UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

ON CERTIFICATION OF THE DEPARTMENT OF THE TREASURY--OFFICE OF THE COMPTROLLER OF THE CURRENCY

In the Matter of a Notice to
Prohibit Further Participation Against
GENE ULRICH,
Former Senior Vice President
and Senior Loan Officer, and

SUSAN DIEHL MCCARTHY,
Former Vice President and Loan Officer

Six Rivers National Bank,
Eureka, California.

DOCKET NO. AA-EC-00-40

FINAL DECISION

This is an administrative proceeding brought pursuant to the Federal Deposit Insurance Act (AFDI Act@) in which the Office of the Comptroller of the Currency ("OCC") seeks to prohibit the Respondents Gene Ulrich ("Ulrich") and Susan Diehl McCarthy ("Diehl McCarthy") from further participation in the affairs of any financial institution because of their respective conduct as officers at the Six Rivers National Bank, Eureka, California (the ABank@). Respondent Ulrich served as Senior Vice President and Senior Loan Officer at the Bank, and Respondent Diehl McCarthy held the positions of Vice President and Loan Officer. As required by statute, the OCC has referred the action to the Board of Governors of the Federal Reserve System (the "Board") for final action.

Upon review of the administrative record, the Board issues this Final Decision adopting the Recommended Decision (ARecommended Decision@) of Administrative Law Judge Ann Z. Cook (the AALJ@) except as specifically supplemented or modified herein. The Board therefore orders that the attached Orders of Prohibition issue against Respondents prohibiting them from future participation in the affairs of any federally-supervised financial institution, without the approval of the appropriate supervisory agency.

I. STATEMENT OF THE CASE

A. Statutory Framework

1. Standards for Prohibition

Under the FDI Act and the Board's regulations, the ALJ is responsible for conducting an administrative hearing on a notice of intent to prohibit participation. 12 U.S.C. ' 1818(e)(4). Following the hearing, the ALJ issues a recommended decision that is referred to the deciding agency together with any exceptions to those recommendations filed by the parties. The Board makes the final findings of fact, conclusions of law and determination whether to issue an order of prohibition in the case of a prohibition order sought by the OCC. 12 C.F.R. § 1818(e); 12 C.F.R. ' 263.40.

The FDI Act sets forth the substantive basis upon which a federal banking agency may issue against a bank official an order of prohibition from further participation in banking. In order to issue such an order pursuant to section 1818(e)(1), the Board must make each of three findings: 1) that the respondent engaged in identified misconduct, including a violation of law or regulation, an unsafe or unsound practice, or a breach of fiduciary duty; 2) that the conduct had a specified effect, including financial loss to the institution or gain to the respondent; and 3) that

the respondent=s conduct involved culpability of a certain degree -- either personal dishonesty or a willful or continuing disregard for the safety or soundness of the institution.
12 U.S.C. ' 1818(e)(1)(A) - (C).

2. Statutory and Regulatory Lending Restrictions

Section 84 of the National Bank Act (12 U.S.C. § 84) imposes limits on the degree to which national banks may concentrate credit to particular borrowers. In general, the total loans and other extensions of credit to a single borrower may not exceed 15 percent of a national bank's unimpaired capital and surplus. Under the OCC's regulations, loans to one borrower will be attributed to a second borrower when the proceeds of the loan are used for the "direct benefit" of the second person. 12 C.F.R. § 32.5(a)(1). Proceeds are deemed to be for the "direct benefit" of another person when the proceeds are "transferred to [the other] person," except in the case of a "bona fide arm's length transaction where the proceeds are used to acquire property, goods, or services." 12 C.F.R. § 32.5(b).

B. Procedural History

On October 12, 2000, the OCC issued a combined Notice of Intention to Prohibit Further Participation, a Notice of Charges for Restitution and a Notice of Assessment of Civil Money Penalty (together, the "Notices") against Ulrich and Diehl McCarthy. The Notices alleged that Ulrich and Diehl McCarthy violated law and regulation, recklessly engaged in unsafe or unsound practices and breached their fiduciary duties in connection with five loans they approved in December 1996. The Notices further alleged that Ulrich and Diehl McCarthy's misconduct resulted in a substantial monetary loss to the Bank and demonstrated personal dishonesty and a willful or continuing disregard for the safety or soundness of the Bank.

Following 18 days of hearings and post-hearing briefing, the ALJ issued a Recommended Decision in this matter, to which Respondents filed lengthy exceptions. The OCC did not file any exceptions. In her Recommended Decision, the ALJ concluded that the facts in this case warranted the imposition of an order of prohibition, restitution and second tier civil monetary penalties.

The case was then referred to the Board for review of the recommendation for prohibition, and to the OCC for review of the recommendations for restitution and civil monetary penalties. On September 2, 2003, the Comptroller issued a Decision and Order upholding the recommended restitution and imposing civil monetary penalties of $35,000 and $20,000, respectively, on Respondents Ulrich and Diehl McCarthy.

II. DISCUSSION

The Board has reviewed the record in this matter to assure that substantial evidence in the record supports the factual and legal conclusions of the ALJ and warrants the imposition of a prohibition order against Respondents. The Board finds that the allegations contained in the OCC's Notices and proved at the hearing meet the statutory criteria for the issuance of an order of prohibition and adopts the Recommended Decision of the ALJ except as specifically modified or supplemented herein.

A. Facts

1. Ulrich and Diehl McCarthy's Positions at the Bank

Respondents Ulrich and Diehl McCarthy started working at the Bank around 1993 and 1994, respectively. (ALJ's Findings of Fact at ¶¶2,7) (hereinafter "FF at ¶ __"). Prior to coming to the Bank, each Respondent had obtained a significant amount of experience working in the banking industry, including holding positions of considerable responsibility. (FF at ¶¶3-5, 8).

In December 1996, and at all other times relevant for the purposes of this Final Decision, Respondent Ulrich served as Senior Vice President and Senior Loan Officer at the Bank, and Respondent Diehl McCarthy held the positions of Vice President, Government Guaranteed Loan Manager, and Loan Officer at the Bank. (FF at ¶¶1, 6). As a senior officer of the Bank, Ulrich was responsible for ensuring that loans issued by the Bank complied with the Bank's policy, as well as recommending or making revisions to the policy. (FF at ¶67). As an officer of the Bank, Diehl McCarthy also was responsible for ensuring that loans extended by the Bank complied with the Bank's policy. (FF at ¶68).

2. NCH and Straightline's Lending From the Bank

Northcoast Hardwoods, Inc. ("NCH") and Straightline Investments, Inc. ("Straightline") were two local companies to which the Bank extended loans before and during 1996. (FF at ¶11). NCH and Straightline were owned and operated by the same individual, Matthew Galt ("Galt"). (FF at ¶¶9, 10). The two companies operated for all practical purposes as two units of the same business. NCH served as the operating and sales unit, while Straightline functioned as the holding company that owned the real property and equipment. (FF at ¶10). For these reasons, NCH and Straightline were considered a single borrower for lending limit purposes. (FF at ¶10).

As of early December 1996, the Bank had approved and issued loans to NCH and Straightline totaling at least $928,159. (FF at ¶62). The Bank's legal lending limit, in effect during December 1-30, 1996, was $985,322. (FF at ¶63). *See* 12 U.S.C. §84, 12 C.F.R. Part 32.

3. Respondents' Knowledge of NCH's History of Loans from the Bank and of NCH's Financial Condition

As of early December 1996, Respondents understood that NCH/Straightline had almost reached the maximum lending limit for a single borrower. (FF at ¶¶17, 29). In addition, Respondents knew that up to and around early December 1996, NCH consistently asked the Bank for additional loans, but simultaneously failed to meet its existing obligations to the Bank. Between February and December 1996, NCH requested and Respondents approved four loans to the company. In July and December 1996, NCH requested and Respondents approved extensions to NCH on existing loans for which payments were either "slow" or "past due" and in October 1996, NCH requested and Respondents approved a restructuring of NCH's existing debt. (FF at ¶¶11-12).

Finally, Respondents were familiar with the financial crisis NCH confronted by early December 1996. Respondents received letters in early December 1996 from Matthew Galt stating that NCH's net worth was negative $600,000, that the company had no money to pay for the supply and production costs of its outstanding customer orders, and that the company laid off almost 25% of its employees in November 1996. (FF at ¶13; OCC Exh. 51).

4. NCH Searches For Help: Application for a Guaranteed Loan Through USDA

Due to the financial difficulties NCH experienced in 1996, the company, with the help of both Respondents, sought additional means to obtain funds needed to maintain its operations. (FF at ¶¶18-31). Respondents worked with Galt to apply for a United States Department of Agriculture loan guarantee. (FF at ¶¶21-31). Loans guaranteed by a Federal agency do not count in the calculation of loans to a particular borrower, so the Bank could have made such a loan to

NCH if the guarantee could be obtained. 12 C.F.R. § 32.2(c)(4). As Respondents assisted Galt in the application process, they were well aware of NCH's troubled credit and of the extreme difficulties NCH would encounter in attempting to raise capital for the company without first receiving a conditional commitment from the USDA for the guaranteed loan. (FF at ¶¶23, 26).

By letter dated December 9, 1996, the USDA declared it was unwilling to issue a conditional commitment to NCH for a guaranteed loan because of NCH's unproven products and markets, as well as the company's negative net worth of $600,000. (FF at ¶27). The letter stated if NCH was able to raise the company's tangible balance sheet equity to 10%, the USDA would consider issuing a conditional commitment subject to NCH being able to increase the company's tangible balance sheet equity to 20%. (FF at ¶27). However, the letter concluded by reiterating concerns about NCH's financial stability and warning that the USDA made no guaranty to approve a conditional commitment or guaranteed loan even if NCH increased the company's tangible balance sheet equity. (FF at ¶27).

After receiving the December 9th letter from the USDA, Respondents met with Galt to discuss how NCH could raise 10% equity, which equated to $970,000. (FF at ¶¶28, 31). The three of them spoke about the possibility of third parties injecting capital into NCH, including the possibility that the Bank could issue loans to third parties who would inject the proceeds into NCH. (FF at ¶30). At that meeting, Ulrich told Galt that the Bank could not make any further loans to NCH. (FF at ¶29).

5. The Five December 1996 Loans From The Bank

Within days of the conversation about obtaining funds to inject into NCH, Respondents approved five loans, totaling $900,000, to friends and business associates of Galt (hereinafter,

collectively, "the December 1996 loans"). (FF at ¶32, 34). On December 16, 1996, Respondents approved a $200,000 loan to Timothy and Paula Crowley and a $200,000 loan to Frank and Virginia Nemetz; on December 18, 1996, Respondents approved a $200,000 loan to Gary Johnston; and on December 30, 1996, Respondents approved a $200,000 loan to Mitchell and Maggie Tonini and a $100,000 loan to Valerie Weyna. Within a day or two of disbursement, the procdeeds of each of the December 1996 loans were transferred to NCH. (FF at ¶¶38, 42, 49, 53-56, 60).[1] The aggregate amount of these loans, $900,000, equaled substantially all of the additional equity needed by NCH to enable to USDA to consider a conditional commitment.

Respondents drafted and signed credit memoranda to accompany the Crowley, Nemetz and Johnston loans. These credit memoranda stated that each loan would initially "be booked by NCH as a loan," and would "convert to equity" upon approval of the USDA, or, in any event, "even if the [USDA] loan is not approved." (FF at ¶¶36, 40, 47; OCC Exh. 56, 58, 60). Other documents created and/or reviewed by Respondents in connection with all five transactions also indicated that all five loans would be re-loaned to NCH. (FF at ¶52; OCC Exh. 57, 76).

The loan approval process for the December 1996 loans did not start until after the meeting Respondents had with Galt on December 10, 1996. (FF at ¶¶28-32). Respondents allowed Galt to both contact and obtain information from the five borrowers in connection with the loans, and with one exception, Respondents communicated with the borrowers only through Galt. (FF at ¶79).[2] The loans violated the Bank's lending policy, which entirely prohibited loans for "speculative investments in securities," and also prohibited "capital loans for a start-up

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[1] The disbursements to NCH were made despite Respondents' representations to the Bank's loan committee that $500,000 of the proceeds would be held in a "bank controlled account." (OCC Exh. 57). The account was never established. (Trans. 2635 (Ulrich)).

[2] Diehl McCarthy spoke briefly with borrower Weyna at the time the loan documents were signed. (FF at ¶ 80).

business" in the absence of a government loan guarantee. (FF at ¶¶69-70; OCC Exh. 140). Bank policy also provided that personal loans exceeding $20,000 required adequate collateral. (OCC Exh. 140 at 269). Respondents wrote up the December 1996 loans not as personal loans but as commercial "term capital loans," a category intended to provide working capital through a direct loan to an established company. (OCC Exh. 56, 58, 60, 63, 67; OCC Exh. 140 at 23-25; Trans. 94 (Tornborg)). Under the Bank's loan policy, even this type of loans could be issued on an unsecured basis only "extremely rarely, depending on debt coverage." (OCC Exh. 140 at 23-25). Yet all five of the December 1996 loans were unsecured; in none was any exception to the loan policy identified in the credit memoranda generated by Respondents. (OCC Exh. 56, 58, 60, 63, 67).

The loans were structured two-year, interest-only loans, with a balloon payment of all principal due at the end of the two-year term. (OCC Exh. 144-148). Despite the substantial amount and the short term of the loans, however, Respondents never spoke to any of the borrowers or made any efforts to identify a source of funds for repayment of the loans. In the minimal efforts they made to assess the financial condition of the borrowers, Respondents failed to obtain information necessary to make realistic credit assessments, included information that was outdated and/or not indicative of the borrowers' ability to repay the loans in accordance with their terms, and excluded critical factors such as the borrowers' living expenses. (*See, e.g.,* Trans. 3112-13, 3158 (Diehl McCarthy); Trans. 3370-71, 3373-74, 3377-78, 3384-85, 3388-90, 3392-93 (Matt Johnson); OCC Exh. 215, 199). This was particularly critical in the case of several borrowers, who had limited cash flow and whose net worths were tied up in personal businesses or real estate. (OCC Exh. 63, 67). Assuming, as Respondents claim to have done, that the loan proceeds would be used to acquire stock in NCH, it is unlikely that investment, in a

closely-held private company, could serve as a source of repayment of the principal of these loans; in any event, there is no evidence that this question was ever considered by the Respondents.[3]

As Respondents acknowledge, the December 1996 Loans caused the Bank to violate its lending limits. Under the OCC's rules, loans to one borrower are attributed to another if the proceeds of the loan are transferred to the other, unless the transfer involved a "bona fide arm's length transaction where the proceeds are used to acquire property, goods, or services." 12 C.F.R. § 32.5(b). Here, there was no such arm's length transaction, and the loans were properly combined with those to NCH, causing the lending limits violation.

6. Loss to the Bank

Ultimately, none of the borrowers ever received any value in return for the $900,000 they collectively gave to NCH, the USDA never issued a loan guarantee to NCH, NCH filed for bankruptcy, and the Bank was unable to collect on four of the five December loans. (FF at ¶¶61, 92, 94, 95). The Bank's board of directors bought two of the loans, and settlement by some of the borrowers and restitution by several members of the Bank's loan committee provided some additional recovery. However, the Bank currently maintains a loss of $232,000. (FF at ¶95-99).

B. Legal Conclusions

1. Prohibition

The sole purpose of this Final Decision and Order is to review the ALJ's recommendation for an order of prohibition against Respondents, as the ALJ's recommendation for an order of

[3] Diehl McCarthy suggested that her obligation to identify a source of repayment was satisfied by suggesting to borrower Weyna that if the investment did not work out as hoped, the loan could be restructured when principal payment became due. (Trans. 3123-24 (Diehl McCarthy)). This is obviously insufficient as a means of identifying a source of repayment; even a restructured loan eventually involves the repayment of principal.

restitution and civil monetary penalties is reviewed by the OCC. To adopt the ALJ's conclusion regarding the prohibition, the Board must find that three elements have been met: (1) misconduct, including violation of law or regulation or participation in an unsafe or unsound practice, (2) a specified effect, including financial loss to the institution, and (3) culpability. 12 U.S.C. ' 1818(e)(1)(A) - (C). Because the evidence in the record supports that all three elements have been met, the Board adopts the ALJ's recommendation for an order of prohibition against Respondents.

(a) Misconduct and Specified Effect

Respondents concede that they participated in a lending limits violation and that the Bank suffered a loss of $232,000 as a result. (Respondents' Exceptions at p. 25, 34). These admissions, along with the record evidence that supports them, establish the first and second elements needed for an order of prohibition.

The ALJ also found, and the evidence supports, that Respondents engaged or participated in unsafe or unsound practices even apart from their participation in the lending limits violation.[4] As detailed above, in a number of critical respects, the December 1996 loans and the process by which they were approved contravened Bank policies designed to assure safety and soundness. If considered as loans to purchase stock in NCH, as Respondents contend, the loans violated the Bank's loan policies prohibiting loans for speculative investments in securities. If considered as capital loans, the loans violated the policy against capital loans to start-up businesses in the absence of an agency guarantee. If considered as personal loans to the borrowers, the loans violated the policy requiring collateral for such loans above $20,000. Even accepting as accurate

[4] Respondents' procedural argument that any evidence relating to unsafe and unsound practices should not have been admitted is discussed below.

the loan category in which Respondents placed these loans in their credit memoranda -- commercial "term loans for capital," a category clearly not intended for loans of this type -- such loans too required collateral and could be issued on an unsecured basis only "extremely rarely, depending on debt cover." (OCC Exh. 140 at 24).[5] Nonetheless, all of the December 1996 loans were approved on an unsecured basis, and the credit memoranda failed even to note, much less explain, the departure from the lending policy. The Bank's loan policy was established to limit the bank's exposure to risk; such violations of the loan policy clearly constituted unsafe or unsound practices.

As discussed earlier, the process by which the loans were granted also constituted an unsafe or unsound practice. Respondents rushed to approve the loans on the basis of incomplete or outdated information in violation of the loan policy, and left it to Galt, whom they knew to be desperately in need of funds, to communicate with the borrowers. They thereby opened themselves, and the Bank, up to be "victimized" by Galt's scheme to the extent they did not actively endorse it.[6] Respondents also failed to identify a source of repayment for the loans despite the obvious risk that such action entailed in the case of these large balloon loans made to borrowers whose cash flow did not appear sufficient to repay principal.

(b) Culpability

The only element in dispute in the case at hand is whether the record supports the ALJ's finding that Respondents' misconduct involved the requisite culpability. In a case involving a

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[5] According to the loan policy, term loans for capital were to be "used for established companies," with an emphasis on those with a "good [credit] history" with the Bank – a category of company that clearly excluded NCH. (OCC Exh. 140 at 24).

[6] The risk associated with this practice is evidenced by the fact that Respondents claim to have been unaware that the borrowers had no intention of investing the proceeds of the loans in NCH, and expected Galt to repay the loans for them. Had they discussed the loans with the borrowers, they presumably would have learned of Galt's scheme before approving the loans.

prohibition order under the FDI Act, culpability is established by showing that a respondent's misconduct involved either personal dishonesty or a willful or continuing disregard for the safety or soundness of the institution. 12 U.S.C. § 1818(e)(1)(C)(i)-(ii). Whatever the precise basis of culpability, the agency must prove that the respondent's misconduct exhibited a "degree of culpability beyond mere negligence." *Kim v. Office of Thrift Supervision,* 40 F.3d 1050, 1054 (9th Cir. 1994).

Acts of personal dishonesty have been described as those "involving fraud or lack of integrity." *Van Dyke v. Board of Governors of the Federal Reserve System*, 876 F.2d 1377, 1379 (8th Cir. 1989). Continuing disregard is considered to be conduct which has been "voluntarily engaged in over a period of time with heedless indifference to the prospective consequences." *Grubb v. FDIC*, 34 F.3d 956, 962 (10th Cir. 1994). Willful disregard has been defined as "deliberate conduct which exposed the bank to abnormal risk of loss or harm contrary to prudent banking practices." *Grubb*, 34 F.3d at 961-62; *Van Dyke*, 876 F.2d at 1380. For example, in *Cavallari v. Office of the Comptroller of the Currency,* 57 F.3d 137, 145 (2d Cir. 1995), the court upheld a prohibition order where the Board found that the respondent's misconduct evidenced an "utter lack of attention to an institution's safety and soundness" or a "willingness to turn a blind eye to [the bank's] interests in the face of a known risk."

While all three types of culpability can be present in a given case, only one type is needed to support an order of prohibition. Here, the Board finds that Respondents' misconduct involved at least willful disregard for the safety and soundness of the Bank, and therefore does not reach the other bases of culpability.

Substantial evidence in the record supports a finding that Respondents' actions went beyond negligence and amounted to "willful disregard" of the Bank's safety and soundness. As

noted above, Respondents approved $900,000 in loans in a matter of days, on the basis of information provided solely by a source with an obvious conflict of interest. Respondents knew that the proceeds of the loans would be transferred to NCH. As experienced bankers, they should have known that the loans were therefore attributable to NCH for lending limits purposes and would cause the Bank to violate its lending limits.

Prior to approving the loans, Respondents failed to determine whether the borrowers would be able to repay the loans based on their personal cash flow, and apparently considered the possibility that the Bank would renegotiate the loans at the conclusion of their two-year term to be sufficient for purposes of assuring repayment. Moreover, regardless of whether the five December loans are classified as commercial "term working capital loans," or as Respondents are more appropriately calling them now, "loans to individuals" (*see* Respondents' Exceptions at p. 27), Respondents ignored the risk they posed to the Bank by approving them on an unsecured basis. Several provisions of the Bank's loan policy established that the loans were of a type that posed an unacceptable risk to the Bank. To the extent Bank policy permitted loans of this type to be made at all, the policy required that they be adequately collateralized. Adequate collateral obviously would have assisted the Bank in avoiding the losses it suffered in connection with the loans. By approving these loans on an unsecured basis, Respondents not only violated Bank policy, but they "turn[ed] a blind eye to [the bank's] interests in the face of a known risk." *Cavallari*, 57 F.3d at 145.

These and other actions on the part of Respondents reveal their "utter lack of attention" to the safety and soundness of the Bank in connection with the December 1996 loans. *Cavallari*, 57 F.3d at 145. For example, the record reveals that Respondents were expressly asked by another bank officer whether two of these loans would be combinable with the NCH loans for

lending limit purposes. Without any inquiry or research, Respondent Ulrich simply asserted they were not combinable, and Diehl McCarthy followed suit. (Trans. 2688-89 (Ulrich); Trans. 3160-61 (Diehl McCarthy)). This complete lack of concern about compliance with regulations designed to safeguard the Bank is further evidence of Respondents' "utter lack of attention" for the safety and soundness of the Bank.

The Board rejects Respondents' argument that they lacked the requisite culpability because they believed that the borrowers would use the loan proceeds to purchase stock and, as such, that they would not be combinable with NCH's loans for lending limits purposes. First, regardless of whether Respondents truly believed that the loans would *eventually* be converted to stock, they cannot claim that the loans would be used to purchase NCH stock upon disbursement.[7] Their own contemporaneous credit memoranda explicitly state that each of the five December loans would be "booked by NCH as a loan" from the borrower and only later "converted to equity" upon approval of the USDA loan guarantee "or even if the loan is not approved." (OCC Exh. 56, 58, 60). Given the Respondents' knowledge of the highly uncertain nature and timing of the USDA approval, it is evident that Respondents had no expectation when they approved the loans that conversion to equity was imminent.

Moreover, even if the December 1996 loans had been for the purpose of funding the borrowers' purchase of shares in NCH immediately, the loans still would have been considered a "direct benefit" to NCH and therefore would still have resulted in violations of the Bank's lending limit. *See* 12 C.F.R. § 32.5(a)(1), (b); OCC Interpretive Letter, January 29, 1987

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[7] In any event, Respondents' contemporaneous statements make clear that they did understand that the borrowers would transfer the loan proceeds to NCH. For example, in a December 13, 1996 letter to the USDA, Diehl McCarthy stated that Crowley, Nemetz, and Johnston would each contribute to NCH the precise amount which they subsequently borrowed from the Bank, and that each would "lend these funds to [NCH]" and that "NCH's proforma balance sheet will indicate that the funds are converted to stock." (OCC Exh. 55).

(1987 WL 149851) (OCC "considers an equity investment in a corporation to be a direct benefit because the company thereby receives additional working capital. Thus, when a borrower uses a loan to purchase newly-issued stock in a corporation, the latter has received the benefits of the proceeds and the investor's loan must be combined with any loans to the corporation.").[8]

Respondents' violations were not technical or minor violations. They were, instead, deliberate conduct that violated law, policy, and prudent banking practices that are designed to protect the Bank from the very harm it suffered here. For these reasons, the Board finds that Respondents' misconduct demonstrated willful disregard and an order of prohibition against them is justified.

2. Procedural Issues Challenged By Respondents

The Board also finds that none of the four procedural issues raised by Respondents is sufficient to deny an order of prohibition in this case. In general, the Board defers to evidentiary and trial management rulings by an ALJ "in absence of an abuse of discretion or manifest unfairness." *In the Matter of Augustus I. Cavallari*, 80 *Federal Reserve Bulletin*, 1046, 1049 (1994). No such abuse or unfairness is evident here and the ALJ's rulings are therefore sustained.

First, Respondents argue that the ALJ improperly used official notice to absolve the OCC of its burden to establish jurisdiction in this case. Specifically, Respondents challenge the ALJ's post-hearing acceptance and subsequent official notice of information from the FDIC's official website to the effect that at all relevant times, the Bank was an "insured depository institution," a prerequisite to Respondents' status as "institution-affiliated parties" as defined by 12 U.S.C. § 1813(u).

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[8] Thus, the "bona fide sale" exception to the direct benefit rule, 12 C.F.R. § 32.5(b), is inapplicable even under Respondents' view of the case.

The ALJ's action was both appropriate and timely. The OCC's regulations permit the ALJ to take official notice of "any material fact which may be judicially noticed by a United States district court and any material information in the official public records of any Federal or state government agency." 12 C.F.R. § 19.36(b)(1). Similar information to that accepted here has been subject of judicial notice in civil cases in the federal courts. *See, e.g.*, *In re Wellbutrin SR/Zyban Antitrust Litigation*, 2003 WL 22099725 (E.D. Pa. 2003); *Morris v. Valesco*, 2003 WL 21397742 (N.D. Ill. 2003); *Ligon v. Doherty*, 208 F. Supp. 2d 384 (E.D.N.Y. 2002). Moreover, Respondents have not suggested that the information on the FDIC web site regarding the Bank's insured status was in any way flawed or incorrect.[9]

Nor was it improper for the ALJ to have accepted this material after the hearing. Respondents were on notice of Enforcement Counsel's request to take judicial notice and had a full opportunity to object. In addition, as the ALJ explained in her August 6, 2002 Order, Federal Rules of Evidence 201(d) and (f), applicable by analogy, permit judicial notice to be taken "at any stage of the proceeding" and mandate that official notice be taken if a party requests it and supplies the necessary information. Here, the OCC requested that the ALJ take official notice regarding the insured status of the Bank and supplied the necessary information as described in 12 C.F.R. § 19.36(b). Accordingly, the ALJ did not abuse her discretion by taking official notice of the OCC's post-hearing submission.

Second, Respondents contend that they were denied their right to counsel because the "sequestration" order entered by the ALJ in this case prohibited them "from speaking to their counsel regarding the case while they were on the stand . . . including overnight breaks."

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[9] Respondents claim that they contested the Bank's insured status in their Answers. In fact, their answers claimed only that they lacked sufficient information to respond to the allegation that the Bank was an insured depository institution, and on that basis the allegation was denied.

(Respondents' Exceptions at p. 14). Respondents claim that the sequestration order violates their right to counsel under the Administrative Procedure Act, 5 U.S.C. § 555(b), the OCC's procedural rules at 12 C.F.R. § 19.183(b), and the Sixth Amendment to the Constitution. (Respondents' Exceptions at p. 14-17).

None of these sources provides a basis to hold that the ALJ's order, which prohibited only discussion of a witness's *testimony* while he or she was under oath (Trans. 2594, 2806), was improper. While the Administrative Procedure Act allows parties to be "accompanied, represented, and advised by counsel," it does not state or suggest that parties are entitled to discuss their on-going testimony with counsel while on breaks at an administrative hearing. The regulation cited by Respondents, 12 C.F.R. § 19.183, applies to *investigative* testimony, not testimony given at an administrative hearing. Finally, the protections provided by the Sixth Amendment to the United States Constitution do not apply to administrative hearings because such protections "are explicitly confined to 'criminal prosecutions.'" *Austin v. United States*, 509 U.S. 603, 608 (1993); *see also United States v. Ward*, 448 U.S. 242, 248 (1980).[10]

Third, Respondents assert that the ALJ prevented them from recalling certain OCC witnesses for further testimony after their cross-examination of those witnesses, and as such, that they were denied their right to cross-examine and confront witnesses. (Respondents' Exceptions at p. 17-19). The ALJ stated that she would consider permitting additional testimony from a witness who already had testified and been cross-examined if Respondents submitted information as to the topics to be covered and how the testimony would provide relevant and non-repetitive information. This requirement was certainly within the ALJ's discretion to control the flow of

[10] Even under the Sixth Amendment, a criminal defendant "has no constitutional right to consult with his lawyer while he is testifying." *Perry v. Leeke*, 488 U.S. 272, 281 (1989).

witnesses at the hearing. Respondents failed to provide such information within the time permitted by the ALJ. As such, Respondents' argument is now moot.

Fourth, Respondents argue that the OCC never alleged unsafe and unsound banking practices or breach of fiduciary duties in its original Notice of Intent, and thus that the ALJ should have dismissed all testimony and evidence related to such claims.

The OCC's rules permit the ALJ conform the notice to the evidence where issues not raised in the notice are tried at the hearing by express or implied consent of the parties, or where the objecting party fails to show that admission of such evidence would unfairly prejudice the party's defense. 12 C.F.R. § 19.20(b). Here, Respondents were aware at least through the evidence introduced at the hearing that the allegations against them went beyond lending limit violations and involved the structure and approval of the loans, as well as the creditworthiness of the borrowers, and they failed to object to the introduction of such evidence at the hearings. For example, neither Respondent objected to the introduction of OCC Exhibit 140, the Bank's extensive loan policy manual. (Trans. 107). Furthermore, both Respondents testified at the hearing regarding the issues of the borrowers' creditworthiness and of compliance with loan policies and procedures. (*See, e.g.,* Trans. 2776-78 (Ulrich); Trans. 3086, 3089-90, 3104-06, 3108-13, 3176-77, 3262, 3264-75, 3279-80 (Diehl McCarthy)). [11]

[11] Respondents also insist that the ALJ improperly excluded testimony from their witness, John Moulton, regarding the creditworthiness of the borrowers. (Respondents' Exceptions at p. 24). The Board concludes that the ALJ properly excluded such evidence. Respondents did not indicate in their pre-hearing filings that Mr. Moulton would testify about the borrowers' creditworthiness, even after the issue was raised by the OCC's witness designations. (Trans. 3664-3670).

CONCLUSION

For these reasons, the Board orders the issuance of the attached Orders of Prohibition. [12]

By Order of the Board of Governors, this _____ day of October 2003.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

____
Robert deV. Frierson
Deputy Secretary of the Board

[12] Respondents have requested oral argument but have not established good cause for such a request or identified reasons why arguments cannot be presented adequately in writing. Accordingly, their request is denied. 12 C.F.R. § 263.40(b).