

THE STATE OF SOUTH CAROLINA
In the Court of Appeals
Appellate Case No. 2017-002472

APPEAL FROM OCONEE COUNTY
Court of Common Pleas

R. Lawton McIntosh, Circuit Court Judge

Case No. 2015-CP-37-635

RECEIVED
SEP 17 2018
SC Court of Appeals

Community First Bank, Inc.,..... Appellant,

v.

Frederick D. Shepherd, Jr., Respondent.

**MEMORANDUM IN SUPPORT OF APPELLANT’S RENEWED
MOTION TO SEAL**

INTRODUCTION

To accomplish its congressionally mandated responsibility, the Board of Governors of the Federal Reserve (“Federal Reserve”) conducts periodic supervisory inspections of banks that are members of the Federal Reserve System and the Federal Deposit Insurance Corporation (“FDIC”) conducts periodic supervisory inspections of banks that are not members of the Federal Reserve System, such as Appellant Community First Bank, Inc. (“Community First” or “Bank”).

Examination reports and other documents prepared in connection with the examination process constitute “confidential supervisory information” (“CSI”), 12 C.F.R. § 261.2(b), and, as such, are the property of the Federal Reserve and FDIC, *id.* § 261.11(g). Supervised financial institutions, such as Community First, cannot disclose CSI, even in

response to legal process or in connection with legal proceedings, without the express permission of the General Counsel of the Federal Reserve or the FDIC. *See id.* § 261.14.

In connection with Appellant's appeal of the trial court's sanctions order in this case, Appellant seeks to seal from the general public the documents with CSI in the parties' Record on Appeal ("Documents"). Each of the factors the Court must consider in deciding whether to seal a court record strongly supports sealing the Documents with CSI. Appellant's Renewed Motion to Seal ("Motion") should be granted.

FACTS

In the discovery phase of the instant case, Appellee Frederick D. Shepherd, Jr. ("Shepherd") requested documents from Community First that contained CSI and other information that belongs to the FDIC and with regard to which disclosure by the Bank to third-parties, such as Shepherd, was and is prohibited without the express authorization of the FDIC. (*See, e.g.,* Bank's Resp. in Opp'n to Sanctions Mot., Ex. B-000069-70, R. pp. 954-955).

After its receipt of Shepherd's document requests, the Bank requested the permission of the FDIC to provide the Documents with CSI to Shepherd. (*See* Bank's Resp. in Opp'n to Sanctions Mot., Ex. B-000061, 64-65, 69-70, R. pp. 946-950, 954-955). While Community First's requests for permission from the FDIC to produce the FDIC's Documents to Appellee were still being considered by the FDIC, on March 15, 2016, the trial court orally ordered the parties to complete certain discovery tasks. (Mar. 15, 2016 Hr'g Tr., R. pp. 1348-1395). During the hearing, Shepherd's counsel expressed knowledge and familiarity with the various FDIC documents which the Bank was not permitted to produce because they contained CSI. (*Id.* at 33, lines 2 to 25, at 34, lines 1 to 4, R. pp.

1380-1381). The trial court's oral orders were reduced to writing and memorialized in an August 1, 2016 order ("August 2016 Order"). (Aug. 2016 Order at 3-4, R. pp. 3-4).

On or about August 24, 2016, the FDIC authorized Community First to disclose certain of its Documents to Shepherd. The FDIC expressly provided, however, that this authorization was subject to the Confidentiality Order the Court previously entered in the lawsuit. Further, the FDIC required that the Documents containing CSI be marked "confidential" and that any disclosure of the CSI be strictly limited to only the parties mentioned in the Confidentiality Order. Moreover, the FDIC expressly stated that any further disclosure of CSI was not authorized without the prior approval of the FDIC and warned that unauthorized revelation of certain CSI may violate federal law, such as 31 U.S.C. §§ 5318(g), 5321, and 5322.

Also on or about August 24, 2016, the FDIC sent a private letter to the trial court in this matter regarding documents Shepherd requested from Community First that contain CSI. (Bank's Resp. in Opp'n to Sanctions Mot., Ex B-000039, R. p. 924). The substance of the letter was provided to the trial court on a confidential basis – it was not shared with the parties. (*See id.*). However, upon information and belief, through the letter the FDIC informed the trial court on the FDIC's position on the topic and expressed concerns regarding the handling of CSI. (*See id.*).

On September 15, 2016, the Court sent an email to all of the parties, acknowledging its receipt of the FDIC's letter to it. (Bank's Resp. in Opp'n to Sanctions Mot., Ex. B-000039, R. p. 924).

On September 29, 2016, Shepherd filed a Motion for Sanctions against Community First, alleging that Community First had failed to comply with its discovery obligations

and engaged in “willful disobedience” of the August 2016 Order by not providing the FDIC’s Documents to it sooner. (Shepherd’s Mot. for Sanctions at 1, R. p. 430). No other defendant filed a motion for sanctions.

Subsequently, on December 6, 2016, the FDIC authorized Community First to disclose certain other and additional Documents with CSI to Shepherd. (*See Bank’s Resp. in Opp’n to Sanctions Mot.*, Ex. B-000061, 64-65, 69-70, R. pp. 946, 949-950, 954-955). Like with the August authorization, the FDIC expressly provided that this authorization was subject to the Confidentiality Order the Court previously entered in the lawsuit, required that the Documents containing CSI be marked “confidential,” required that any disclosure of the CSI be strictly limited to only the parties mentioned in the Confidentiality Order, and stated that any further disclosure of CSI was not authorized without the prior approval of the FDIC, with unauthorized revelation of certain CSI potentially violating federal law.

Under federal law and regulations, Community First provided each and every one of the Documents containing CSI to Shepherd as soon as it possibly could in (1) strict accordance with the authorizations provided to the Bank by the FDIC (as the Documents legally belong to the FDIC, not Community First) and (2) complete compliance with the orders of the Court, including the August 2016 Order. (*See id.*). The Documents should not be made available to the public or any non-parties to the lawsuit, which has been resolved by settlement of the parties. Community First’s Renewed Motion to Seal the Documents with CSI should be granted.¹

¹ In connection with the filing of the instant appeal, Appellant filed a Motion to Seal the Documents. On July 26, 2018, this Court denied the Motion to Seal “at this time” because Appellant “failed to address the factors enumerated in Rule 41.1, SCRCP, and *Ex parte Capital*.” Appellant’s Renewed Motion to Seal and

LEGAL STANDARD

There is no provision in the South Carolina Appellate Court Rules for sealing records in the appellate court. However, South Carolina law is clear that the court has the inherent power to control its own records. See *Ex parte Capital U-Drive-It, Inc.*, 369 S.C. 1, 12, 630 S.E.2d 464, 470 (2006) (“*Ex parte Capital*”). Further, Rule 41.1(b) of the South Carolina Rules of Civil Procedure provides that courts must consider the following factors in deciding whether to seal or unseal a court record:

(1) ensuring the parties’ right to a fair trial or hearing; (2) the need for witness cooperation; (3) the reliance of the parties upon expectations of confidentiality of the proceeding; (4) the public or professional significance of the proceeding; (5) the perceived harm to the parties from disclosure; (6) why alternatives other than sealing the documents are not available to protect legitimate private interests; and (7) why the public interest, including, but not limited to, the public health and safety, is best served by sealing the documents.

Id. Moreover,

the court may consider (8) public interest in the proceeding; (9) the private or public status of the litigants and case generally; (10) whether release would enhance the public's understanding of an important historical event; (11) whether the public already has access to information contained in the records; and (12) whether a particular decision will sustain or offend the fundamental interests of public access, and any other relevant factors.

Id.

ARGUMENT

Applying the *Ex parte Capital* factors in this case, it is clear the Documents, which contain CSI, should be sealed. First, disclosure of the Documents with CSI, which belong to the FDIC (not Community First), is prohibited under federal law and regulations. Pursuant to federal law and regulations and in full compliance with the orders of the trial

this memorandum in support thereof respectfully asks the Court to reconsider its decision under Rule 41.1, SCRCP, and *Ex parte Capital*.

court, Community First could not (and lawfully did not) provide the Documents to anyone without first receiving express authorization from the FDIC to do so.

The banking industry is perhaps the most heavily regulated industry in the United States. Brief of the New York Clearing House Association As Amicus Curiae In Support of Petition for Writ of Mandamus at 4-7, *In Re: Bankers Trust Co.*, No. 95-3199, 1995 WL 17845087 (6th Cir. Feb. 27, 1995), 4-7. Decades ago, Congress established the Federal Reserve to continuously monitor the financial condition and performance of banks. *Id.* The Federal Reserve is responsible for detecting and remedying unsafe and unsound banking practices. *Id.*

To accomplish its congressionally mandated responsibility, the Federal Reserve conducts periodic supervisory inspections of banks that are members of the Federal Reserve System, *id.* (citing 12 U.S.C. § 325), and the FDIC conducts periodic supervisory inspections of banks that are not members of the Federal Reserve System. In connection with these examinations, Federal Reserve and FDIC examiners spend weeks at examined banks. *See id.* During the examinations, examiners thoroughly review a wide range of sensitive material such as individual loan files containing confidential customer information, confidential correspondence and opinions of counsel, strategic plans, market studies, board of directors and board committee minutes and related financial information. *Id.* Bank employees collect and provide this information and meet with the examiners, responding to their questions and providing additional information when requested. Generally, the supervisory examination process is cooperative. *Id.* Examiners rely upon the voluntary assistance of the examined bank in providing information, including confidential and proprietary documents, and depend upon responsible bank personnel to

respond freely and fully to questions and aid the examiners in interpreting data. *Id.*

Based upon their analyses of the bank's documents and their discussions with bank personnel, the examiners prepare a confidential bank examination report that summarizes their judgments regarding the condition of the examined bank and recommends supervisory action where necessary (and communicate with the bank in connection therewith). *Id.* A function of the examination report is to anticipate potential weaknesses before problems develop and to recommend measures to improve the examined bank's operations. *Id.*

The tone of the reports is intended to encourage prompt remedial attention by the examined bank. *Id.* The Federal Reserve and FDIC provide copies of the examination reports, along with supervisory correspondence from the Federal Reserve or FDIC, to the directors and senior management of the examined bank. *See id.* “This supervisory correspondence assists the examined bank in addressing any violations, criticisms or observations noted by the examiners.” *Id.* Based upon the conclusions contained in the reports, the Federal Reserve and FDIC may require specific remedial measures or may institute regulatory enforcement proceedings, such as cease-and-desist orders, prohibitions or suspensions. *Id.* “The examined bank, in turn, may prepare written responses to the report and supervisory correspondence and, if appropriate, may initiate requested corrective measures or improved procedures.” *Id.*

Given the sensitive, critical nature of the examination reports and correspondence, the Federal Reserve and FDIC have adopted regulations to restrict their dissemination. *See id.* (citing 12 C.F.R. §§ 261.11-261.14). The regulations provide “‘reports of examination’ and ‘any information derived from, related to, or contained in them’ remain the property of the Federal Reserve.” *Id.* (quoting 12 C.F.R. §§ 261.2(b); 261.11(g)). *Id.* Moreover, the

regulations state “[n]o supervised financial institution ... may disclose such information without the prior written permission of the [Federal Reserve’s or FDIC’s] General Counsel.” *Id.* (quoting 12 C.F.R. § 261.11(g)). “Any unauthorized disclosure or use of examination reports or related information may subject the supervised bank to federal criminal prosecution under 18 U.S.C. § 641.” *Id.*

Second, the public interest is served by sealing the Documents with CSI, and public disclosure of the documents would harm the Bank and the FDIC, as well as other banks and regulators. Unauthorized public disclosure of the Documents would chill communications between the Bank and the FDIC and discourage the FDIC from authorizing any limited disclosures in future cases (such as it did to the Defendants and trial court in this case), thereby undermining the effectiveness of bank supervision and the ability of parties to obtain information from the FDIC that is potentially relevant to their cases. *See id.*

“Federal banking regulators rely upon the voluntary cooperation and ‘give-and-take’ of the examined bank to obtain a thorough understanding of the bank's operations and the insights of its management regarding those operations.” *Id.* at 13. “The voluntary cooperation of [Community First] and the entire banking industry in these examinations is premised upon the continued confidentiality of examination reports and related documents and correspondence.” *Id.* (bracketed text added).

Courts have long recognized that unauthorized disclosure of bank examination material would endanger banks’ cooperation with regulators. *Id.* “Where the possibility of future disclosure could inhibit candid discussions by bank officials of their banks’ financial condition, the bank examiner’s ability to detect potential problems would be

impaired.” *Delozier v. First Nat'l Bank of Gatlinburg*, 113 F.R.D. 522, 526 (E.D. Tenn. 1986). “Without a relationship grounded in mutual confidence [between examiners and banks,] there could be a serious breakdown in the system.” *United States v. Provident Nat'l Bank*, 41 F.R.D. 209, 210 (E.D. Pa. 1966).

Because bank supervision is relatively informal and more or less continuous, so too must be the flow of communications between the bank and the regulatory agency. Bank management must be open and forthcoming in response to the inquiries of bank examiners, and the examiners must in turn be frank in expressing their concerns about the bank. These conditions simply could not be met as well if communications between the bank and its regulators were not privileged.

In re Subpoena Served Upon Comptroller of Currency and Secretary of Bd. of Governors of Fed. Reserve Sys., 967 F.2d 630, 634 (D.C. Cir. 1992).

Third, sealing the Documents with CSI will not hamper any need for witness cooperation or right by any party to a fair trial or hearing. The lawsuit among the parties has been resolved through settlement.

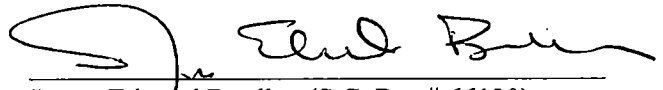
Fourth, sealing the Documents with CSI is consistent with the FDIC's reasonable expectation that the Documents would not be disclosed to the public. Further, alternatives other than sealing the Documents with CSI are not available. The Documents belong to the FDIC, not Community First, and disclosure of the Documents is not allowed under federal laws and regulations without the FDIC's express authorization. *Supra*. While the FDIC authorized limited disclosure of certain of the Documents with CSI (or portions of the Documents) to the trial court and to the parties, it did not authorize broad disclosure of the Documents to the public. In authorizing limited (non-public) disclosure, the FDIC expressly provided that its authorization was subject to the Confidentiality Order the trial court previously entered in the lawsuit, required that the Documents containing CSI be marked “confidential,” required that any disclosure of the CSI be strictly limited to only

the parties mentioned in the Confidentiality Order, and stated that any further disclosure of CSI was not authorized without the prior approval of the FDIC, with unauthorized revelation of certain CSI potentially violating federal law.

CONCLUSION

For the foregoing reasons, the Documents, which contain CSI, should be sealed. Community First's Renewed Motion to seal should be granted.

Respectfully Submitted,



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September 10, 2018

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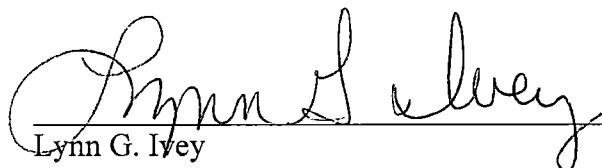
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PROOF OF SERVICE

I, Lynn G. Ivey, an employee of Moore Taylor Law Firm, P.A., certify that I have served the Memorandum in Support of Appellant's Renewed Motion to Seal on Respondent Frederick D. Shepherd, Jr., by depositing a copy of same in the United States Mail, postage prepaid, addressed to his attorneys of record as follows:

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September 11, 2018