No. 22-714

IN THE

Supreme Court of the United States

HARRY C. CALCUTT, III,

Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF THE AMERICAN ASSOCIATION OF BANK DIRECTORS AS *AMICUS CURIAE* SUPPORTING PETITIONER

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INTEREST OF *AMICUS CURIAE*

The American Association of Bank Directors ("AABD") is a non-profit organization that represents the interests of bank directors throughout the United States.[1] Founded in 1989, AABD is the only trade group in the United States devoted solely to bank directors and their information, education, and advocacy needs. Because the Federal Deposit Insurance Corporation ("FDIC") significantly increased the number of investigations and lawsuits against bank directors after the Great Recession, AABD established a Bank Director Liability Resource Center to serve as a clearinghouse for developments in these areas.

This case involves issues that are vitally important to AABD and its members—especially independent directors of community banks, who comprise most of AABD's membership. As it stands, the decision below imposes an extraordinary sanction—a lifetime ban from industry and $125,000 in civil money penalties—on Harry Calcutt, who was a director of a community bank in Michigan. Bank directors are usually paid little and are not professional bankers, yet they are continually exposed to potentially ruinous liability and reputational risk by enforcement actions from the FDIC and other bank regulators. These directors are typically the businesspeople of small-town America—

[1] No party's counsel authored this brief in whole or in part, and no person or entity, other than *amicus* or its counsel, made a monetary contribution to fund the brief's preparation or submission. All parties in this case were provided notice of *amicus*'s filing of this brief.

realtors, doctors, pharmacists, teachers, and leaders of their respective communities. They often serve with the primary purpose of supporting the availability of credit in their community. They generally have few resources to fight the federal government, which by contrast has virtually limitless resources that it often uses to exert pressure and extract settlements.

Given these dynamics, it is vitally important that the FDIC be required to operate within strict constitutional and statutory parameters before depriving bank directors of their livelihoods. But the Sixth Circuit panel below, despite recognizing that the FDIC's decision in this case was rife with legal error, attempted to rescue the agency's flawed reasoning by supplying its own rationales for the agency's result. If permitted to stand, the decision will only encourage agencies like the FDIC to cut more corners in the future, circumventing congressional limits on their authority and placing *amicus*'s members at needless legal, financial, and reputational risk.

SUMMARY OF THE ARGUMENT

Because the Federal Deposit Insurance Act "can deprive citizens of their property and livelihoods," Panel Dissent, Pet. App. 111a, it is imperative that its penalties be imposed only by actors who are constitutionally and statutorily empowered to do so. And like other statutes, the Act authorizes only certain specified executive branch actors to impose its penalties. Under the Act and the Constitution's separation of powers, therefore, the federal judiciary has no authority to decide as a policy matter whether certain penalties are appropriate. That is why this Court's *Chenery* doctrine requires courts to "judge the propriety of [agency] action solely by the grounds invoked by the agency." *SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947). Courts may not replace the agency's judgment with their own.

But as both Petitioner and Respondent have explained to this Court, the court below flagrantly violated these fundamental principles. The panel recognized that the FDIC reached its decision sanctioning Petitioner only after badly misapprehending the law in crucial respects. But the panel did not allow the FDIC the opportunity to determine whether and how much Petitioner should be sanctioned under the correct application of the law. Instead, the panel took it upon itself to determine whether the record supported a lifetime industry ban and $125,000 in civil penalties. The panel did so even though the statute leaves it to the FDIC's discretion whether to impose the lifetime ban, even when all statutory preconditions exist. In usurping the FDIC's obligation to make that policy judgment itself, the panel brazenly violated the *Chenery* doctrine's letter and spirit.

That clear legal error will have serious consequences if left undisturbed. Bank directors—and persons considering the role—should feel assured that federal regulators will conduct any enforcement proceeding brought against them in strict conformity with the law. Yet the decision below ensures that the regulator's enforcement arm will often get its way regardless of whether agency decision-makers properly applied the correct legal standard. Indeed, the decision below would only embolden regulators—often as here insulated from political accountability by multiple layers of for-cause removal protections—to play fast and loose with legal protections for bank directors like Petitioner, secure in the knowledge that courts of appeals will supply any defect in reasoning.

The panel's error worked special mischief here, where the FDIC's course of conduct called into question its fairness and impartiality. Its investigation appears to have been tainted from the beginning by examiner bias, and then its administrative law judge ("ALJ") prohibited Petitioner from probing the extent of that bias. And in addition to the many errors identified by the court below, the FDIC's order rests on the agency's improper second guessing of a good-faith business decision made in real time during a generational financial crisis. If left undisturbed, the decision below will deter bank directors from taking acceptable risks when in the bank's best interests—or will deter those best suited for the job from taking it in the first place.

Given the clear conflict between the Sixth Circuit's decision and decisions of this Court and other courts of appeals, *see* Pet. 15–22, the petition should be granted. Indeed, as the government itself suggested in agreeing to a stay and recall of the mandate, summary reversal would be appropriate.

ARGUMENT

I. THE DECISION BELOW FLAGRANTLY VIOLATES *CHENERY*

Certiorari, and indeed, summary reversal, is appropriate to correct the panel's flagrant violation of the "[f]undamental principles of administrative law" teaching that federal courts should not "decide[] a question that has been delegated to an agency if that agency has not first had a chance to address the question." *Smith v. Berryhill*, 139 S. Ct. 1765, 1779 (2019). Appellate courts sometimes affirm a lower *court's* decision "on an alternative ground" when "the record" supports that alternative basis. *Hoppman v. Liberty Mut. Ins. Co.*, 774 F. App'x 418, 419 (9th Cir. 2019). But it is a "well-settled principle of administrative law" that courts "may not uphold an agency decision based on reasons not articulated by the agency itself" and "cannot search the record" to "find other grounds to support the decision." *Mayo v. Schiltgen*, 921 F.2d 177, 179 (8th Cir. 1990); *see also, e.g.*, *Elzour v. Ashcroft*, 378 F.3d 1143, 1150 (10th Cir. 2004) ("[O]ur review is confined to the reasoning given by the [agency], and we will not independently search the record for alternative bases to affirm."); *Secaida-Rosales v. INS*, 331 F.3d 297, 305 (2d Cir. 2003) ("we will not search the record independently").

That is because when an agency order is "valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made," "a judicial judgment cannot be made to do service for an administrative judgment." *SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943). This is a matter of statutory authority and separation of powers: When "affirming no less than reversing [an agency's] orders," a court "cannot intrude upon the domain which Congress has exclusively entrusted to [the] agency." *Id.*

As all parties have explained, the panel disregarded these fundamental principles. *See* Pet. 14–23; FDIC Stay Resp. 12–16. The panel recognized that in numerous critical respects, the FDIC committed clear legal error—including failing to recognize its basic obligation to prove causation. *E.g.*, Panel Majority, Pet. App. 73a (FDIC "err[ed] in identifying the appropriate causation standard"); *see also* Panel Dissent, Pet. App. 126a (FDIC order is "riddled with legal error"). But for each error, the panel majority conducted its own independent review of the record to make its own assessment of whether sanctions of a lifetime ban and $125,000 were supportable. *See* Panel Majority, Pet. App. 4a (citing "evidence in the record"), 55a ("the record supports the FDIC['s] conclusion"), 56a (record presents "evidence to find" that Petitioner's actions presented abnormal financial risk "even if [the FDIC] did not explicitly draw that connection"), 58a ("[t]he record presents substantial evidence"), 59a ("[t]he record provides substantial evidence"), 64a ("the record indicates"), 67a ("[t]he record indicates"), 67a ("the record … shows"), 67a (FDIC "could have" concluded "from the record" that certain loans "exacerbated the problem"), 68a ("we conclude from the record as a whole"), 72a (declining to remand because of panel's view of "the record in this case"). As many circuits have explained, a panel's independent review of the record contravenes *Chenery*. And that independent review is especially pernicious because in this case the statute grants the FDIC discretion to decline to impose sanctions even when the necessary conditions for sanctions are satisfied. 12 U.S.C. § 1818(e)(1) (FDIC "may" impose lifetime ban in certain circumstances). The panel should have "remand[ed] for the FDIC—the fact finder—to apply the correct [legal] rules to the [facts] in the first instance," Panel Dissent, Pet. App. 125a, and determine in its discretion whether to impose sanctions upon any finding that the statutory conditions had been met.

The panel's independent review of the record is all the more "inexplicable," *id.* at 126a, because of the nature of the legal errors the FDIC committed. As the dissent explained, the FDIC imposed the lifetime ban "after holding [Petitioner] responsible for well over $8 million" in damages. *Id.* But as all three judges agreed, the FDIC failed to "identify[] the appropriate causation standard." Panel Majority, Pet. App. 73a. It is possible that with a remand the FDIC would "find that [Petitioner]'s conduct caused [only] a tiny fraction of this harm." Panel Dissent, Pet. App. 126a. And with that finding, the FDIC would—one would hope—"reconsider its 'draconian' sanction" of a lifetime ban. *Id.* The decision below robs the FDIC of its entitlement to make that determination.

The panel majority's explanation for why it thought a remand unnecessary only underscores the problem. *First*, the panel majority asserted that the FDIC's "fail[ure] to adequately support [certain] effects findings" "does not limit its power" to issue a lifetime ban. Panel Majority, Pet. App. 70a–71a; *see also id.* at Pet. App. 71a (asserting that the statutory text "permits" the FDIC to impose lifetime ban on Petitioner). But if the FDIC holds power to sanction Petitioner, his sanction is the FDIC's decision to make—not the judiciary's. As the dissent observed, the Federal Deposit Insurance Act provides that the FDIC "may" impose a lifetime ban—not that it must—when certain conditions are satisfied. Panel Dissent, Pet. App. 126a (quoting 12 U.S.C. § 1818(e)(1)); *see also* FDIC Stay Resp. 16 (making the same point).

Second, the panel majority observed that an agency's erroneous finding does not require remand when the agency made an alternative finding sufficient to meet the pertinent legal standard. Panel Majority, Pet. App. 71a–72a. But that is a red herring here because the panel did not conclude that the FDIC made a sufficient alternative finding—rather, the panel concluded that based on its own review of the record the FDIC "could have" made such a finding. *Id.* at Pet. App. 67a; *see also* FDIC Stay Resp. 16 (explaining that the FDIC did not "indicate the extent to which its [order] rested on each of the harmful effects found").

Third, the panel majority asserted that "the record in this case" provides sufficient "evidence to conclude" that the lifetime ban and $125,000 penalty are "merit[ed]." Panel Majority, Pet. App. 72a. But again, whether the record merits sanctions under a correct view of the law is the FDIC's decision, not the judiciary's. *See, e.g.*, *Jaradat v. Holder*, 498 F. App'x 592, 595–96 (7th Cir. 2012) ("Even if the [agency's] decision would have been supported by substantial evidence … , the *Chenery* doctrine forbids us from rewriting the [agency's] opinion.").

The panel's inexplicable violation of the *Chenery* doctrine makes certiorari, and indeed, summary reversal appropriate. *See* FDIC Stay Resp. 13 ("During the past 20 years, this Court has twice summarily reversed lower-court decisions that failed to apply the ordinary remand rule." (citing *INS v. Orlando Ventura*, 537 U.S. 12 (2002) (per curiam), and *Gonzales v. Thomas*, 547 U.S. 183 (2006) (per curiam)).

II. THE DECISION BELOW WILL HAVE SEVERE ADVERSE CONSEQUENCES

If left undisturbed, the decision below will send bank directors a clear message: do not risk the government's wrath with decisions that are designed to maximize shareholder value but could be second guessed years later if the future holds bad luck. The decision will therefore chill bank directors from exercising sound business judgment and will deter qualified persons from taking the role in the first place.

The decision below erodes confidence in the federal government's fairness and impartiality. The sanctions imposed on Petitioner include a lifetime ban from banking, the "industry equivalent of capital punishment." *Saad v. SEC*, 873 F.3d 297, 306 (D.C. Cir. 2017) (Kavanaugh, J., concurring). Yet the panel startlingly assumed that whether the FDIC applied the correct legal standard or one far from it, the FDIC inevitably was "bound to" impose that most draconian sanction regardless. Panel Majority, Pet.

App. 73a. The panel never explained why after asking for the first time whether (for example) Petitioner's conduct actually and proximately caused harm, the FDIC inevitably would have reached identical remedial conclusions. The panel's reasoning helps ensure that an agency's enforcement arm will obtain the result it desires in the courts, regardless of what Congress or this Court's precedents dictate.

The panel decision further reduces the odds that an individual has to prevail against an already stacked deck at the agency. Federal financial regulators hold enormous power over the regulated community, in part because of imprecise statutory language and the regulators' tendency to stretch statutory text for all it is worth. For example, as the panel dissent observed, "courts … have recognized that their reading [of "unsafe or unsound practice"] could lead to 'open-ended supervision.'" Panel Dissent, Pet. App. 114a; *see also id.* at Pet. App. 111a (courts have "create[d] a 'flexible' statute allowing regulators to address 'changing business problems'").

Most targets simply acquiesce to an agency's demands both because their limited resources are insufficient to resist the United States government and because their likelihood of winning is vanishingly small. *See, e.g.*, *Tilton v. SEC*, 824 F.3d 276, 298 n.5 (2d Cir. 2016) (Droney, J., dissenting) (quoting SEC Director of Enforcement acknowledging that the mere "threat[] [of] administrative proceedings" is enough to coerce settlement in the "'vast majority of [the SEC's] cases'"); Comments of Andrew N. Vollmer on Office of

Mgmt. & Budget Request for Information, OMB-2019-0006, at 4 (Mar. 9, 2020), tinyurl.com/y5qcknzx (former SEC Deputy General Counsel answering whether administrative enforcement "proceedings coerce settlements": "Yes they do"). At the SEC, for example, proceedings are so "slanted against defendants" (as two ALJs put it) that almost everyone settles well before the results of adjudication are revealed. Office of Inspector General, Report of Investigation, Case No. 15-ALJ-0482-1, at 20 (2016), tinyurl.com/y9xjr7fr. And the few defendants who fight it out almost always lose—in one twelve-month period, for example, the SEC won "all" contested cases before its ALJs (compared to 61 percent of cases before federal district courts). Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, Wall St. J. (Oct. 21, 2014), tinyurl.com/yb6dgtzb; *see also, e.g.*, Jean Eaglesham, *Fairness of SEC Judges Is in Spotlight*, Wall St. J. (Nov. 22, 2015), tinyurl.com/yatob4qx (reporting ALJ's warning to "defendants during settlement discussions … [that] he had *never* ruled against the agency's enforcement division" (emphasis added)). The federal judiciary should not incorporate into doctrine the notion that even the most draconian sanctions are foreordained—whatever the adversarial process may uncover—when the agency reaches a conclusion based on material error.

The decision below, moreover, sustains a "good-enough-for-government-work approach," Panel Dissent, Pet. App. 126a, that in this case did not meet even that relatively low-bar standard. The panel got it backwards: Because agency adjudication that deprives individuals of private rights is constitutionally suspect in the first place, the FDIC's "significant authority" should "[a]t the least" make courts "diligent to ensure that the agency has 'turned square corners when' dealing with the regulated community." *Id.* at Pet. App. 76a (quoting *Niz-Chavez v. Garland*, 141 S. Ct. 1474, 1486 (2021) (alteration omitted)). Here, however, the FDIC's order is the product of an irregular investigative process and is "riddled with legal error." *Id.* at Pet. App. 126a.

First, the factual basis for the FDIC's liability finding is its Monday-morning quarterbacking of Petitioner's business judgment exercised during a "once-in-a-century storm" that "would have caused the flooding even if [he] had built the dam to perfection." *Id.* at Pet. App. 118a. As president and a director of Northwestern Bank, a small community bank in Michigan, Petitioner renewed a loan and extended credit to a borrower called the Nielson Entities when it faced severe financial difficulty. Petitioner took that action in hopes that it would enable the Nielsen Entities to recover and repay its debt, but ultimately the Nielsen Entities defaulted.

Petitioner's decision-making took place during the Great Recession, which presented bank directors with a gauntlet of no-win decisions. Because loans based on real estate were underwater at the time, banks across the board found themselves between a rock and a hard place: either call the loans and immediately recognize a loss, or attempt workouts with borrowers and hope that the real-estate market would stabilize and the borrowers would recover. Ex ante, it was generally impossible to know which path was optimal—that would depend on chance and future market dynamics outside of any individual's control. *See* FDIC, *Crisis And Response: An FDIC History, 2008–2013*, 223 (2017) ("the magnitude and speed of banking crises are unpredictable"). If the real-estate market was slow to rebound, a quick call would minimize losses. But if the market regained its footing as it typically does, stopgaps would save millions of dollars.

The common law developed the business-judgment rule for precisely this sort of situation.[2] In hindsight, the storm ended up a tsunami and the FDIC thinks that Petitioner would have been better off taking immediate losses on the Nielsen Entities account.[3] Even if the FDIC is correct, however, that does not mean Petitioner's decision-making was unreasonable *without* the benefit of hindsight. Indeed, many banks were forced to make business

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[2] In fact, the rule originated in cases involving the business decisions of bank directors. *See, e.g.*, *Percy v. Millaudon*, 8 Mart. (n.s.) 68, 1829 WL 1592 (La. 1829).

[3] It appears that the FDIC is incorrect—it may well be that the Nielsen Entities workout that Petitioner authorized was profitable. The Nielsen Entities used the sale of existing collateral on another loan to bring the Northwestern loans current, and then continued to make payments on the Northwestern loans even beyond the additional loan amount as part of the workout. *See* Pet. 7. The Nielsen Entities ultimately paid down more than $1 million of its outstanding loans above and beyond what would have been paid if Northwestern had called the loans earlier. *Id.* at 8. And Northwestern was one of the few Michigan banks that successfully navigated the Great Recession—it ultimately was sold in 2014 at a premium, a testament to the bank's sound judgment and business practices. *Id.* at 6–7.

decisions during the Great Recession that ultimately turned out unprofitable—almost *five hundred* U.S. banks failed from 2008 through 2013. FDIC, *Crisis and Response: An FDIC History, 2008–2013*, Overview at xiii, fdic.gov/bank/historical/crisis. And the overwhelming majority of those failures, unfortunately, were community banks. Compared to large banks, community banks and their boards have greater resource constraints that inhibited their ability to address problems caused by the Recession's systemic challenges.

The specter of agency overreach impedes the nation's small banks when recruiting and retaining directors. If bank directors must operate under the knowledge that their real-time decisions may be second guessed by a powerful government agency years later if chance renders one of those decisions a loser, "no man of ordinary prudence [will] accept" a bank-director position in the first place. *Godbold v. Bank at Mobile*, 11 Ala. 191, 199 (1847). Indeed, in a recent AABD survey, 24.5 percent of banks reported that fear of personal liability was a reason why a director resigned, a person declined a directorship offer, or a director declined to serve on or resigned from the bank's loan committee. AABD Survey Results On Measuring Bank Director Fear Of Personal Liability Are Not Good News (Apr. 9, 2014), http://aabd.org/aabd-survey-results-measuring-bank-director-fear-personal-liability-good-news (last visited Mar. 1, 2023).

Agency overreach also affects existing directors' decision-making. The risk of personal liability and reputational damage can cause directors to become overly cautious—sometimes, unfortunately, to the point of imprudently avoiding moves that could substantially benefit their banks and shareholders. Bank directors are aware that this case is not atypical—most FDIC lawsuits against directors of failed banks challenge the decisions to approve individual loans. *See generally* David Baris & Loyal Horsley, *FDIC Director Suits: Lessons Learned* (2d ed. 2015).

Second, the FDIC's investigative process may have been tainted by a biased examiner. Most FDIC enforcement actions, including this one, are initiated after a bank examination. Bank examinations, which the FDIC considers "key" in "helping the FDIC identify the cause and severity of problems at individual banks," FDIC, *RMS Manual Of Examination Policies*, Part 1: Basic Examination Concepts and Guidelines, § 1.1-2 (2021), generally occur every twelve to eighteen months, *see* 12 U.S.C. § 1820(d). The examiner (i) conducts a thorough evaluation of every aspect of a bank's operations; (ii) assigns the bank certain ratings; (iii) issues a report; and (iv) determines whether there are sufficient grounds to initiate an enforcement action.

Here, the FDIC case manager overseeing Northwestern appears to have engaged in highly irregular and inappropriate conduct. For example, in apparent violation of federal law, the case manager divulged to the Nielson Entities confidential details of the FDIC's meeting with Northwestern's board of directors. C.A. App. 620; 18 U.S.C. §§ 1905, 1906. The manager told the Nielson Entities that Northwestern "should have fired" Petitioner. C.A.

App. 620. The manager asked the Nielsons whether they had spoken with a lawyer and encouraged them to sue Northwestern. C.A. App. 620. In apparent violation of federal law, the manager disclosed to the Nielson Entities confidential developments about the FDIC's investigation, including informing them of "[a] little news to brighten your weekend" while ensuring it was understood that "you didn't hear it from me!" C.A. App. 622–23; 18 U.S.C. §§ 1905, 1906.

Compounding the problem, the FDIC's ALJ prohibited Petitioner from cross-examining the case manager on her bias. The Fifth Amendment's Due Process Clause and the Administrative Procedure Act guarantee agency defendants the right to cross-examine witnesses. *See Goldberg v. Kelly*, 397 U.S. 254, 269 (1970) ("In almost every setting where important decisions turn on questions of fact, due process requires an opportunity to confront and cross-examine adverse witnesses."); 5 U.S.C. § 556(d) ("A party is entitled to … conduct such cross-examination as may be required for a full and true disclosure of the facts."). And "the right to cross-examine includes the opportunity to show that a witness is biased." *Pennsylvania v. Ritchie*, 480 U.S. 39, 51 (1987). The panel recognized that cross-examination would have allowed Petitioner to "further develop his bias argument," but reasoned that because there was already "information regarding the possible bias" in the record, "any error" was "harmless." Panel Majority, Pet. App. 52a. That approach—where there is smoke, no need to ask if there is fire—makes no sense. If anything, the existing evidence of bias made the FDIC's decision to prevent Petitioner from probing the nature and extent of that bias more egregious.

Third, the FDIC committed numerous additional legal errors:

- As all three members of the panel recognized, the FDIC failed to even "identify[] the appropriate causation standard." *Id.* at Pet. App. 73a; *see also* Panel Dissent, Pet. App. 122a (FDIC "did not apply basic causation rules"), 76a, 120a (FDIC "ignored but-for cause and disavowed proximate cause" and "[t]he FDIC's jurisprudence leaves no hint that it adheres to these first-year torts-class concepts").
- The FDIC premised its sanction on findings related to "a *single* loan" rather than an "unsafe or unsound *practice*" as the Act's plain text requires. *Id.* at Pet. App. 115a (quoting 12 U.S.C. § 1818(e)(1)(A)(ii) (second emphasis added)).
- The FDIC premised its sanction in part on the conclusion that "[Petitioner]'s misconduct caused the Bank to incur expenses by retaining a CPA firm and a legal firm," but as the panel observed, "professional fees" could not be considered in the sanctions calculation because "[b]anks regularly engage accounting and legal firms as part of their normal business." Panel Majority, Pet. App. 64a.
- The FDIC believed that the Act "does not require a finding of a threat to bank stability," but as the panel observed, that is incorrect. *Id.* at Pet. App. 54a.

*   *   *

The FDIC's missteps in this case were not isolated or benign—rather, the adjudicative process was infected with procedural and substantive error from start to finish and front to back. And the decision below greenlit it all on the assumption that the FDIC inevitably would have imposed the same punishment regardless. The agency's process was "riddled with … error" and the panel's decision "runs afoul of basic administrative law principles." Panel Dissent, Pet. App. 125a, 126a. This morass of errors harms not only Petitioner but all bank directors by chilling and deterring their exercise of reasonable business judgment. This Court should undo the damage.

CONCLUSION

This Court should grant the petition for a writ of certiorari for plenary review or summary reversal.

Respectfully submitted.

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