Banking and Finance Law Daily Wrap Up, ENFORCEMENT ACTIONS—6th Cir: Bank exec's constitutional challenges to FDIC enforcement action rejected, (Jun. 13, 2022)

Banking and Finance Law Daily Wrap Up

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By Sherri M. Schroeder, J.D.

The executive and director had sought review of an FDIC order removing him from his position based on, among other things, structural constitutional challenges and procedural challenges after *Lucia*'s invalidation of SEC ALJs.

The Sixth Circuit Court of Appeals has denied the petition of a bank executive and director for review of an order issued by the Federal Deposit Insurance Corporation that removed him from his position, prohibited him from participating in any insured depository institution, and imposed civil money penalties. The FDIC previously determined that he, directly or indirectly, participated or engaged in unsafe or unsound banking practices and/or acts, omissions, or practices that constituted breaches of his fiduciary duty as an officer of the bank (see *Banking and Finance Law Daily*, Oct. 1, 2013). The executive brought several constitutional challenges to the appointments and removal restrictions of FDIC officials in light of the Supreme Court's decision in *Lucia v. SEC*, which invalidated the appointments of administrative law judges (ALJs) in the Securities and Exchange Commission (SEC) similar to the FDIC ALJ who first heard his case in 2015. In addition, he attacked the conduct and findings in his individual proceedings. The Sixth Circuit court, however, denied his petition, stating that his challenges to the removal restrictions at the FDIC are unavailing because he has not shown that he is entitled to relief, his 2019 hearing satisfied *Lucia*'s mandate, and any error committed by the ALJ as to limits on cross-examination at that hearing were harmless. In addition, there was substantial evidence in the record to support the FDIC Board's findings regarding the elements of 12 U.S.C. section 1811(e)(1) on FDIC removal and prohibition orders. (*Calcutt v. FDIC*, June 10, 2022, Boggs, D.).

***Lucia*.** Until *Lucia*, the ALJs who heard FDIC removal and prohibition proceedings 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, the FDIC Board newly appointed the same ALJs without conceding that their previous appointments had been unconstitutional.

Structural constitutional challenges. The bank executive's claims fall into two broad categories, the first being structural constitutional challenges. The bank executive contended that:

- The FDIC Board of Directors is unconstitutionally shielded from removal by the President after the Supreme Court's decision in *Seila Law LLC v. CFPB*;
- The FDIC ALJs who oversee enforcement proceedings are unconstitutionally insulated from removal in light of *Free Enterprise Fund v. Public Company Accounting Oversight Board*; and
- The second hearing he was given before a different ALJ failed to afford him a "new hearing" as mandated by *Lucia*.

Procedural challenges. The second category of the bank executive's claims attack the procedure used and the results reached in his post-*Lucia* adjudication. He contended that:

- The ALJ abused his discretion by curtailing cross-examination about witness bias; and
- The FDIC Board failed to find that he had committed misconduct that caused "effects" for his bank, as required by section 1818(e)(1).

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Conclusion. The court found the bank executive's challenges to be unavailing. Per the court, even if he were to establish a constitutional violation, the executive had not shown that he was entitled to relief under *Collins v. Yellen*, in which the Court explained that 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 inflicts compensable harm, which the bank executive could not demonstrate. Specifically, he did not specify the harm that occurred as a result of the allegedly unconstitutional removal restrictions. Even if he could, the court opined that *Free Enterprise Fund* explicitly excludes ALJs from its prohibition on multiple levels of for-cause removal protection, meaning that this provides only weak support for the bank executive's position.

In addition, the court found that the executive's 2019 hearing satisfied *Lucia*'s mandate. *Lucia* required that the executive receive a new hearing after his hearing in 2015, which he did with his 2019 hearing. According to the court, "[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." The court found that the 2019 hearing's ALJ and the FDIC Board did not abuse their discretion by admitting the 2015 materials when they "remained capable of drawing their own conclusions" about the executive's case.

Furthermore, any error committed by the ALJ on cross-examination limits at that 2019 hearing were found to be harmless, as other substantially equivalent evidence of the same challenged facts was admitted into evidence. Finally, the court found substantial evidence in the record to support the FDIC Board's findings regarding the elements of section 1818(e)(1).

Dissenting opinion. Judge Murphy dissented. He agreed with his colleagues as to the executive's constitutional claims, but not as to the statutory claims. He argued that the FDIC misread the statute on which it relied to sanction the bank executive. According to his reading of section 1818(e)(1)(B), the FDIC cannot bar the executive from banking "unless it proves that his bank will suffer a loss (or that he will receive a benefit) 'by reason of' his misconduct." Per Judge Murphy, the FDIC's order "ignored but-for cause and disavowed proximate cause." Therefore, Judge Murphy dissented and would remand for the FDIC "to apply the proper law."

This is case No. 20-4303.

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