April 18, 2006

By Federal Express and
E-Mail [regs.comments@ots.treas.gov]
Office of Thrift Supervisor
Chief General Counsel's Office
1700 G Street NW
Washington, DC 20552

Re: Proposal Docket No. 2006-05

Gentlemen:

I write to provide comments on the Model Director Qualification By-Law that is proposed by the Office of Thrift Supervision ("OTS"). Please note that I represent Lawrence B. Seidman ("Seidman"), and many of my comments pertain to how the proposed Model By-Law could/would arguably affect him.

A. Introductory Comments

We are most concerned about three (3) aspects of the existing, and the now proposed, Model By-Laws. First, the Model and Proposed By-Law are an effort to circumvent the federal law governing the sanctions and the restrictions that may be imposed by bank regulatory agencies. Second, the OTS has been improperly informing people in this industry that the existing Model By-Law applies to Seidman. (Currently, this means that those adopting the By-Law can eliminate Seidman from membership on their Boards. If the new proposal is adopted, this would also prevent Seidman from being able to nominate candidates for election.) Third, the Model By-law is targeted at Seidman, since he is the only person who has been subjected to a Cease and Desist Order and is active in this industry, as a shareholder who would either seek a position on a Board or nominate others.

One need look no further than the Third Circuit's Opinion in Seidman v. OTS, 37 F.3d 911 (3d Cir. 1994) to definitively confirm that the Model By-Law should not affect Seidman. In that Opinion, it was concluded that the "OTS may not, on this record impose the draconian sanction of removal and prohibition under Section 1818(e) because all of the conditions that

statute imposes on that ultimate penalty have not been met" (37 F.3d at 938)[1] It was also expressly concluded that the Director's finding of a breach of fiduciary duty was unsupported and erroneous. (37 F.3d at 935) The Court ruled that Seidman's conduct "constituted an unsafe or unsound practice and so could support a cease and desist order." (37 F.3d at 937)

This proposed Model By-Law does not preserve an institution's reputation. It is not an integrity provision; rather, it is a management entrenchment provision and the OTS is well aware of this fact.

The Cease and Desist Order entered on the remand did not – and by definition could not – be based upon dishonesty or a breach of fiduciary duty. *A fortiori,* the Model By-Law cannot legitimately be deemed to be applicable to Seidman.

On October 25, 2000, the OTS proposed the Model By-Law. The OTS received the following five (5) comment letters to the proposed Model by-Law:

1. December 11, 2000 letter from Independent Community Banks of America.
2. December 21, 2000 letter from Bray, Chiocca & Rappaport, L.L.C.
3. December 22, 2000 letter from Arthur Leibold, Jr., Esq.
4. January 2, 2001 letter from America's Community Banks.
5. January 2, 2001 letter from American Bankers Association.

Three of the comment letters recommended that the Model By-Law not be approved in its entirety for various reasons, including the OTS' lack of statutory authority to enact such a regulation and the serious constitutional issues raised by such a regulation. One comment letter did not think that the provision that would prevent an ineligible person from nominating directors was necessary.

As stated in the January 2, 2001 comment letter issued by the American Bankers Association to the original Model By-Law:

> "Further, financial institutions are subject to a number of technical and complicated laws and regulations and the potential to violate one of the requirements is high. For this reason, Congress empowered the banking agencies to issue cease and desist orders and civil money penalties. These enforcements tools focus intently the attention of management and the board on compliance. In contrast, a removal and prohibition order requires personal gain or financial harm and specific intent (not the 'or' as proposed in subpart (3) of the option by-law).[2] It is a higher burden that has a

[1] Earlier in the Opinion, it was noted that a prohibition order could only be issued upon a finding that there had been dishonesty or breach of fiduciary duty.
[2] 12 U.S.C. § 1818(e).

> higher and more intense remedy. To graft a removal and prohibition remedy as a consequence of a cease and desist violation exceeds the statutory bounds of the Home Owners Loan Act even if adopted by the savings association as a 'voluntary' by-law provision. If the remedy is needed, and quite frankly, it isn't, it is the responsibility of Congress to add the provision to the enforcement quiver of the federal banking agencies."

When the OTS has tried to expend its Congressional mandated enforcement process and sanctions, the Courts have rejected these attempts. As stated in the American Banker Association's January 2, 2000 letter:

> "In the area of director actions, the OTS has not succeeded in creating new and stricter standards, (c.f. Kaplan v. OTS, Seidman v. OTS). It is prudent regulatory behavior to consider the lessons of the courts when promulgating rules in the absence of new law even when 'cloaked' in voluntarism. This provision, if adopted, would set the unsophisticated and less, well advised financial institution in the position of retroactively applying standards that did not exist, indeed, were soundly criticized in court when the agency attempted to use them in the past. It is misleading for the agency to insert one of its regulates into a judicial debate that it has lost without even a mention of the court cases."

Nevertheless, OTS now wants to circumvent Congress and disregard judicial precedent to accomplish an action that exceeds its statutory authority.

In this case, there is absolutely no question that Congress created a statutory framework that defines those individuals who can, and cannot, be a director of a financial institution. See, 12 U.S.C. 1818 and 12 U.S.C. 1829. Congress did not grant the OTS any power to expand this class of prohibited individuals. This is also an attempt by the OTS to create federal common law rather than state law to determine certain qualifications for service on the Board of Directors of a federally-chartered association. See, O'Melveny and Meyers v. FDIC, 512 U.S. 79, 1145 S.Ct. 2048, 129 L.Ed 2d 67 (1994); and Atherton v. FDIC, 519 U.S. 213, 117 S.Ct. 666, 136 L.Ed. 2d 656 (1997).

Since the OTS itself does not have the statutory authority to expand the scope of its cease and desist authority, it surely does not have the statutory authority to use cease and desist orders issued by other regulatory agencies as the basis for prohibiting affected individuals from being directors.

In addition, and perhaps most troubling, the OTS seeks to expand its authority to persons who are not "institution affiliated parties". Pursuant to Proposed Model By-Law, a disqualified person could not nominate any individual to a board of directors, regardless of the individual's character or qualifications. "Guilt by association" is a standard that is legally unsupportable. Use of a "guilt by association" standard is not appropriate in either the rules of a Federal Agency or the by-laws of a federally chartered savings association.

The OTS now proposes to change the existing Model By-Law by removing the disqualification time period (the ten (10) year period), and adding language that disqualifies ineligible persons from nominating others to serve as directors. In addition, the proposed By-Law prohibits entities controlled by a disqualified person from nominating persons to be a director. The reasons given by the OTS for the need for this type of By-Law are:[3]

(a) "The proposal is intended to permit federal savings associations to protect their businesses from the adverse effects that are LIKELY to result when the reputation of their board members is not conducive to maintaining the public's trust."

(b) "The OTS is concerned that an institution may suffer REPUTATION RISK if the representatives of a disreputable person are elected to the institutions board of directors." To protect financial institutions against, "serious dishonesty, breach of fiduciary duty, or willful violation of financial regulatory law."

(c) To keep people from becoming directors who have "personally profited from a breach of his or her fiduciary duties." (emphasis added)

Under the APA, an agency rule shall be held unlawful and set aside if it is "in excess of statutory jurisdiction [or] authority." 5 U.S.C. §706(2)(C). See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed. 2d 694 (1984). No federal agency can exceed the power granted by Congress. Santa Fe Indus., Inc. v. Green, 430 U.S. §§462, 473 (1977).

In summary, the proposed Qualification By-Law is questionable under the Constitution, the OTS statute and case law.

HISTORICAL BACKGROUND

B. Cease and Desist Order Entered Against Seidman

Seidman's Cease and Desist Order was entered in 1995 after his Prohibition Order was reversed by the Third Circuit Court of Appeals. In the Third Circuit's Opinion, it was

[3] The OTS states in proposed By-Law that support for integrity standards are derived in part from the existing standards contained in § 563.39(b)(1) for terminating officers for cause. However, § 563.39(b)(1) when dealing with reference to a Cease and Desist Order requires that the officer willfully violate the Cease and Desist Order.

determined Seidman's actions profited his institution, and the OTS placed him in a "Catch 22" position. Seidman did not appeal his Cease and Desist Order because his counsel properly advised him that it would not limit his ability to be an officer or director of a financial institution. This advice was subsequently confirmed by the OTS when several financial institutions sought guidance as to whether Seidman could be a director of their institution. The OTS consistently (and accurately) stated that Seidman's Cease and Desist Order did not prohibit him from being a director of any financial institution.

Subsequent to 1995, Seidman has been the director of several OTS-regulated financial institutions. Because Seidman's Cease and Desist Order was issued more than ten (10) years ago, the Securities and Exchange Commission disclosure rules do not require disclosure pursuant to the Securities Exchange Act of 1934. Even if he was convicted of a crime, disclosure would not be required pursuant to the 1934 Act.

We submit that it is not a coincidence that the Model By-Law with the ten year limitation was satisfactory until late 2005, when Seidman's Cease and Desist order approached ten years.

C. Origin of the Model By-Law

In 1999, Seidman requested Board representation at an OTS regulated financial institution. This institution reacted by proposing to amend its By-Laws to include a director qualification By-Law. This amendment was not possible without OTS approval. Thus, the institution applied to the OTS for, and received, approval. [The language of this institutions' amended By-Law was almost identical to the Model By-Law.] The institution then informed Seidman that because of its new By-Law, he was not eligible to be a director. Seidman conducted a proxy contest seeking shareholder support to re-amend the institution's By-Laws. A majority of the institution's shareholders supported Seidman and voted to re-amend the By-Laws, and thereby clearly demonstrated the fact that the shareholders were not concerned about a "reputational risk". Shortly thereafter, Seidman was added to the institution's Board, and was told by several directors that the qualification By-Law was specifically directed at him and the OTS was aware of this fact.

An OTS staff attorney also told Seidman that the OTS approved the institution's proposed By-Law knowing full-well that it was solely targeted at Seidman. The attorney told Seidman that the By-Law had been named after him, by the OTS' staff.

D. OTS Cease and Desist Orders from 1989 to March 15, 2001

The OTS was created in 1989. From 1994[4] to March 15, 2001, seventy-two (72) persons/entities were subject to Cease and Desist Orders issued by the OTS, which are arguably

[4] A search of the public records does not reveal the existence of cease and desist orders for the period before 1994.

within the ambit of the Model By-Law. Based upon research conducted, not a single person who could arguably be covered by the Model By-Law, (except Seidman), is still actively involved in seeking representation on a Board of an OTS regulated institution or is a director of an OTS regulated institution. It would be very easy for the OTS to obtain the empirical data on this point.

Thus, it is clear that this Model By-Law was, and is being, targeted against Seidman.

E. Model By-Law

On October 25, 2000, the OTS proposed the Model By-Law. (If this proposal is adopted, the OTS will have exceeded its statutory authority.)

On March 15, 2001, the Model By-Law was approved, but without the provision that ineligible persons could not nominate directors. [It was, and still is, Seidman's position that he is not covered by the prohibitions established in the Model By-Law.] Seidman felt this rule violated his constitutional rights, but did not challenge the rule because the rule had a ten (10) year term, and his Cease and Desist Order only had four (4) more years to reach the ten (10) year limit, and for this short period of time, he could nominate other qualified candidates. In addition, Seidman planned to seek OTS approval to vacate his Cease and Desist Order. Further, it was also felt that the litigation cost and time it would take for a litigated resolution did not warrant the filing of a lawsuit.

It is to be noted that the OTS did not provide any empirical date from any study to substantiate the need for the proposed Model By-Law or demonstrate that it should be applied retroactively.

F. OTS Cease and Desist Orders from March 21, 2001 to February 14, 2005.

From March 21, 2001 to February 14, 2005, the OTS issued nine (9) Cease and Desist Orders that are arguably within the ambit of the Model By-Law. Based upon research, not a single person who could arguably be covered by the Model By-Law, except Seidman, is still actively involved in seeking representation on a Board of an OTS regulated institution or is a director of an OTS regulated institution. It would be very easy for the OTS to obtain the empirical data on this point.

G. The Proposed New Model By-Law

The OTS now proposes to change the Model By-Law by removing the disqualification time period (the ten (10) year period), and adding language that disqualifies ineligible persons from nominating others to serve as directors. In addition, the proposed By-Law prohibits entities controlled by a disqualified person from nominating persons to be a director.

The stated impetus to expand the reach of this By-Law is the fact that the OTS, on March 17, 2005 (OTS Order No. 2005-13), approved a By-Law amendment similar to the presently proposed Model By-Law for an OTS institution, and a number of other federal savings associations have requested permission to adopt a similar By-Law. (This statement makes the OTS appear to be more like a trade association than a federal regulatory agency whose conduct is governed by the Constitution.)

The OTS neglects to disclose that the By-Law amendment request by the savings association was made because a representative of that company spoke to a senior OTS official and told this official that Seidman was a shareholder, and that the company wanted to do something to block Seidman. The OTS representative (the same OTS representative who signed the March 17, 2005 approval of the requested By-Law) indicated that the company could eliminate Seidman by adopting a qualification by-law with no temporal limit. (This sort of advice and counsel was clearly inappropriate.)

The OTS is correct that Congress has addressed the issue of integrity of management of savings associations (12 U.S.C. 1818). The Model By-Law is an attempt to amend 12 U.S.C. 1818, without Congressional authorization. The OTS statement that "[T]he proposed regulation does not bar anyone from the industry" is unsupported and absolutely wrong.

The fact that the Model By-Law is structured as a voluntary (permissive) action for an association, in contrast to an action required or demanded by the OTS, is a distinction without a difference. Without the OTS' approval of the proposed By-Law or OTS' approval of a By-Law amendment that is not part of its Model By-Laws, an OTS regulated institution is barred from utilizing such a By-Law. Therefore, such an attempt at expansion, at the invitation of the OTS does not make the act more "legal", but rather less so.

Furthermore, based upon the above, it is clear that the By-Law is wrongfully targeted at - and solely directed toward - Seidman.

1. <u>The Proposed Model By-Law Violates Seidman's Constitutional Rights</u>

The OTS seeks comments addressing this proposal, which would permit federal savings associations to disqualify individuals who have been subject to a case and desist order indefinitely rather than for a maximum of ten (10) years.

First, as stated above, the original Model By-Law violated Seidman's constitutional rights. Second, as described above, after a comprehensive administrative proceeding, Prohibition Order, Appellate Review and Remand, and Remand Hearing, the OTS issued a Cease and Desist Order against Seidman. There is no question that Seidman's Cease and Desist Order cannot be used as the basis to prohibit him from being a director of an OTS regulated institution.

The OTS now seeks to extend and expand the sanctions imposed against Seidman without an additional proceedings, or reason; and the OTS is using his Cease and Desist Order as a bar to prohibit him from being a director of an OTS regulated institution.[5]

If approved, the proposed Model By-Law would: (i) violate the due process clause of the Fifth Amendment of the Constitution which provides that "no person shall be … deprived of life, liberty or property without due process of law."; (ii) be a bill of attainder which is a legislative act which inflicts punishment without a judicial trial; (iii)be a *Ex Post Facto* law which is classified, in part, as "Every law that changes the punishment, and inflicts a greater punishment, than the law annexed to the crime, when committed."

It is also beyond debate that not even Congress can enact a statute to be applied retroactively unless the language and intent is clear and unambiguous. Unless stringent criteria are met, all statutes can only be applied prospectively. There is no question the OTS wants to apply the Model By-Law retroactively without any authority for such an application.

There is also absolutely no question that Seidman's right to earn a living as a director is a property right which is protected by the Constitution. It is also beyond question that every OTS regulated institution must utilize OTS Model By-Laws or Optional By-Law and no institution can amend its by-laws without OTS approval. Employing the charade that the increase punishment is being caused by the voluntary acts of the regulated institutions is non-sensical.

J. Is the Change to the Model By-Law Necessary?

The OTS did not provide any empirical date to support the necessity for the original Model By-Law or for its proposed elimination of the maximum ten year period. In one instance, where shareholders were given the opportunity to vote on a Qualification By-Law, they voted against it.

K. Should Prohibition Provisions be Expanded to Cover Cease and Desist Orders Issued by Other Regulatory Agencies?

Since the OTS itself does not have the statutory authority for the proposed Model By-Law, it surely does not have the statutory authority to use cease and desist orders issued by other regulatory agencies as the basis for prohibiting affected individuals from being directors.

[5] It is interesting to note that Seidman is not barred by the Qualification By-Law from being an officer of an OTS regulated institution.

L. OTS Wants to Bar Disqualified Individuals from Being Able to Nominate Individuals to Serve on the Board of Directors.

The OTS appears to subscribe to the principle of guilt by association, which is a deplorable standard. Pursuant to the Model By-Law, a disqualified person could not nominate any qualified individual. Again, the OTS proposal provides no empirical data to support its guilt by association provision.

M. Additional Questions

The OTS requested comments as to whether: (i) the Model By-Law is intended to reduce the risk of harm to the reputation of the adopting federal saving association; (ii) OTS concerns about the reputation risk posed by persons who have engaged in dishonest conduct is valid; (iii) the proposed optional by-law is an effective comprehensive means of reducing risk to reputation; and (iv) there are other methods or means of addressing reputation risk that are less restrictive.

The answer to every one of the above questions is for the OTS to enforce the statutes Congress enacted to the fullest, or return to Congress and have it, not the OTS, expand OTS enforcement tools. The OTS cannot trample the individual rights guaranteed by the Constitution.

CONCLUSION

If the OTS wants greater enforcement or sanctioning powers, the OTS must seek this in Congress.

Very truly yours,

PETER R. BRAY

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