Mr. Calcutt accrued a total bonus of $1,258,121, while under the Call Reports as restated through the third quarter of 2012 that accrual was $1,103,190, a drop of $154,931.[905]

Further, Mr. Smith testified that the Bedrock collateral ultimately was taken into the Bank's possession, and sold off, resulting in a loss to the Bank.[906]

Ms. Miessner agreed that the Bank's net income, while reduced in 2009 and 2010, increased in 2011 as a result of the adjustments in the restated Call Reports:

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902 Tr. at 1347 (Calcutt).

903 *Id.* at 1348 (Calcutt). But see EC Ex. 117, Recalculated Bonus Calculation showing Respondent had been overpaid $68,841 in 2009 and $59,858 in 2010.

904 *Id.* at 619-20 (Smith). But see EC Ex. 79 (Call Report Restatements Proposed by the Bank through December 31, 2011); transcript of Ms. Miessner, confirming the ending balance of net income before tax fell from $6.9 million to $2.8 million. Tr. at 802 (Miessner)

905 Tr. at 618-10 (Smith); EC Ex. 117. But see Tr. at 632-63 (Smith) confirming prior testimony by the witness that after restatement of the Call Reports, he agreed during the prior hearing that Mr. Calcutt was actually paid less than the amount he was entitled to under the restated Call Reports.

906 *Id.* at 620-21 (Smith).

> And that's a result of the fact that in 2011 when the Bank recognized the Nielsons as problem credits for the first time and put in a large provision expense which is, a provision expense is an allotment of funds towards the allowances for lease losses, so they had put all of that into 2011; and so when we had to move that back to 2009 and 2010 to accurately reflect the risk profile of the institution in those years, then there was less that was needed by the time you pull all of that forward to 2011.[907]

6. Issues Pertaining to the Civil Money Penalty

Ms. Miessner testified that civil money penalties "are analyzed on an individual, case-by-case basis."[908] She was asked whether, in her opinion, Mr. Calcutt's misconduct merited a civil money penalty of $125,000, and responded that it did, opining that the level of misconduct, the ongoing nature of the misconduct, and Mr. Calcutt's refusal to cooperate all form the basis for that opinion.[909]

Asked on cross examination whether such penalties are typically sought where the person answering examiner questionnaires simply looked at answers given in prior years and "did not give the care that he should have in answering these questions," Ms. Miessner responded that she "can't really provide an opinion on whether the

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[907] *Id.* at 825-26 (Miessner).

[908] *Id.* at 866 (Miessner).

[909] Tr. at 811 (Miessner). Ms. Miessner further testified that it is her understanding that Mr. Calcutt "has stipulated to the fact that he has the ability to pay" a $125,000 penalty if it is assessed. Tr. at 811-12 (Miessner); Joint Ex. 16.

FDIC would consider CMPs on a situation such as that or not."[910]

Examiner Dennis O'Neill prepared a draft recommendation for the proposed penalty, using a matrix through which a penalty analysis is conducted.[911] Ms. Miessner then reviewed the draft recommendation, and submitted it for approval through the FDIC's regional management.[912] She testified that she considered factors set forth in the applicable regulations and statute, and the factors required under the FFIEC.

With respect to Respondent's good faith, Ms. Miessner concluded that Respondent had not acted in good faith:

> . . . that throughout the time period where we were looking at this and talking to him to try to get answers, he did not fully disclose to us the nature of the Bedrock Transaction. He never took the opportunities that were given or even made opportunities of his own to come to us and explain to us what happened, why it happened. There were a lot of questions about, you know, well, how do you know his intent? Well, we don't. Because he didn't, he didn't come talk to us. He didn't share that with us. And so we determined, the FDIC determined that he had not acted in good faith both, you know, leading up to us identifying the practice; and also subsequent to us notifying him that we knew what happened, he still hadn't

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[910] Tr. at 886 (Miessner).

[911] *Id.*

[912] *Id.*

acted in good faith.[913]

With respect to the gravity of the violation, Ms. Miessner concluded thus:

> So in the regulatory world, having a concentration of this size that the Nielsons, that the Nielson Loans represented, just having a loan relationship that size was imprudent anyway. That presented a lot of risk to the Bank, which presents a lot of risk to the Deposit Insurance Fund which is where, you know, our two interests lie: Risk to the Bank, risk to the Fund. And then on top of that, the relationship was managed imprudently for many years as far as allowing the Borrower to take draws on loans to make payments on other loans, capitalizing interest, not performing global financial analysis. So you have this huge concentration of credit that's 50 percent of the Bank's capital and yet bank management is continuing to loan them more and more and more money without ever doing a global financial analysis and really understanding the whole financial position of this borrowing group.[914]

With respect to Mr. Calcutt's history of previous violations, Ms. Miessner "was able to trace back to at least 2004" where the 2004 Examination cited several of the same types of lending practices that were still occurring in 2010. And that of course occurred in conjunction with the Bedrock Transaction."[915]

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[913] *Id.* at 887 (Miessner).

[914] *Id.* at 888 (Miessner).

[915] *Id.* at 888-89 (Miessner).

For his part, Mr. Calcutt testified that the Bedrock Transaction was not a significant transaction for the Bank in 2009: "[E]ach of the loans was individually underwritten, well-secured with mortgages and separate cash flow. They stood alone. The entire relationship amounted to less than7 percent of our loan portfolio. Yes, it was a large relationship but less than 7 percent of our loan portfolio. A $760,000 loan is one-tenth of one percent of our whole loan portfolio at that time."[916] As noted above, however, not all of the LLCs had cash flow, and in the absence of current appraisals, it was not possible to determine whether the loans were well-secured with mortgages.

With respect to whether Respondent's breaches of fiduciary duties owed to the Bank, or his unsafe practices, were intentional or committed with a disregard for either the law or the consequences to the Bank, Ms. Miessner testified thus:

> So I believe that the conduct related to the loan portfolio and the unsafe and unsound practices that, that the Bank had a history of doing, the fact that, you know, it wasn't like we just found this one time and then now we're going "Oh, my gosh, you did a bad thing." This was traced back many, many years. And so that's where we think that it was a willful disregard because they willfully disregarded the FDIC and the State when the FDIC and the State said we have concerns with capitalizing interest. We have concerns with equity pulls. We have concerns with the fact that the Bank is allowing draws on one loan to make payments on another loan and that masks the past

[916] *Id.* at 1425-26 (Calcutt).

> due status of the loan, provides an appearance of a performing loan. Those types of language are in reports, again going all the way back to 2004. And so, so we believe that it's a willful disregard for safety and soundness standards that are, you know, readily available for him to look up on the internet and read them if he didn't know what they were already, right? And willful disregard for regulatory recommendations.[917]

With respect to the duration and frequency of both the unsafe practices and fiduciary breaches, Ms. Miessner opined that "this type of behavior" goes back many years and was not limited to the Nielson credits,[918] and continued even after the matters were brought to Mr. Calcutt's attention, continuing until 2012, at which point "the Board was more aware . . . and those types of practices stopped happening."[919]

Asked the degree to which Mr. Calcutt was either cooperative or uncooperative, Ms. Miessner opined as follows:

> Well, Mr. Calcutt instead of working with us and the Agency to help figure out how to address the Bank's problems in an effective manner, his, he always just argued with us and said we were wrong, right? And in the meantime, the financial condition of the Bank was deteriorating even further. And so then when, when we finally knew what happened and confronted him with it and

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[917] *Id.* at 890-91 (Miessner).

[918] *Id.* at 891 (Miessner).

[919] *Id.* at 892 (Miessner).

> asked him many questions, he still didn't open up to us and tell us what was going on and, and let us be, you know, part of the solution.[920]

Asked whether Mr. Calcutt either voluntarily disclosed breaches or concealed the same, Ms. Miessner responded "he certainly didn't voluntarily disclose it to us. If he had, the whole situation would have turned out much differently, I'm sure."[921]

Opining on the threat of loss or actual loss or other kinds of harm to the Bank, Ms. Miessner opined:

> So the situation in 2009 where they had a bank, you know, a large borrower at the Bank whose financial condition was deteriorating, lending more money to them increased the risk to the Bank. Releasing cash collateral? Increased the risk to the Bank. Then reputationally, you know, they got to the point where we had no choice but to put them under a Consent Order because of the conditions and practices that were happening at the Bank. And so -- the Consent Orders are public documents. And so anyone in the public realm can look up a Consent Order and they would be able to see it. During the crisis, there were a lot of news articles that came out that had, that would like put lists of banks sometimes. And so it did increase the risk of the Bank's reputation, right? So increased reputational risk.[922]

Asked whether she found that Mr. Calcutt realized

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[920] *Id.* at 893 (Miessner).

[921] *Id.*

[922] *Id.* at 895 (Miessner).

any financial gain or other benefit from his misconduct, Ms. Miessner said she did not find any evidence of "defalcations like fraud," but inasmuch as "dividends [were] being paid based on falsely inflated earnings and capital numbers," Mr. Calcutt, as a "large shareholder of the holding company" received "direct personal benefit through the dividends."[923]

Asked to comment on what she saw as Mr. Calcutt's "tendency to engage in unsafe or unsound practices or breaches of fiduciary duty," Ms. Miessner responded that the tendency "speaks to the history" in that there is a "long and well documented history of failure to address safety and soundness concerns specifically to the lending functions".[924] Beyond that, she said through the exam process, Mr. Calcutt frequently "would state his refusal to implement recommendations and would argue the validity of regulatory guidance. And so I think he did have the tendency to just, to not follow the rules."[925]

And Ms. Miessner was asked whether there is an agreed upon order in place, and responded that there is a Section 39 plan in place.[926]

During cross examination, Examiner O'Neill was presented with the premise that in 2011, Teri Gillerlain was an FDIC Investigator who was going through the files at the Bank and found a three-page document, the first page

[923] *Id.*. See testimony of Mr. Calcutt that "the shareholders [of the holding company] own stock in the holding company which in turn was 100 [percent] owner of . . . Northwestern Bank." Tr. at 1347-48 (Calcutt).

[924] Tr. at 896 (Miessner).

[925] *Id.*

[926] *Id.* at 896-97 (Miessner).

of which is an email from Ms. Gillerlain to herself at the FDIC.[927] Mr. O'Neill stated that he had no knowledge that Ms. Gillerlain was an investigator for the FDIC, and offered no explanation for why she sent an email message to herself.[928]

When asked why Ms. Gillerlain found the document but Mr. O'Neill did not, Mr. O'Neill responded

> Again, we have already seen an exhibit where Mr. Calcutt was saying he was responding at a later point to a request from the investigator in supplying things like DVDs, and so on. Mr. Gomez made a point of saying "Well, what did you give the Examiners when they asked for it in the normal course of their examination before the investigator started asking for these things?" And what was what was recorded. And I during the normal course in the normal examination did not find this in the loan files. If she found it through other materials being supplied to her at a later date? That may well be, but I can't testify to it yes or no.[929]

Mr. O'Neill testified that an examiner's role is "generally confined to the books and records of the institution

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[927] Tr. (2015) at 651 (O'Neill), referring to Resp. Ex. (2015) 122 at 1, by which Ms. Gillerlain sent to her own email box at the FDIC a copy of an email transmission dated September 22, 2009, from Mr. Calcutt to Mr. Green in which Mr. Calcutt provided Mr. Green, as an fyi, a copy of settlement discussions between Mr. Calcutt and Cori Nielson.

[928] Tr. (2015) at 651 (O'Neill).

[929] Tr. (2015) at 652, 775 (O'Neill); and Resp. (2015) Ex. 93 at 1 wherein FDIC Case Manager Miessner wrote to Examiner O'Neill on September 1, 2011, that "We will be sending an investigation specialist to the Bank."

and also bank staff," whereas the investigator "can go beyond the four walls of the Bank and interview bank customers, others outside the institution."[930] He said as such, he would not have been empowered to have meetings with Cori Nielson as a borrower, in order to gather information.[931]

7. Respondent's Allocution

Mr. Calcutt acknowledged that as a director and officer of an FDIC-insured bank, he has a responsibility to know what he is doing in order to operate the bank in a safe and sound manner – to act diligently, prudently, honestly, and carefully.[932] When asked whether he intended to return to any management function in banking, Mr. Calcutt said "no."[933] When asked why, then, given his age and status, he was fighting this enforcement action, Mr. Calcutt testified:

> It is absolutely unjustified and unwarranted what I have been put through and what my family has been put through. So why am I fighting? Because it's a matter of right and wrong. And Northwestern Bank was an extremely successful bank, well regarded, loved by all its depositors, customers, all its customers. We made money from the day I started there right through the Great Recession. And in spite of all the Amended Call Reports, we made money. And we took care of our shareholders and this is just a shame what I've been put

[930] Tr. (2015) at 756(O'Neill).

[931] *Id.* at 756-57 (O'Neill).

[932] Tr. at 1352 (Calcutt).

[933] *Id.* at 1350 (Calcutt).

through, given our tremendous success.[934]

Part III - Analysis

1. Respondent's Affirmative Defenses

In his Second Amended Answer to Notice, Respondent presented seven affirmative defenses: that these proceedings are being conducted in violation of the FDIC Board's July 19, 2019 Order in Pending Cases, that the proceeding should be dismissed because it fails to cure the Appointments Clause violation; that the proceedings violate the Removal Power, that the proceeding barred by 28 U.S.C. 2462, the applicable statute of limitations; that the proceeding is barred under the doctrine of laches; that the FDIC should be barred from asserting its claims because of entrapment, and that it should be barred because the FDIC questioned Mr. Calcutt as part of an investigation seeking his removal, and did so in violation of the *Accardi* principle and Due Process.[935]

For the reasons set forth in a prior Order, the merits of the defenses based on laches, entrapment, and *Accardi* were determined and the defenses were stricken.[936] The analyses set forth in that Order are incorporated by this reference as if fully rewritten here.

Respondent's First Affirmative Defense is premised on the claim that the "supplemental proceeding established by the March 19 [2019] Order Regarding New Oral Hearing . . . sets what amounts to [be] a modified paper review, rather than the full, new oral hearing required by

[934] *Id.* at 1351 (Calcutt).

[935] Respondent's Second Amended Answer at 32-36.

[936] Order Regarding Motion to Strike Affirmative Defenses issued July 3, 2019.

the Board's Order."[937] Respondent posited similar arguments in a motion seeking interlocutory review, and on June 20, 2019 the Board entered an order granting the relief sought both in the motion for review and Respondent's First Affirmative Defense. Upon considering the merits of the defense and the Board's actions through the interlocutory relief order, I find the issues presented in Respondent's First Affirmative Defense are now moot.

With respect to the affirmative defense based on the Appointments Clause, Respondent asserts that the supplemental proceeding established by the Board's July 19, 2019 Order in Pending Cases was "inconsistent with the remedy required by Lucia for Appointments Clause violations," and that a "full, new hearing must be set."[938]

In support, Respondent avers that "the FDIC has never argued nor demonstrated that ALJ Miserendino was properly appointed, despite amble reason to do so."[939] According to Respondent, upon these premises, and without citation to the record in support of his factual claims, "[t]he only issue left is remedial."[940]

Recent analyses by the FDIC Board of Directors provides the analysis called for regarding both Respondent's Appointments Clause and Removal provisions affirmative defenses. Presented with claims invoking both defenses, and presented with similar facts and arguments, the Board of Directors in *In re Sapp* opined thus:

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[937] Respondent's Second Amended Answer at 32.

[938] Respondent's Post Hearing Brief at 33.

[939] *Id.* at 34.

[940] *Id.* at 35, quoting Lucia, 138 S.Ct. at 2055.

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.

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).[941]

Respondent has presented no facts that would support a conclusion other than that reached by the FDIC Board in *Sapp*. I find Respondent has not presented facts to support the affirmative defense, and by applying the rationale endorsed by the FDIC Board in *Sapp*, I find Respondent's Second Affirmative Defense to be without merit.

To the same effect, the Board in *Sapp* addressed the merits of arguments based on "restrictions on removal of the FDIC's ALJs". Citing no legal authority or reference to the record, Respondent averred in his Third Affirmative Defense that the FDIC Board is "unable to properly supervise the ALJ's actions" because the presiding ALJ "is unconstitutionally shielded from removal by the President of the United States."[942]

In *Sapp*, the Board held thus:

> The issue largely hinges on the interpretation of the Supreme Court's decision in *Free Enterprise Fund*. In *Free Enterprise*, the Supreme Court held that the dual limitation on the President's ability to remove inferior officers that served on

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[941] *In the Matter of: Michael R. Sapp*, Individually and as an Institution-Affiliated Party of Tennessee Commerce Bank, Franklin, Tennessee (Insured State Nonmember Bank), 2019 WL 5823871, at *18–19.

[942] Respondent's Second Amended Answer at 33.

the Public Company Accounting Oversight Board ("PCAOB") "subvert[ed] the President's ability to ensure that the laws are faithfully executed." 561 U.S. at 498. A "double removal restriction" existed because PCAOB board members were appointed by the SEC and could only be removed by the SEC "for cause." In turn, SEC members are appointed by the President and can also only be removed "for cause." Id. at 486-87. This two-level protection from "at-will" removal was what the Supreme Court held violated the Constitution's separation of powers doctrine because it overly diluted the vesting of executive power within the President. *Id.* at 484, 498.

In deciding *Free Enterprise*, the Supreme Court's majority opinion specifically exempted ALJs from the scope of its holding, stating that the "holding also does not address that subset of independent agency employees who serve as administrative law judges." Id. at 507 n.10. The rationale for that distinction is because ALJs perform "adjudicative" not enforcement or policymaking functions like PCAOB board members do. Id. Thus, Free Enterprise does not support Respondent's arguments that the for cause removal of ALJs performing adjudicative functions for the FDIC violates the separation of powers doctrine.[943]

Finding the analysis by the FDIC Board in *Sapp* applicable here, I find Respondent's Third Affirmative

[943] *In re Sapp*, 2019 WL 5823871 at 19.

Defense to be without merit.

Respondent's Fourth Affirmative Defense posits that as the Bedrock Transaction occurred in November 2009, it is too late now for the FDIC to bring an action under the FDI Act, which is subject to the five year period of limitations found in 28 U.S.C. § 2462.[944] Under Respondent's theory, the ingredients necessary to commencing proceedings were absent – specifically, the "filing of the Notice and a valid tribunal."[945]

Respondent offers no legal authority for the proposition that the status of the FDIC's ALJs in 2013, when this enforcement action began, determines the applicability of the limitations statute.[946] Instead, he cites to the requirement in the FDIC's Uniform Rules of Practice and Procedure that an administrative enforcement hearing "shall be held before an administrative law judge" of the Office of Financial Institution Adjudication.[947]

I do not read the FDIC's Uniform Rules as narrowly as urged by Respondent. When the matter was presented to the reassigned ALJ, it was held before an administrative law judge of OFIA. No conclusion from this requirement compels a conclusion that the action when commenced was constitutionally infirm. Respondent made no claim when the proceedings commenced indicting

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[944] Respondent's Post-Hearing Brief at 38.

[945] *Id.*

[946] I am mindful of Respondent's reliance on *United States v. Crawford*, 60 F. App'x 520 531 (6th Cir. 2003) for the proposition that an indictment after the statute has run is not timely. That is not the case here, where the Notice of Intention was filed well within the five year period.

[947] *Id.*, citing 12 C.F.R. § 308(103(a).

the credential of the ALJ, and waited until after the Board had acted on its own motion to raise the matter.

2. Grounds for Section 8(e) Orders - Prohibition

The Federal Deposit Insurance Act authorizes the entry of a prohibition order removing and barring future "participation ... in the conduct of the affairs of any insured depository institution" when the appropriate federal banking agency finds that a party affiliated with an insured institution (1) violated "any law or regulation," "engaged or participated in any unsafe or unsound practice," or breached a fiduciary duty; (2) that either causes the bank to "suffer[ ] or ... probably suffer financial loss or other damage," prejudices or could prejudice depositors' interests, or gives the party "financial gain or other benefit;" and (3) that "involves personal dishonesty ... or ... demonstrates willful or continuing disregard ... for the safety or soundness of [the bank]."[948] These three prongs of the prohibition action are known respectively as "misconduct," "effects," and "culpability."[949] For each prong, any one of multiple alternative grounds can support an adverse finding. An order of prohibition is supportable upon proof of each prong so long as the misconduct creates a "reasonably foreseeable" risk to the financial institution.[950]

The "misconduct" prong of § 1818(e)(1)(A) may be satisfied by a finding of violation of law or regulation, unsafe

[948] 12 U.S.C. § 1818(e)(1).

[949] *See Proffitt v. FDIC*, 200 F.3d 855, 862 (D.C.Cir.2000).

[950] *Kaplan v. OTS*, 104 F.3d 417, 421 (D.C.Cir.1997); see *Kim v. OTS*, 40 F.3d 1050, 1054 (9th Cir.1994).

or unsound practices, or breach of fiduciary duty.[951] Evidence detailed above established Respondent engaged in both unsafe and unsound banking practices, and breached fiduciary duties he owed to the Bank. Through this evidence, Enforcement Counsel met their burden regarding the misconduct prong.

The "effects" prong may be satisfied by a finding that "by reason of" the misconduct, the bank "has suffered or will probably suffer financial loss or other damage; the interests of the insured depository institution's depositors have been or could be prejudiced; or such party has received financial gain or other benefit."[952] It is satisfied by evidence of either potential or actual loss to the financial institution, and the exact amount of harm need not be proven.[953] Enforcement Counsel have by preponderant evidence established Respondent's misconduct caused the Bank to suffer, and made it probably that the Bank would suffer, financial loss and other damage; and that Respondent received financial gain because of his misconduct. Upon such evidence, Enforcement Counsel met their burden regarding the effects prong.

The "culpability" prong may be satisfied by a finding of personal dishonesty or "willful or continuing disregard ... for the safety or soundness of" the bank.[954] The personal

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[951] *Dodge v. Comptroller of Currency*, 744 F.3d 148, 156 (D.C. Cir. 2014), citing *Landry v. FDIC*, 204 F.3d 1125,

1138 (D.C.Cir.2000).

[952] 744 F.3d at 158, quoting 12 U.S.C. § 1818(e)(1)(B).

[953] 744 F.3d at 158, citing *Pharaon v. Bd. of Governors of the Fed. Reserve Sys.,* 135 F.3d 148, 157 (D.C.Cir.1998);

Proffitt, 200 F.3d at 863.

[954] 12 U.S.C. § 1818(e)(1)(C).

dishonesty element of § 1818(e) is satisfied when a person disguises wrongdoing from the institution's board and regulators, or fails to disclose material information.[955] Both the personal dishonesty and willful or continuous disregard elements "require some showing of scienter."[956] "[W]illful disregard" is shown by "deliberate conduct which exposed the bank to abnormal risk of loss or harm contrary to prudent banking practices," and "continuing disregard" requires conduct "over a period of time with heedless indifference to the prospective consequences".[957]

Enforcement Counsel by preponderant evidence established Mr. Calcutt's personal dishonesty and his willful and continuing disregard for the safety and soundness of the Bank throughout 2009 to 2011. Respondent knowingly concealed material information from the Bank's Board and its regulators, and knowingly gave false and misleading answers to questions presented during this time period. He further established a bookkeeping scheme making it difficult or impossible for the Bank's Board and its regulators to discover the true nature of the Nielson Entities loan portfolio, in order to avoid mandatory state lending limits. Upon the foregoing evidence, Enforcement Counsel has met its burden of establishing Respondent's personal dishonesty and his willful and continuing disregard for the safety and soundness of the

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[955] 744 F.3d at 159–60 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); see also *Van Dyke v. Bd. of Governors of the Fed. Reserve Sys.*, 876 F.2d 1377, 1379 (8th Cir.1989).

[956] 744 F.3d at 159–60 quoting *Landry*, 204 F.3d at 1139 (citing *Kim*, 40 F.3d at 1054–55).

[957] 744 F.3d at 160, quoting *Grubb v. FDIC*, 34 F.3d 956, 961–62 (10th Cir.1994),

Bank.

Respondent owed and breached his duty of care and candor to the Bank's Board of Directors. Officers and directors of financial institutions are deemed to be fiduciaries of the institution and, as such, owe the institution duties of care and loyalty.[958] The *duty of care* requires directors and officers to act as prudent and diligent business persons in conducting the affairs of the bank. Withholding relevant information constitutes a breach of the *duty of candor*, even where members of the Board do not raise questions regarding the issue.[959] Thus, a director must inform other board members of any information in his or her possession that is related to a transaction under the board's consideration. "It is well established that a person can breach a fiduciary duty by failing to disclose material information even if not asked[.]"[960]

I found Respondent's testimony on key material issues to be other than fully credible, particularly with respect to his claims of having insufficient knowledge regarding the course of the Bank's negotiations with the Nielson family representative in both 2009 and 2010; and his claim that other members of the Bank's Board of Directors had approved the Bedrock Loan prior the disbursement of funds from that loan. Respondent's testimony was internally inconsistent, inconsistent with testimony from other Bank employees (including Mr.

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[958] *Constance C. Cirino*, 2000 WL 1131919 at *4 (FDIC May 10, 2000) (citing *In the Matter of Ramon M. Candelaria,* FDIC Enf. Dec. and Orders at A-2847 (1997)).

[959] *Michael v. F.D.I.C.,* 687 F.3d 337, 351 (7th Cir. 2012) (citing *De La Fuente v. FDIC*, 332 F.3d 1208, 1222 (9th Cir. 2003))

[960] *In re Bush*, 1991 WL 540753 at *6.

Smith and Mr. Hollands), and inconsistent with other Bank Board members, whose testimony I found no valid reason to doubt.

I found Respondent's own actions in obscuring from Bank Board members and the Bank's regulators the true nature of the Nielson Entities as a common group was a knowing, willful, and ongoing effort that used Respondent's leadership position at the Bank to obstruct both the Bank's own auditors and its regulators from fully appreciating the risks to the Bank's safety and soundness. And I found gross ineptitude on Respondent's part by his fostering a banking environment throughout the relevant time period that permitted dozens of limited liability companies known to be part of the Nielson Entities to borrow millions of dollars from the Bank without there being evidence of sufficient cash flow to support the loans, without there being timely and accurate appraisals of collateral securing the loans, and without there being personal guarantees by the borrowers as an elementary measure of protecting the Bank and through it, the FDIC Insurance Fund.

There was, in short, no valid banking reason supporting Mr. Calcutt's decision to continue to lend Bank funds to the Nielson Entities based on Mr. Calcutt's supposition that because the Nielson Family had millions of dollars that it *could* pay to the Bank, that members of the family *would* in fact do so, when there was no legal requirement calling for such payment. Preponderant evidence tends to show that the risks to the Bank central to this enforcement action could have been significantly abated had Mr. Calcutt simply required personal guarantees from the Nielson family members as support for these loans.

Through the foregoing evidence, Enforcement Counsel met their burden of establishing that Mr. Calcutt breached fiduciary duties of care and candor he owed to the Bank.

3. Grounds for Section 8(i) Orders – Civil Money Penalty

Accompanying the Notice of Intention is a Notice of Assessment of a second-tier penalty in the amount of $125,000.[961] Pursuant to the Debt Collection Improvement Act, a second tier penalty of up to $37,500 per day may be assessed upon cause shown.[962] At this daily rate, the $125,000 assessment would be supported upon a demonstration of cause lasting at least three days. Cause has been shown here for an assessment that would begin no later than September 1, 2009, when it became reasonable to question the Nielson Entities' intention and ability to pay the portfolio's loans. The daily rate would thereafter apply until at least July 19, 2012, when the Bank's external auditors, Plante Moran, determined that the Nielson loans "should have been classified as impaired/non-accrual during the fourth quarter of 2009".[963] With 1052 days between those dates, the potential second-

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[961] Notice of Intention to Remove from Office and Prohibit from Further Participation, Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law, Order to Pay, and Notice of Hearing at 27.

[962] 12 U.S.C § 18181(i)(2)(A) & (B) (establishing a second-tier penalty); 28 U.S.C. § 2461 (directing the heads of all federal agencies to periodically adjust the civil money penalties under their jurisdiction for inflation); and 12 C.F.R. § 308.132(c)(3)(i) (73 FR 73153-01, 2008 WL 5054465 December 2, 2008) (setting the second tier maximum penalty at $37,500 per day).

[963] EC. Ex.77 at Bates pp. 7, 16 (page 9 in the report).

tier penalty was $3.945 million. If anything, the assessment that was presented in the Notice of Intention understated the gravity of Mr. Calcutt's misconduct.

A second-tier civil money penalty may be entered for violating laws, regulations, or other requirements, "recklessly engag[ing] in an unsafe or unsound practice," or breaching a fiduciary duty, when that action is "part of a pattern of misconduct," or "causes or is likely to cause more than a minimal loss to [the bank]," or "results in pecuniary gain or other benefit to such party."[964]

The requirements to impose a second-tier civil monetary penalty are similar to the criteria for an order of prohibition. The only new misconduct element under 12 U.S.C. § 1818(i)(2)(B) requires evidence of "reckless" engagement in unsafe or unsound practices. "The Comptroller may satisfy the effects prong on any of the following grounds: that the misconduct was 'part of a pattern of misconduct,' that it 'causes or is likely to cause more than a minimal loss' to the Bank, or that it 'results in pecuniary gain or other benefit.'"[965]

Having considered the evidence in mitigation as reflected above, and for the reasons set forth above, I find that Enforcement Counsel have met their burden of establishing a legal and factual basis for a $125,000 civil penalty against Mr. Calcutt.

4. Recommendation

Upon the foregoing findings and conclusions, I recommend the Board issue a removal and prohibition order

[964] 12 U.S.C. § 1818(i)(2)(B).

[965] *Dodge*, 744 F.3d at 161, quoting 12 U.S.C. § 1818(i)(2)(B)(ii).

against Respondent and assess a civil penalty against Respondent in the amount of $125,000. A proposed order to this effect is appended to this Recommended Decision on Remand.

April 3, 2020

Christopher B. McNeil
Christopher B. McNeil, JD, Ph.D
Administrative Law Judge
Office of Financial Institution
Adjudication

CERTIFICATE OF SERVICE

On April 3, 2020, I served by electronic mail the foregoing Recommended Decision, the Certified Index of Admitted Exhibits, the Certified Index of the Record of Proceedings, and the complete Administrative Record of Proceedings upon:

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Andrea Winkler, Acting Assistant General Counsel
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Further, on April 3, 2020, I served by electronic mail the foregoing Recommended Decision, the Certified Index of Admitted Exhibits, and the Certified Index of the Record of Proceedings, upon:

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Christopher B. McNeil
Christopher B. McNeil
Administrative Law Judge

Office of Financial Institution Adjudication

Appendix 1 – Proposed Orders

EDERAL 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)	FDIC-12-568e FDIC-13-115k ALJ McNeil

[PROPOSED] ORDER OF PROHIBITION FROM FURTHER PARTICIPATION AND ORDER TO PAY

On August 20, 2013, the Federal Deposit Insurance Corporation (FDIC) issued a Notice of Intention to Remove from Office and Prohibit from Further Participation, Notice of Assessment of Civil Money Penalties, Findings of Fact, Conclusions of Law, Order to Pay, and Notice of Hearing against Harry C. Calcutt, III (Respondent), individually, and as institution-affiliated party of Northwestern Bank, Traverse City, Michigan. The Respondent filed a timely answer to the Notice.

From October 29, 2019 through November 6, 2019, a hearing was held in Grand Rapids, Michigan to determine: (1) whether a permanent order should be issued to prohibit the Respondent from further participation in the conduct of the affairs of any insured depository institution or organization 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 permission 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); and (2) whether the FDIC's ORDER TO PAY should be issued. The Respondent appeared, personally and through counsel, and was given the opportunity to be heard, and evidence was taken.

Having considered the evidence presented at the hearing and the record as whole, the arguments of both parties, and the Recommended Decision issued by the presiding administrative law judge, pursuant to section 8(e) of the FDI Act, 12 U.S.C. § 1818(e), it is hereby ORDERED, that:

1. Harry C. Calcutt, III, is prohibited from participating in any manner in the conduct of the affairs of any insured depository institution, agency, financial institution or organization 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); and

2. Harry C. Calcutt, III is prohibited from soliciting, procuring, transferring, attempting to transfer, voting, or attempting to vote any proxy, consent or authorization with respect to any voting rights in any financial institution, agency, insured depository institution or organization 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); and

3. Harry C. Calcutt, III is prohibited from violating any voting agreement previously approved by the appropriate Federal banking agency, 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); and

4. Harry C. Calcutt, III is prohibited from voting for a director, or serving or acting as an institution-affiliated party, as that term is defined in section 3(u) of the FDI Act, 12 U.S.C. §1813(u), 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).

This ORDER will become effective thirty (30) days from the date of its issuance. 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.

FURTHER, pursuant to section 8(i) of the FDI Act, 12 U.S.C. §1818(i):

IT IS HEREBY ORDERED:

That the Respondent, Harry C. Calcutt, III, pay a civil money penalty in the amount of One Hundred Twenty-Five Thousand Dollars ($125,000) made payable to the Treasury of the United States.

IT IS FURTHER ORDERED that the Respondent is prohibited from seeking or accepting indemnification from any insured depository institution for the civil money penalty assessed and paid in this matter.

IT IS SO ORDERED.

Dated at Washington, D.C., this ___ day of _________, 20__.

____
Board of Directors
Federal Deposit Insurance Corporation

Appendix 2 – Respondent's Offers of Proof

The evidentiary hearing conducted in November 2019 afforded the parties a second opportunity to present evidence in support of their respective issues and claims. The parties prepared for that second hearing by filing prehearing submissions pursuant to an Order I issued on March 20, 2019.[966]

The March 20, 2019 Order required the parties to provide notice to the opposing party of the identity of witnesses the party intended to call, and of the documents the party intended to present to the witness. The parties were given a May 15, 2019 deadline by which they were to submit a prehearing statement that included copies of all exhibits the party intended to introduce at the hearing.[967] In addition, the parties were directed to identify which witnesses the party intended to present and the following order was entered regarding the presentation of testimony by a party's witnesses:

> b. A short summary of the expected testimony of each witness, e.g., "This witness will testify that …." Note that during the evidentiary hearing, witness testimony will be limited to the descriptions provided in this summary. In order to ensure the efficient and orderly presentation of witness testimony, the parties are directed to identify, in their prehearing submissions, by exhibit number or numbers, and page number or numbers, the documents relied upon by each witness, whether fact witness, expert witness, or

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[966] Notice of Hearing and Supplemental Prehearing Orders, issued March 20, 2019.

[967] Id. at 2.

> hybrid expert and fact witness. **During the direct examination of the witness and absent sufficient cause to vary from this provision, only those exhibits and page numbers identified in this prehearing submission may be presented to the witness by the party calling the witness.** (Emphasis *sic*)[968]

The prehearing submissions Order thus ensured that the parties would know in advance of the hearing which witnesses would be called and what exhibits the witness would be presented during the hearing.

Through this set of prehearing Orders, the parties are given the opportunity to identify the witnesses they seek to question. Respondent in his first Offer of Proof, addressed questions he sought to present to Autumn Berden. The questions, presented below, addressed matters that had not been raised in direct examination of this witness. For that reason, and for that reason alone, Enforcement Counsel's timely objection was sustained, as the questions sought to address matters that had not been raised during direct examination of the witness.

Nothing in the order sustaining this objection prevented Respondent from introducing testimony from Ms. Berden on the subjects presented. The ruling (included in the transcript excerpt here) made it plain that the questions would be permitted if they addressed subjects that had been raised during direct examination. This was not the only means by which Respondent could have introduced such testimony, however. Had Respondent wished to present testimony responsive to the First Offer of

[968] Id. at 3.

Proof, if he wished to ask the questions that he has included in his First Offer of Proof, then he needed only to include Ms. Berden in his list of witnesses and identify the topics she would be asked about and the documents she would be shown during testimony. Respondent failed to do so, and offered no explanation for this failure, with counsel for Respondent baldly stating he did not need to do so.

Respondent through Counsel asserts that he is entitled to establish a witness's bias and motive through cross-examination. This is true, to the extent those traits can be developed during cross examination. But cross-examination is limited to the scope of facts presented during direct examination, so to the extent Respondent wanted to introduce testimony establishing the bias of a witness, he could do so either during cross-examination, by questions addressing matters that were raised in direct examination, or by calling the witness as his own. Here, Respondent elected to do one, but not the other.

Nothing about this analysis changes when one takes into account the limitations imposed on the parties in advance of the hearing. Through prehearing motions, Enforcement Counsel successfully argued for the exclusion of Respondent's proposed Exhibit 186, which was the FDIC's 2017 Report of Examination for Central State Bank, and Exhibit 187, which was the 2019 Report for State Savings Bank. The merits of this argument were determined when I reviewed Respondent's prehearing statement and found nothing in the statement that would justify introduction of Reports concerning banks other than Northwestern for periods of time not pertinent to the allegations appearing in the Notice of Intention.[969]

Respondent argues that "nothing in the Federal Rules of Evidence nor the Uniform Rules of Practice and Procedure required Respondent to create a witness list for cross-examination."[970] That is true; but by electing not to call the witness, Respondent's opportunity to cross-examine the witness is limited to the scope of what is presented on direct examination.

It also is a mischaracterization of events to suggest that Respondent was required to "anticipate the witnesses Enforcement Counsel would call and then have to list the documents he intended to use for impeachment."[971] That is not what occurred here. By requiring both parties to fully disclose the scope of direct examination, the prehearing order placed the parties on a level playing field, so that they would not be surprised at the scope of a witness's testimony or the documents the witness would be shown.

Nothing prevented Respondent from identifying and calling the witnesses and covering the topics reflected in the following offers of proof, other than the strategic decision made by the Respondent not to identify the witnesses in his prehearing statement. It is true that "documents to be use for impeachment never have to be disclosed", as Respondent noted.[972] Impeachment documents may be introduced without prior disclosure, but only to the extent the testimony regarding the documents is within the scope

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[969] Order Regarding the Parties' Motions in Limine, dated October 4, 2019, at 6.

[970] Respondent's Post-Hearing Brief at 44.

[971] *Id.*

[972] *Id.*

of direct examination of the witness.

Offer of Proof No. 1: Respondent's Cross-examination of Autumn Berden

Questions for Ms. Berden, cross-examination by Mr. Hovis at Tr. 178-87

> Q. And there was a meeting that occurred in May 5 2009 where there were a lot of heated words exchanged. Do you recall Cori Nielson in that meeting threatening to
>
> 8 MR. BECK: Your Honor, I'm going to object. I think he's talking --
>
> 10 THE COURT: Let him finish the sentence. Let him finish the question.
>
> 12 BY MR. HOVIS: Q. Do you recall Cori Nielson in that meeting threatening to destroy the Bank?
>
> 15 THE COURT: Now.
>
> 16 MR. BECK: I am going to object, Your Honor. He's referring to a May 2012 meeting when --
>
> 18 MR. HOVIS: I misspoke if I said that.
>
> 19 MR. BECK: It went beyond the scope of direct, so I'll object. He can ask Cori Nielson about that meeting.
>
> 22 THE COURT: Your response?
>
> 23 MR. HOVIS: I meant May 2011, if I said May 2012.
>
> 25 MR. BECK: I am sorry, I misspoke. He misspoke first because he said May 2009. I misspoke when I

said May 2012. For the record, it is May 2011 he's referring to.

THE COURT: Are you maintaining the objection or no?

MR. BECK: Yes, I'm still maintaining the objection.

MR. HOVIS: Can I respond, Your Honor?

THE COURT: Yes.

MR. HOVIS: I will be asking a series of questions to establish the bias of the Nielson representatives: Ms. Berden, Cori Nielson, and Anne Miessner, all of whom are testifying at this proceeding, and these questions are all going to go to their bias, their motive, and their efforts among themselves to destroy the Bank and Scrub Calcutt. And this witness is a principal player in that because she participated in that process and she's taking the notes. So if I don't have the opportunity to question her with regard to the notes she took of those conversations, then I'll face an objection the notes can't be used with regard to other witnesses in the case. So this is crucial to me in terms of establishing bias, motive, and impeachment.

THE COURT: Well, it would seem to me that that would be an appropriate thing to let us know about ahead of time by calling her as your own witness.

MR. HOVIS: I don't need to do that.

THE COURT: You do here. The objection is sustained.

MR. HOVIS: May I make a record?

THE COURT: You may.

8 MR. HOVIS: Thank you. It's held in United States versus Green, 617 F.3d 233, 251 (Third Cir. 10 2010). Proof of bias is almost always relevant. There are other citations that I'll pass over. "Because a showing of bias on the part of a witness would have a tendency to make the facts to which he testified less probable in the eyes of the jury than it would be without such testimony. Bias is always relevant in assessing credibility. Indeed, evidence concerning a witness's credibility is always relevant because credibility is always at issue." Now I need not, with all due respect, designate a witness that I am going to cross-examine as my witness in order to establish the bias, the motive, and the credibility of that witness. I am entitled to do that on my cross-examination. That's what I'm asking the court to allow me to do.

25 THE COURT: I understand your record.

1 BY MR. HOVIS: Q. There has been reference this morning to a binder which is Exhibit 3 about all this questioning which Mr. Beck has addressed. Were you participatory in preparing that binder?

6 A. I was requested to provide documents that I believe went in the binder.

8 Q. And after that binder was forwarded to the FDIC, did you have a series of meetings with Teri Gillerlain, who also was addressed in questioning this morning?

11 A. Yes.

12 Q. And as you've testified, she was a representative of the FDIC?

14 A. Yes.

15 Q. Do you recall that the first of those meetings was on September 8, 2011?

17 MR. BECK: I am going to object again, Your Honor. It's going beyond the scope of direct examination.

20 THE COURT: Response?

21 MR. HOVIS: Yes, Your Honor. During the course of these meetings that the witness had with Ms. Gillerlain, she, Cori Nielson, and Anne Miessner all agreed that they would cooperate among themselves in order to remove Scrub Calcutt as a part proceeding. I have this witness's notes of those meetings of what she did in collaboration with the FDIC, and they all go to show the bias, the motive, and the lack of credibility of any of their testimony in this case.

6 THE COURT: Okay, as proffered, the objection is sustained. Ask your next question.

8 MR. HOVIS: Alright, I will make an offer of proof.

10 THE COURT: Go ahead.

11 MR. HOVIS: I am going to offer into evidence Respondent's Exhibit 98.3. This was a request for information to Ms. Berden from Anne Miessner and Teri Gillerlain. Respondent's Exhibit 125, September 8 following the meeting where Ms. Berden provided letters from the Bank regarding the transfer of loans. In fact, that was admitted into evidence this morning. How is it, with all due respect, that the FDIC gets to pick and choose what it provides to the court of the information provided by this witness to the FDIC and I do not?

23 THE COURT: You have the opportunity to present this all; just tell us ahead of time in your statement and you did not do that. You did not identify this witness as yours. That's why. End of dialogue on this point. Next question.

3 MR. HOVIS: [Continues proffer:] Respondent's Exhibit 131, more information provided by Ms. Berden. Respondent's Exhibit 136, information provided by Ms. Berden to the FDIC. Respondent's Exhibit 144, further information provided. Respondent's Exhibit 145, further information provided. Respondent's Exhibit 146, further information provided. Respondent's Exhibit 175, further information provided. I'll now move to -- those are all e-mail communications. Respondent's Exhibit 205 are this witness's notes of a conversation with Anne Miessner on March 23, 2012, in which Ms. Miessner advised this witness that the Board of Directors at the exit meeting should have fired Mr. Calcutt and gave advice to Ms. Berden that the Nielsons probably have legal standing to sue and have they consulted a lawyer, presumably to sue Scrub Calcutt. Further, in Respondent's Exhibit 205 this witness's notice of a meeting of June 22 of 2012 in which Ms. Miessner advised this witness "Scrub and Jackson are out," in which another witness in this case, Mr. Byl being called by the FDIC, Ms. Miessner said to this witness, Ms. Berden "Byl, he hates Scrub." Another note that says "Don't want no Scrub." Further meeting occurred on the day of Mr. Calcutt's deposition in this case, a meeting with Gillerlain, Mr. Sup, and Lisa Thompson. Respondent's Exhibit 126 represent that meeting, and this witness's notes of that meeting are

Respondent's Exhibit 205. Respondent's Exhibit 203 is a communication from Ms. Gillerlain to this witness of March 22, 2013, further communication about status of Calcutt. "He resigned." The purpose in doing all of that is to establish the reason for this agenda was simple: An act among these people to drum Scrub out of the industry.

THE COURT: Any further questions for the witness?

MR. HOVIS: I request that all of those Exhibits be entered into the record, Your Honor.

THE COURT: Government's response?

MR. BECK: Well, if he's making an offer of proof, that's one thing, Your Honor. I'm going to object to receiving these Exhibits. I mean the relevant time period of this matter is from 2008 to 2012, and he's talking about events that occurred subsequent to that. I don't think under the decision in Landry by the board that bias is, is material here in this context. The focus of this case is on the allegations in the notice and if those are proved, that's all that's required under the Board's interpretation of Section 8 and so I object to the receipt of these Exhibits into evidence.

THE COURT: Mr. Hovis, your response?

MR. HOVIS: Thank you, Your Honor. This is somewhat of an extraordinary proceeding in the sense that the FDIC is able to both identify fact witnesses and hybrid witnesses that are also expert witnesses. The communications and especially those notes involving Ms. Miessner in which she reflected such clear bias against Mr. Calcutt are crucial to our being able to challenge her credibility both with regard to her recitation of the facts and maybe far more so in the context of her expert testimony. Her agenda from the very beginning was to entrap Mr. Calcutt. While I recognize that you've stricken our Affirmative Defense, that has nothing to do with it. And in the Motion in Limine in our response I did clearly identify that we would not try to introduce this evidence in the context of the Affirmative Defenses that you had stricken, but that we would try to introduce the evidence because of the crucial relevance of this to credibility and bias, as I cited to the court. That is always an issue and it cannot be more of an issue in this case because Ms. Miessner is their primary witness and she is the one that is giving this, this assistance to the Nielson family. I, I think that it will devastate the defense and I would suggest be reversible error if I'm not allowed to put in the evidence of this bias.

10 THE COURT: I'm not at all prepared to say one way or the other that you can or cannot get that evidence in. You just can't use this witness to do it. What's your next question for this witness?

14 MR. HOVIS: Well, then that concludes my examination.

16 THE COURT: Any rebuttal? Any further questioning of the witness?

18 MR. BECK: No, Your Honor.

19 THE COURT: May the witness be excused?

20 MR. BECK: Yes, we would ask that she be excused.

22 MR. HOVIS: Just so the record is clear, I did offer

the Exhibits into evidence and I assume you are sustaining the objection.

25 THE COURT: I am making the decision to keep them as an offer of proof for the time being because I don't think you gave adequate notice to present these documents to the witness. These are documents that are beyond the scope of direct examination. And clearly, if you wanted to have them in, clearly you could have presented that to me and to adverse counsel way before we had this hearing through the prehearing submission and you declined to do that. That's the extent of my ruling. I'm not saying anything about how these documents may or may not be presented to witnesses in the future. In fact I would expect that they would be. Any questions?

14 MR. HOVIS: Well, just for my own clarification and not to further argue the point --

16 THE COURT: Sure.

17 MR. HOVIS: -- when we get to Anne Miessner and I did not for obvious reasons through me identify Anne Miessner as a witness I was going to call, I am sure that Mr. Beck is very carefully not going to go into any of these communications but nevertheless they go to the heart of her bias and of her credibility and of her motive, and none of the cases say that one needs to identify you're going to call that witness for that purpose. That is always part of cross examination. It is not part of my direct examination, so it never occurred to me and I think is fundamentally wrong that I would need to have identified this witness as my witness for purposes of saying I'm going to use her for bias, credibility, and motive. I, I just

think that's wrong.

6 THE COURT: Understood. You made a record. Anything else you need me to consider?

8 MR. HOVIS: No, Your Honor.

9 THE COURT: Thank you very much. This witness is released.

Offer of Proof No. 2 – Respondent's Cross-Examination of Anne Miessner

Here again, Respondent elected not to identify as witnesses those individuals he sought to gather testimony from with respect to the examination practices he attributed to the FDIC. Having not identified these witnesses, their testimony in cross-examination was limited to the subjects addressed by the witness during direct examination. Respondent could have presented testimony that went beyond direct examination by Enforcement Counsel, but if he sought to do so he was under an affirmative obligation to disclose his intention to question these witnesses and needed to identify the documents he was going to show the witnesses, if his questions exceeded the scope of direct examination. Nothing prevented Respondent from seeking to have these witnesses testify, but he did not identify them as witnesses and as such was limited in the scope of their examinations.

Tr. at 874-80

MR. HOVIS: The evidence that I would be offering if I had the ability to do so would be that an investigator was placed into the Examination, that that was not disclosed to anyone at the Bank, that that investigator then worked hand-in-glove with the Nielson family in pursuing a common objective of bringing an 8(e) action, that the motive of both Ms. Miessner as reflected in a series of e-mails, some of which were discussed with Mr. Gomez was to get Mr. Calcutt on the record in a way that would be inconsistent so as to justify an 8(e) action in e-mails that I would refer, to reference that. As I commented with regard to the testimony of Ms. Berden, she provided extraordinary information as a part of a quid pro quo where in turn this witness, Ms. Miessner, with the assistance of Ms. Gillerlain challenged the Bank's handling of collections with regard to CB Richard Ellis, that this witness instructed Mr. O'Neill to raise those questions, that when I went through what this witness did in trying to pursue the interests of the Nielsons, he characterized it as shocking, that all of that collaboration continued through the resignation of Mr. Calcutt from the Board with numerous e-mails going back and forth involving this witness and Cori Nielson about the progress with this witness in saying in one of those e-mails the Board should have fired him at the exit meeting to which she just testified; And the reason I believe that that is all appropriate evidence is because bias and motive are always an issue for cross-examination. I cited to the court a case with regard to bias, with regard to the testimony of Autumn Berden. And with regard to motive I would like to cite, this is in our Motion in Limine, United States vs. Masino, 275 F 2nd, 129, 132, 2nd Circuit, 1960. "When a witness in a criminal case is being questioned as to his possible motives for testifying falsely, wide latitude should be allowed in cross-examination. Cross-examination is proper when its purpose is to reveal bias or interest on the part of the witness being examined," citing further authority. This is akin to a criminal proceeding. It is akin to a criminal proceeding because of the nature of the penalty. While Mr. Calcutt is not going to be placed in jail behind bars, he is if the Court Rules against him and the FDIC upholds that, he's going to be barred from his source of likelihood. A banking career. And he's going to face a substantial civil money penalty. My position and I believe what the law requires is that this has nothing to do with whether it's beyond the scope of the direct. That's not the issue here, even though that's the way it's being framed between the FDIC and the court. This has to do with the latitude that is given in cross-examination. I need not have designated this as a witness because she is entirely hostile to my client. I believe that just as stated in United States vs. Masino, in cross-examination I am entitled to pursue the fact that she for years now has been trying to get Mr. Calcutt removed, that she did so in conjunction with the Borrower, that she acted on behalf of the Borrower in a shocking fashion; And I think that, I, I raise this in a quiet fashion because that is my nature, but I wouldn't, I, I believe it rises to the level where this matter could be overturned, and I want to give the court and the FDIC every opportunity to correct what I see as an egregious error. If I lose that, I'd like to run through just some Exhibits and pages of testimony that I would offer as my offer of proof.

11 THE COURT: You can do that now.

12 MR. HOVIS: Okay. And when he's done with that, if the Government wants to make a response to the offer of proof, it may.

MR. BECK: Okay, thank you, Your Honor.

MR. HOVIS: The Exhibits are Respondent's 97.3, which references pursuing the 8(e) action. Some of these I did go through with Mr. Gomez, but I was going to question this witness about them. Respondent's 98 about "not letting them know we're digging." Respondent's Exhibit 99. These are all Respondent's. Respondent's Exhibit 100. Respondent's Exhibit 101 An admission by Ms. Miessner that the purpose was to use the answers from that September 14th meeting in an 18(e) action, which is at 1386 of the transcript. Respondent's Exhibit 107, which is in evidence about no clearer picture. Respondent's Exhibit 106 at page 1265, Ms. Gillerlain was an investigator appointed at the regional level. Respondent's Exhibit 102.5, right after Gillerlain was appointed she met with Cori Nielson. This is duplication with what I did with Bird, so I'll just tell you what they are: Respondent's Exhibits 127, R-131, R-136, R-144, R-145, R-146, R-175, R-128. This now relates to the quid pro quo of the help that was being provided by Ms. Miessner to the Nielsons: Respondent's Exhibit 130, CBRE, begins at 129. Respondent's Exhibit 133 is her direction to O'Neill to inquire about CBRE at the September 14th meeting. Respondent's Exhibit 135, Cori still complaining. Respondent's Exhibit 137, O'Neill attached a two-and-a-half page memo of the answers on CBRE. The acknowledgement by this witness at 1269 that nothing within those answers indicated any wrongdoing by the Bank, the Bank was acting within its rights. Respondent's Exhibit 139, Gillerlain continues to advocate. Respondent's Exhibit 140, Gillerlain alleges or asserts that Mr. Calcutt is skirting criminal activity because of the position he was taking on CBRE. Her lack of experience in that area,that she's supposed to be an independent investigator. Respondent's Exhibit 141, Cori Nielson contacts Ms. Miessner directly saying "I just wish there was a fresh face to talk to." Respondent's Exhibit 143 where, going back to Exhibit 141, Cori says "Can you, is there anything the state can do? Can you forward it to the state?" Respondent's Exhibit 143 is when Ms. Miessner did forward and asked if the state could intervene on the Borrower's behalf. And I'll then run through again I did this with Ms. Berden, so I'll note them. Respondent's Exhibit 205, a Berden conversation with this witness on March 23 in which she reports her opinion that the Board should have fired Mr. Calcutt at the exit meeting. This witness suggests that has the Borrower looked into whether they have legal standing to sue Scrub presumably directly. Respondent's Exhibit 202, an e-mail exchange "A little news to brighten your weekend about the charges being filed against Mr. Calcutt." Respondent's Exhibit 203, in which Ms. Gillerlain called to report that Scrub is out.

THE COURT: Does that conclude the offer of proof?

MR. HOVIS: Yes, the court had indicated that in the filings that we submit we can identify parts of the transcript that we think should be considered and so I'll do that at that time to save time now.

THE COURT: Alright. Thank you. Any other questions for the witness?

MR. HOVIS: No, Your Honor.

Offer of Proof No. 3 – Respondent's Cross-Examination of Cori Nielson

Here again, although Respondent could have chosen to call Ms. Nielson as a witness, and would thus not have been limited to those areas developed by the witness during her direct examination, he elected not to identify her as a witness. When questions arose that were beyond the scope of direct examination, objections to those questions were sustained.

Tr. at 1012-18

Q. And do you recall that there was a Complaint that was filed by the bankruptcy trustee against the Nielson Entities in that Complaint?

14 MR. BECK: Your Honor, I'm going to object. I don't see the relevance to this inquiry down this line about what occurred in the Immanuel bankruptcy. It was one entity that went into bankruptcy. It is noted in the Report of Exam from 2011, that that entity was in bankruptcy, but I don't see where the relevancy of exploring what occurred in the bankruptcy relates to anything having to do with the Bedrock Transaction or the December 2010 transaction, particularly since Immanuel didn't receive any proceeds from the latter transaction.

THE COURT: Counsel, address both the relevancy and whether that was in the scope of direct examination.

1 MR. HOVIS: Your Honor, during the course of Enforcement Counsel's case, the question of various witnesses with regard to the Call Report and the impact of the $2.8 million adjustment to profits in the

Call Report and you'll recall the note from Ms. Miessner's testimony in which it said it is the expectation of the Bank that out of the Immanuel bankruptcy they will be able to offset what that was, and it goes to that issue.

THE COURT: Based on that proffer, I find the question outside the scope of direct examination. You do not need to answer the question. You may ask your next question.

13 BY MR. HOVIS: 14 Q. Were you involved in continuing discussions after January 1 with regard to trying to resolve the -- well, let me back up. After January 1 did the Nielson Entities cease paying the obligations?

19 THE COURT: January 1 --?

20 MR. HOVIS: 2011.

21 THE WITNESS: The timeline of specific dates are foggy to me there. I don't even know specifically which date we signed that set of renewals so I'm just not sure I can answer that specifically.

25 BY MR. HOVIS: Q. Do you recall that there were continued -- well, do you recall that in terms of the timing that it wasn't until June of 2011 that the negotiations broke down?

4 A. That sounds right.

5 Q. And were you involved in any of the meetings in that period from January to June of 2011?

7 MR. BECK: I am going to object that this is going beyond the scope of direct and I don't see the relevancy of negotiations that ensued from the end of the

renewals to June. It's in the record in terms of the Examination and what they found, and I don't see that there is anything relevant about the back and forth between the Nielson parties and the Bank during that time period, Your Honor.

15 THE COURT: Respond to both the relevance and the scope questions.

17 MR. HOVIS: Yes, Your Honor. This is going to address the issue of the bias and motive of this witness in presenting the binder to the Regulators as she did in July of 2010, and I am going to ask her about the meeting in May 2011 in which she said, quote from the prior transcript "I can destroy your bank and I'm tempted to do it."

24 THE COURT: I will sustain the objection. You don't need to answer the question. You may ask your next question.

2 MR. HOVIS: I intend to take the witness -- well, let me ask a series of questions and I think we'll get the same result and then we'll see if I can deal with it in a summary fashion.

6 BY MR. HOVIS: Q. Do you recall after the breakdown in the negotiations the Bank began collection efforts?

9 MR. BECK: Your Honor, I'm going to object. It's beyond the scope of direct, and I don't believe the collection actions other than as we've heard from Mr. Bimber on Bedrock are pertinent or relevant.

13 THE COURT: Do you want to respond to both scope and relevance?

15 MR. HOVIS: This is going to address the issue of motive, bias, and credibility of this witness.

17 THE COURT: Based on the proffer, the objection is sustained on both bases. You may ask your next question.

20 BY MR. HOVIS: Q. Do you recall the Bank exercising its assignment of rents clause?

23 MR. BECK: I am going to object, Your Honor. Again, this is beyond the scope. It's not relevant. It's not even mentioned in the 2011 Report of Exam, any issue regarding the assignment of rents related to the Nielson properties.

3 THE COURT: Your response to both scope and relevance?

5 MR. HOVIS: The same as before, Your Honor.

6 THE COURT: Same ruling.

7 BY MR. HOVIS: Q. Following the sending of the binder to Ms. Miessner, did you have a conversation with her with regard to the binder and the relationship between the Nielsons and the Bank?

12 MR. BECK: I am going to object. Again, it's beyond the scope of direct. It's not relevant. She testified she sent the binder to the FDIC. There was no inquiry about who she sent it to or any subsequent conversations and again I don't think it's relevant to these proceedings.

18 THE COURT: Address both scope and relevance, please, counsel.

20 MR. HOVIS: Same basis, Your Honor.

21 THE COURT: Same ruling.

22 BY MR. HOVIS: Q. Ms. Miessner said to you "This is perfect timing as we are just starting an Examination," did she not?

25 MR. BECK: Your Honor, I'm going to object. Again, we are repeating the same -- I have the same objections. It's beyond the scope of direct and it is not relevant or pertinent to these proceedings.

4 THE COURT: Address both scope and relevance.

5 MR. HOVIS: Same basis, Your Honor.

6 THE COURT: Same ruling.

7 BY MR. HOVIS: Q. Your objective in sending the binder and providing the help that you did for over two years to Ms. Miessner and the investigator Teri Gillerlain was to make good on your threat to destroy the Bank, was it not?

12 MR. BECK: I am going to object, Your Honor. Again, it's beyond the scope of direct and it is not relevant or pertinent to these proceedings.

15 THE COURT: Response to both scope and relevance, please.

17 MR. HOVIS: Same basis, Your Honor.

18 THE COURT: Same ruling.

19 MR. HOVIS: I have the same series of questions that have been the source of an offer of proof with regard to both Anne Miessner and Autumn Berden. In order to save time, it would seem to me appropriate if the Court deems it so that I would incorporate the proffer that I made earlier and with regard to the

questions that I've just been asking, there are a few pages of this witness's deposition that I would like to add to what I proffered earlier. 553 through 559.

4 THE COURT: And that's from the prior testimony, correct?

6 MR. HOVIS: Yes, from prior testimony from the prior proceeding.

8 THE COURT: Alright.

9 MR. HOVIS: I would also like to note that again simply for the record, the court struck our Affirmative Defenses prior to the proceeding based on entrapment and due process and, therefore, I have not attempted to elicit testimony on those issues in view of the Court's ruling, but I do want the record to reflect that the same proffer we would be making on those defenses if the court had given us the opportunity to present those.

17 THE COURT: First with respect to incorporating the earlier offers of proof in this context, any objection?

20 MR. BECK: No, Your Honor.

21 THE COURT: Alright, and any objection to my considering also the additional pages of 553 to 559 of the transcript?

24 MR. BECK: No, Your Honor.

25 THE COURT: Anything else in the proffer that, offer of proof that you care to make at this time, Mr. Hovis?

3 MR. HOVIS: No, Your Honor.

4 THE COURT: Any other questions for the witness?

5 MR. HOVIS: No, Your Honor.

1012-18

Note: what follows is the excerpted transcript referred to above, from the 2015 hearing: 553-559 (Cross examination of Cori Nielson during the 2015 hearing)

Q. And Mr. Bill Calcutt clearly stated in the September 17, 2015 paragraph that says "The foregoing settlement proposal," it's in the middle of the page "is conditioned upon all the loan documentation including, without limitation, all of the terms and conditions of the loans being satisfactory to Northwestern and its legal counsel." Do you see that?

7 A. I see that.

8 Q. Now this was not what you wanted. You wanted far greater debt relief than on two properties and that's what led then to continued discussions that occurred up until June of 2011?

12 A. Well, I'm not sure that we were only getting debt relief on two properties but, yes, we needed more debt relief than this proposal gave and, hence, we continued negotiations.

16 Q. Alright. You were asked earlier with regard to when you sent the binder to the FDIC. I have a document that will refresh your recollection, but let's set the framework. Is it your memory that negotiations broke down in June 2011?

21 A. Yeah, May or June, 2011. Probably June. Go

with June.

23 Q. And you testified earlier that one of the, one of the things that the Bank did in terms of collection of the debt was to exercise its rights under the assignment of rents clause?

2 A. Yes, it did that later that summer.

3 Q. And actually they did it in June, did they not?

4 A. Oh. I, I, I could be wrong. Maybe they did it in June. It seems like it was later.

6 Q. And aside from exercising their rights under the assignment of rents clause, the Bank also immediately took whatever cash was available in the various accounts to set off against the loans, did it not?

10 A. They did do a loan set-off.

11 Q. And in addition to that, the Bank instituted foreclosure proceedings, as you testified, on all the properties?

14 A. These things you are saying happened at various dates and not all at the same time. The foreclosure proceedings definitely happened along a long-ish time span of dates but, yes, they did end up foreclosing.

18 Q. But you had been told by Mr. Calcutt in that May meeting that if you were going to insist, continue to insist on your position that the Bank was going to suffer all of the losses on these deficiencies, the Bank was going to aggressively go after collection of this debt. He made that very clear to you, did he not?

24 A. Um, I'm trying to make sure I've got the scope

of your question. He was clear that he would exercise his legal remedies. I don't, I mean you're really emphasizing it (pause).

3 Q. Alright. Look at Respondent's Exhibit 85 to see if that refreshes your memory as to when you sent the binder.

6 A. Well, when I sent it to Lansing was I think a very different time than when I sent it actually to Chicago and Washington, D.C.

9 Q. Yes. Let's look at Respondent's Exhibit 85.3. It's hard to read, but it's the best copy that we could get.

12 A. Am I looking for a date?

13 Q. Yes.

14 A. Maybe that's a 7 for the month. July. Looks like July.

16 Q. It does look like July. July --

17 A. Maybe 30th? I really don't know. It's really hard to read. You can't read the "accepted" but the delivery date looks like definitely July.

20 Q. Anyway, does it refresh your memory that it was sometime right around the end of July that you put together and sent this binder to Anne Miessner and to the OIG?

24 THE COURT: Was there a correspondence letter that goes along with this delivery? Did you put a letter in with the binder?

2 THE WITNESS: I might not have because I definitely did not put my name on anything. I might have just sent the binder. It was sort of an anonymous

whistleblower thing.

6 MR. HOVIS: As the court can see, this came from the Nielson production BHN at the bottom.

8 THE COURT: Where is that?

9 MR. HOVIS: The Bates stamp.

10 THE COURT: Who is Judy Smith?

11 THE WITNESS: It's actually Julia. I don't know who miswrote that on there, but I was staying with her, a friend, a personal friend. I didn't want to put my company address on there and I was going to visit her and I just used her address.

16 THE COURT: I think I know the answer to this question, but I take it no one contacted USPS and ran that bar code number through to get the specifics on the delivery date?

20 MR. HOVIS: No. It appears to me from looking at Respondent's 85.3 it has scheduled date of delivery, and that looks to be reasonably legible as 7-20, and the addressee is Anne Miessner.

24 THE COURT: Well, I see something that could be a 7 and a slash. I don't know what the next --

1 MR. HOVIS: It might be better if you weren't looking at the screen, if you wanted to look at the document itself. I think it may be a little more legible.

5 THE COURT: Well, can we stipulate at least to the year?

7 MR. HOVIS: Oh, yes. The witness has already testified that this was 2011.

9 THE COURT: Alright. Let me see the, is that the

original or is that a copy of the original?

11 MR. HOVIS: We do not have the original. It would have been in the Nielson production. All they would have provided was a copy.

14 THE COURT: This does look like the month of 7-20.

16 BY MR. HOVIS: Q. Does anything in your memory suggest a date other than July 20?

19 A. No, I don't have a specific recollection of a date.

21 Q. Following submission of this binder, you were contacted by the FDIC to enlist your help in the investigation, were you not?

24 A. Yes.

25 Q. How many times in the year 2011 did you meet with representatives of the FDIC to help in the investigation?

3 A. I really don't even remember if we met at all in 2011. We only met a few times over the course of these years.

6 Q. So let's look at Respondent's Exhibit 101.5. This is an e-mail that you authored on September 8, 2011 to -- and so that I don't continue to mess up pronunciation, is it Miessner? It is an e-mail that you sent to Anne Miessner and to Theresa Gillerlain. It says "Anne and Teri: I hope all is wrapping up well for both of your investigations/examinations. It was nice to meet you today, Teri." And then you move into a topic I'm going to pursue in a minute. CB Richard Ellis. Does this refresh your recollection?

17 A. Yes.

18 Q. And you referred to investigations/examinations. What did Ms. Gillerlain say to you was her role with regard to the investigations/examinations?

21 A. I think she had a title like investigator or something? And I felt like she was the leader of the group that came to Traverse City to conduct some kind of exam.

25 Q. What did she tell you at this meeting about what it was she was doing?

2 A. Well, I, I already had an understanding of what they were doing in general? Before they arrived? Now that you showed me this, I remember that when I ended up talking with Anne after she received the binder, she said it's perfect timing because they are going to be going there and doing an Exam. I don't know the specifics of what's included in an Exam, but -- so I already knew they were coming to do an Exam. So what exactly Teri told me she was doing different than that? I'm, I'm not sure. I think she specifically told me she had a sit-down with Scrub. I think she told me specifically that she was looking through their e-mail maybe, maybe copying, getting copies of their e-mail database or something.

17 Q. Do you recall at this meeting she began to ask you to help in providing additional information?

19 A. Well, when you say "began," I don't know about began. I was cooperative all along. I gave them this information to begin with, this binder, and, and any follow-up information if they needed any. I don't

know who asked me what when, but I was always co-operative.

MR. HOVIS: Did I move this into evidence

THE COURT: Yes.

MR. HOVIS: Thank you.

Offer of Proof No. 4: Direct Examination of Harry C. Calcutt, III

When he testified, Mr. Calcutt was subject to the same obligations all other witnesses were subject to, specifically that during direct examination the prehearing statement describing the testimony needed to identify in advance of the hearing which documents would be presented to the witness. The following exhibits were not included in the disclosures required by the prehearing Order, and upon objection were not presented to the witness.

Tr. at 1287

Before I proceed with further questioning for Mr. Calcutt, in order to protect my record I would like to make an offer of proof with regard to what the testimony would be on the three Exhibits that you declined to let me question. With regard to FDIC Exhibit 23, that is the response of Northwestern Bank to the visitation in which Ms. Miessner had testified that the Bank did not identify reasons why the ratings that she gave were incorrect. I was going to have the witness testify regarding the violations and the insignificance of those and go through the CAMELS ratings with regard to capital and earnings to show that the Bank did demonstrate why the ratings were wrong. With regard to FDIC Exhibit 44, Ms. Miessner testified at some length about the comments made on Page 4 of that Exhibit related to the relationship has always performed without exception and that is the Northwestern Bank response of June 30, 2011. Mr. Calcutt had he been given the opportunity would have explained that those comments were in the context of the criticism about the prudent banking nature of that relationship and they were historic. They did not reflect the current position which was identified on page 8 which says that those loans are in default and are in collection. With regard to FDIC Exhibit 22, a comment was made and testimony was given regarding a statement purportedly made by Mr. Calcutt relating to blood on the pages having to do with if anybody dissented on the Board that there would be blood on the pages. I was going to have Mr. Calcutt identify that that was a sarcastic, joke-like comment made with no seriousness.

8 THE COURT: Very good. Do you want to make any response to the offer of proof at this time, counsel?

10 MR. BECK: No, Your Honor. We will reserve our response to the post-hearing briefs.

Also at page 1302:

MR. HOVIS: Yes, Your Honor, Joint Exhibit 3 was the subject of our Motion in Limine and the court overruled our Motion in Limine so it would not have been – and we would not have put it on our Exhibit list because we filed a Motion in Limine to keep it out of the court proceeding altogether. The court has allowed it to come in, and so I believe I'm entitled to have the witness now opine on certain statements made in it and it's just inconceivable that we would put it on our list when we were trying to keep it out.

23 THE COURT: Sustain the objection. You can ask your next question.

25 MR. HOVIS: Let me make my offer of proof.

1 THE COURT: Please.

2 MR. HOVIS: If permitted, the witness would have discussed that there was no regulatory definition of performing loan of which he was aware, that this document was prepared by Mr. Jackson, that he relied on Mr. Jackson in terms of the statement made that these were performing loans believing that that was in accordance with what was regulatorily required at the time.

9 THE COURT: Very good.

Also at page 1333:

Alright, I want you to look at FDIC Exhibit 42.

7 MR. BECK: Your Honor, I am going to object. It's not on the list of Exhibits.

9 THE COURT: Mr. Hovis, do you care to comment?

10 MR. HOVIS: Yes, Your Honor. This is another Exhibit that was the subject of our Motion in Limine and, therefore, we did not believe it appropriate or consider putting it on our Exhibit list; and because it has been a topic of the Government's case, we want to clarify issues related to it in rebuttal.

16 THE COURT: The objection is sustained. The

document will not go in. Do you want to make a further offer of proof?

19 MR. HOVIS: The witness had he been given the opportunity to have testified, that he did not see this document, that it was an e-mail exchange between Dick Jackson and Anne Miessner, that it's nothing that would have ever come to his attention.