

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
ASHEVILLE DIVISION
FILE NO. 1:11 cv 00337

FEDERAL DEPOSIT INSURANCE (
CORPORATION, as Receiver of (
The Bank of Asheville, Asheville (
North Carolina (
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Plaintiff, (
 (
v. (
 (
G. GORDON GREENWOOD, (
W. EDWARD ANDERSON, STEVEN D. (
COGBURN, DARRYL J. HART, CAROL (
L. KING, STEVEN L. PIGNATIELLO, (
and DAVID N. WILCOX (
 (
Defendants. (
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_____ (

JURY TRIAL DEMANDED

COMPLAINT

Plaintiff, the Federal Deposit Insurance Corporation, as Receiver of The Bank of Asheville, in Asheville, North Carolina (“FDIC”), for its Complaint states as follows:

The FDIC brings this lawsuit in its capacity as Receiver of The Bank of Asheville (“Asheville” or “Bank”), to recover over \$6.8 million in losses the Bank suffered on thirty (30) commercial real estate and business loans approved by the Defendants between June 26, 2007 and December 24, 2009 (“Loss Loans”). The approval of the Loss Loans as well as numerous other acts of negligence, gross negligence, and/or breaches of fiduciary duty and/or other legal duties by the Defendants were the direct and proximate cause of the Bank’s losses.

Preliminary Statement

Asheville was a North Carolina State-chartered, nonmember bank founded in October 1997. The Bank had five branches, all in Asheville, and serviced lending markets in and around Buncombe County in western North Carolina. The Bank was a wholly owned subsidiary of Weststar Financial Services Corporation (“Weststar”), a single-bank holding company formed in February 2000.

The Defendants are seven former directors and officers of the Bank. The Defendants were also members of the Bank’s Loan Committee (“LC”), the committee “responsible for the amplification, implementation and administration of the loan policy” and “management of the lending function.” The Defendants, enticed by the “bubble” in the real estate sector of the Bank’s lending markets, caused the Bank to pursue a growth strategy heavily concentrated in higher risk, speculative commercial real estate (“CRE”) loans. The Bank’s increased focus on CRE lending resulted in rapid loan growth in 2006, 2007, 2008, and part of 2009. During this period, the Bank’s growth ranked at or near the top of its peer group.

The Defendants, however, were ill-equipped to properly manage the risks associated with the nature and extent of the Bank’s growth. With the exception of the Bank’s President and Chief Executive Officer, G. Gordon Greenwood, the Defendants had virtually no previous banking or CRE lending experience. Moreover, the Defendants increased the Bank’s already high risk exposure by implementing policies and procedures void of the most basic prudent lending controls and neglecting to adequately supervise inexperienced and under qualified lending personnel.

State and federal regulators and outside auditors repeatedly warned the Defendants of the increasing risks associated with the Bank's heavily concentrated loan portfolio and lax oversight and control of the lending function. The Defendants had actual notice of these risks and a growing awareness of adverse changes in the real estate market but made little or no effort to diversify the Bank's real estate portfolio, enhance oversight of the lending function or otherwise mitigate the increased risk they created by following such a high risk growth strategy. Instead, they continued to choose short-term profits over prudent lending, betting that the demand for real estate in the Bank's chosen markets would continue indefinitely.

The Defendants' failures to establish and to adhere to sound policies and procedures resulted in the approval of poorly underwritten and structured real estate dependent loans, including the Loss Loans. The Loss Loans, at the time of approval, (1) increased previously criticized concentrations, (2) violated Loan Policy and applicable laws and regulations, and/or (3) lacked proper financial analysis or verification of the creditworthiness of the borrower and/or guarantor, and/or the value of the collateral. The inherent risks created by these improvidently granted loans were magnified when the inevitable slowdown in the real estate market began in 2008. Rather than restricting high risk lending, working out the existing troubled Loss Loans, and preserving the Bank's capital, the Defendants instead took actions that masked the Bank's mounting problems. They approved additional Loss Loans and renewed and made additional loan advances on non-performing Loss Loans, often replenishing interest reserves which allowed borrowers to pay interest with more borrowed funds. As one of the Defendants so poignantly admitted: "This is almost like throwing good money after bad." These ill-advised measures were

only a temporary stop-gap, however, and the Loss Loans were not repaid, resulting in over \$6.8 million in losses to the Bank.

The Parties

Plaintiff

1.

Plaintiff, the FDIC, is a corporation organized and existing under the laws of the United States of America. 12 U.S.C. § 1811, et seq. The FDIC is an instrumentality of the United States of America and is charged with, among other duties, the orderly liquidation of failed banks. 12 U.S.C. § 1821(d). Asheville was a State-chartered, non-member bank under the laws of the State of North Carolina, and its deposits were insured by the FDIC. On January 21, 2011, the Bank of Asheville was closed by order of the North Carolina Commissioner of Banks, and the FDIC was appointed Receiver of The Bank of Asheville. Attached hereto as Exhibit A is a true and accurate copy of correspondence, dated January 21, 2011, from the North Carolina Commissioner of Banks notifying the FDIC of The Bank of Asheville's closure and requesting the FDIC to act as the Receiver of the assets of the closed bank. Attached hereto as Exhibit B is a true and accurate copy of correspondence, dated January 21, 2011, from the FDIC to the North Carolina Commissioner of Banks, wherein the FDIC accepted appointment as Receiver of The Bank of Asheville. Pursuant to 12 U.S.C. § 1821(d)(2)(A)(i), the FDIC as Receiver succeeded to all rights, titles, powers, and privileges of Asheville and Asheville's shareholders with respect to Asheville, including, but not limited to, Asheville's claims against the Bank's former directors and officers for negligence, gross negligence and breaches of fiduciary duty or other legal duties.

Defendants

2.

G. Gordon Greenwood (“Greenwood”) was a director of the Bank, and held the positions of President and Chief Executive Officer (“CEO”), from January 2000 to August 13, 2010. Greenwood served on the Bank’s Executive Committee and was also a member of the LC during the entirety of his tenure. He retired on June 29, 2010, but continued to act as *de facto* President of the Bank until he was asked to step down on August 13, 2010. Upon information and belief, Greenwood resides in Buncombe County, North Carolina.

3.

Defendant, W. Edward Anderson (“Anderson”), was a member of the Bank’s Board of Directors from October 1997 until the Bank was closed. Anderson served as Chairman of the Board from 2002 through April 2006 and was also a member of the LC. Upon information and belief, Anderson resides in Buncombe County, North Carolina.

4.

Defendant, Steven D. Cogburn (“Cogburn”), was a member of the Bank’s Board of Directors from July 2003 through the time the Bank was closed. Cogburn served on the Bank’s Executive Committee and also was a member of the LC. Upon information and belief, Cogburn resides in Buncombe County, North Carolina.

5.

Defendant, Darryl J. Hart (“Hart”), was a member of the Bank’s Board of Directors from October 1997 until the Bank was closed. Hart served as Chairman of the Board from August

2010 until the Bank was closed. Hart also served on the Bank's Executive Committee and was a member of the LC. Upon information and belief, Hart resides in Buncombe County, North Carolina.

6.

Defendant, Carol L. King ("King"), was a member of the Bank's Board of Directors from October 1997 until the Bank was closed. King served on the Bank's Audit Committee and also was a member of the LC. Upon information and belief, King resides in Buncombe County, North Carolina.

7.

Defendant, Steven L. Pignatiello ("Pignatiello"), was a member of the Bank's Board of Directors from October 1997 until August 19, 2010. Pignatiello served as Chairman of the Board from April 2009 through June 2010. He also served as Chairman of the Bank's LC. He resigned his positions on August 19, 2010. Upon information and belief, Pignatiello resides in Buncombe County, North Carolina.

8.

Defendant, David N. Wilcox ("Wilcox"), was a member of the Bank's Board of Directors from October 1997 until the Bank was closed. Wilcox served as Chairman of the Board from April 2006 through April 2009. Wilcox served on the Bank's Executive and Audit Committees and also was a member of the Bank's LC. Upon information and belief, Wilcox resides in Buncombe County, North Carolina.

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Jurisdiction and Venue

9.

This Court has subject matter jurisdiction over this matter, as actions in which the FDIC is a party are deemed to arise under federal law pursuant to 12 U.S.C. § 1811, et seq.; 12 U.S.C. § 1819(b)(1) and (2), and 28 U.S.C. §§ 1331 and 1345. The FDIC has the power to sue and complain in any court of law. 12 U.S.C. § 1819.

10.

The Court has personal jurisdiction over the Defendants, who at all relevant times were residents of, and conducted the business of the Bank in, the State of North Carolina.

11.

Venue is proper in this District under 28 U.S.C. § 1391(b) as all or substantially all of the events and/or omissions giving rise to the claims asserted herein occurred in this District.

ALLEGATIONS OF FACT APPLICABLE TO ALL COUNTS

Asheville Lacked a True Credit Function

12.

Asheville was founded on October 29, 1997, and opened for business as a community bank in December 1997. From its inception, the Bank's core business was a mix of commercial real estate (CRE) lending and traditional consumer lending in and around Buncombe County in western North Carolina. In response to the real estate "bubble" in the Bank's lending markets in

the early to mid-2000's, the Defendants chose to pursue rapid loan growth by focusing more on CRE and business lending.

13.

Asheville's Board-approved loan policy delegated authority and responsibility for the Bank's lending function to the LC, President and CEO, and Chief Lending Officer. Greenwood, as the Bank's President and CEO, was tasked with "appoint[ing] a loan committee to be responsible for the amplification, implementation and administration of the loan policy... and managing the loan portfolio." The Defendants, however, as caretakers of the Bank's lending function, failed to implement credit risk management policies and procedures commensurate with the inherent risks associated with a rapidly expanding and heavily concentrated loan portfolio.

14.

According to the loan policy approved in July 2006, "the Bank expect[ed] its portfolio to contain a high concentration of commercial, SBA, and loans to small businesses and individuals." The Defendants approved a number of revisions to the loan policy in mid-2006 that served as catalysts to the rapid growth that ensued over the next several years. Certain revisions eased specific policy requirements and protections particularly applicable to commercial loans. For example, commercial loan borrowers were only required to submit interim financial statements annually, rather than quarterly as before. Moreover, the maximum loan to value ("LTV") (the ratio of loan amount to value of collateral) for commercial mortgages was increased from 75% to 80% of the lower of the purchase price or appraised value. Also, the

requirement that construction loans be supported by proper documentation, including a firm take-out commitment in writing, was revised to except construction loans from the written take-out requirement.

15.

The Defendants also failed to enforce other policy provisions applicable to commercial lending which were intended to limit the Bank's risk exposure. For instance, the loan policy required construction projects to be supported by a minimum of 15% cash equity. The Defendants often failed to require borrowers to provide the required cash equity in real estate secured transactions which resulted in loans exceeding supervisory LTV guidelines.

16.

Asheville's informal lending procedures were similarly deficient and/or not adequately enforced. The loan underwriting and approval process lacked the appropriate checks and balances and promoted irresponsible lending. The Defendants entrusted mostly inexperienced and under-qualified loan officers with both the loan production (sales) and quality control (underwriting analysis) functions. Loan write-ups, or credit memoranda (hereinafter sometimes referred to as "CM"), were prepared by the originating loan officer, who had an incentive to cause the loan to be approved. These write ups, typically no more than two pages, often included stale and/or unverified financial information, inaccurate and/or incomplete collateral and project feasibility analysis, and overly optimistic risk assessments. Loan officers also failed to ensure that loan files were properly documented with complete and current financial information, project status reports and loan draw requests. Most of these deficiencies went undetected, however, because of the Defendants' failure to involve themselves in the loan approval process.

17.

Credit memoranda were reviewed by the Bank's Chief Credit Officer, John Hamrick, and then presented weekly to the LC via email for consideration and approval. Notably, the emails to the LC did not include supporting documentation or other pertinent information needed to properly evaluate the loan requests. The LC did not have the benefit of reviewing verifying documentation such as borrower/guarantor financial statements, appraisal reviews and project feasibility studies. The practice of approving loans via email also prevented any meaningful discussion between LC members and severely limited their ability to conduct a complete and objective overview of the factors, both positive and negative, which are necessary to make an informed decision on the extension of credit. Even to the extent there were questions or concerns raised regarding weaknesses or inconsistencies in loan underwriting, the LC did not require these issues to be resolved or more thoroughly addressed prior to approval.

18.

Approval emails indicate that the Defendants were aware that the underwriting analysis in credit memoranda was not always accurate and/or complete. For instance, an email conveying approval of one of the Loss Loans stated that, “[S.R.]¹ owes us \$3.2 million and [P.R.] owes us \$1.9 million. Yet [per the CM] they show liabilities on their PFS of \$244,000 and \$644,000. Factor in their true obligations and they have very little net worth.” Despite the limited and sometimes questionable information and analysis provided in support of loan requests, the Defendants neglected to increase their involvement in the underwriting and approval process and

¹ Individual borrowers/guarantors are identified in this Complaint by their first and last initial only in order to preserve their right to financial privacy afforded by applicable North Carolina and federal banking laws. The Defendants, however, will be provided with the complete names of individual borrowers/guarantors.

instead continued to grant unwarranted deference to less reliable factors such as the borrower's past performance and the recommendations of inexperienced loan officers. The same approval email confirms as much: "Since they have been such good customers of the bank, I'm okay with the credit (since you [loan officer] are high on it), but I would watch them closely, especially in this economic climate."

19.

The CRE loans that Asheville made usually were short-term (12-24 month) interest-only loans secured almost entirely by the real estate project being financed. Interest payments were funded almost exclusively by the Bank through interest reserves established at origination. If loans were not repaid during the approved term, usually at the time a balloon payment was due, the Defendants routinely approved renewals and additional interest reserves often times without the benefit of updated financials or appraisals. The Bank also required little or no borrower equity in the collateral or money out of pocket over the life of the loan, leaving the Bank with all of the risk if the project was not successfully completed and sold.

20.

After origination, these higher-risk loans were also not adequately monitored and tracked by the Bank. The Bank did not maintain reports that tracked loan concentrations or loans funded by interest reserves. The Bank also failed to adequately monitor changes in borrower's financial condition and collateral values as loans seasoned. Without adequate monitoring and tracking systems in place, management was unable to make an accurate assessment of asset quality for purposes of allocating sufficient reserves to cover likely loan and lease losses. The end result was a significantly understated Allowance for Loan and Lease Losses ("ALLL") relative to the

actual risks associated with the Bank's lending practices and materially overstated capital and earnings.

21.

For Asheville, in the short term, these loans, though higher in risk, generated significant interest and fee income on paper and, because of the Bank's liberal use of interest reserves and frequent renewals, had low delinquency rates. The Defendants heavily committed the Bank to this line of lending, assuming that the real estate expansion in the Bank's chosen markets would continue indefinitely. As a result, the Bank experienced rapid growth, ranking at or near the top of its peer category in growth in 2006, 2007 and 2008.

The Defendants Disregarded Regulatory and Auditor Warnings

22.

State and federal regulators and Bank auditors consistently raised concerns over the Bank's significant concentration in CRE lending and repeatedly identified risks and deficiencies in the Bank's loan policy and lending procedures that continued to grow in both number and severity because of the Defendants' failure to take adequate corrective measures.

23.

Regulators (and auditors) identified an increasing loan concentration in CRE lending, and noted deficiencies in the monitoring and reporting of this concentration, in the 2007 through 2010 Reports of Examination ("RoE"). The March 2007 RoE noted a "high concentration" in CRE loans. Together, CRE and business loans represented over 90% of all loans. As of March 31, 2007, CRE loans represented 470% of total risk-based capital, a 55% increase from the

previous exam. Examiners found that within this concentration, construction and development (“C&D”) loans had increased by 149% and represented 25% of the total loan portfolio compared to 14% in the previous exam. These substantial increases coincide closely with the liberal revisions to the commercial loan provisions of the Bank’s loan policy. Examiners concluded in the 2007 RoE that, “this type of growth has exposed the bank to a higher level of risk in their loan portfolio and warrants close monitoring to ensure that risks are mitigated.” Similarly, independent loan file reviews for the first and second quarter of 2007 noted concerns regarding the adequacy of the Bank’s monitoring mechanisms relative to the nature and extent of its growth.

24.

The October 2008 RoE noted a “significant concentration” in CRE lending. The C&D component of the CRE concentration represented nearly 35% of the total loan portfolio, a 10% increase from the previous exam. Finding that management was still not adequately monitoring CRE concentrations, examiners recommended that numerous policy enhancements be made to mitigate the risk of a heavily concentrated loan portfolio. The Defendants finally began discussing “plans to write a policy on loan concentrations” in February 2009. The LC minutes for April and May 2009 indicate that the Defendants were still trying to determine “what percentage of the loan portfolio constitutes a concentration in any loan grouping.” Given the Bank’s focus on CRE lending, such a policy should have been established years earlier.

25.

The April 2010 RoE found that the Defendants had yet to develop and implement adequate guidelines for CRE lending. As of March 31, 2010, the Bank’s C&D loan

concentration represented approximately 310% of Total Risk Based Capital, a significant increase over the 213% noted in the previous examination. In addition, although loans to developers for land developments and loans on vacant land compromised 30% of the loan portfolio and were generally speculative, “no specific guidelines for this type of lending were provided in the credit policies.” By not implementing adequate monitoring and tracking mechanisms, the Bank had outgrown its ability to manage and control its loan concentrations. Consequently, examiners found that “the Bank’s exposure to commercial real estate loans [was] significant.” Accordingly, examiners again recommended that multiple improvements and additions be made to the Bank’s policies and procedures concerning concentrations.

26.

The increased risks created by the Bank’s heavily concentrated loan portfolio were further compounded by the Defendants’ failures to implement and enforce sound loan underwriting and credit administration policies and procedures. Regulators and auditors identified underwriting and administration deficiencies, including inadequate borrower/guarantor financial analysis, defective appraisals, untimely recognition of problem loans, improper use of loan proceeds, and an underfunded ALLL, as early as 2007 which continued to escalate and were noted through the April 2010 RoE.

27.

The Defendants failed to properly supervise the Bank’s mostly inexperienced and under-qualified loan officers or to ensure sound underwriting practices were enforced. The 2008 RoE found that “credit memos typically contained only a cursory financial ratio and trend analysis.” Further, “credit memos also consistently failed to reflect a comprehensive cash flow and liquidity

analysis.” Other specific underwriting weaknesses noted in the 2008 RoE included: inaccurate and inadequately supported loan presentations, inadequate analyses of borrower and guarantor contingent liabilities, inadequate verification of collateral value or feasibility of speculative projects, and no clear purpose for use of loan proceeds. Examiners recommended that substantial improvements be made in underwriting and loan presentations to address these weaknesses. Subsequent examinations and audits, however, show that despite their awareness of these weaknesses, the Defendants did not take adequate corrective measures to improve the quality of loan underwriting and presentations.

28.

The 2009 year-end audit noted “weaknesses in obtaining current financial information on borrowers.” The 2010 RoE found that “credit administration practices and underwriting procedures are significantly lacking and require the immediate attention of the Board.” Among the repeat criticisms noted in the 2010 RoE were inaccurate and incomplete credit memoranda, misleading information in credit approval documentation, inadequate analysis of borrower repayment capacity, failure to verify stated income, and failure to perform global cash flow analysis calculations. The 2010 RoE included a laundry list of items that must be addressed in the loan underwriting process.

29.

The true nature and extent of the substantial underwriting deficiencies and resulting risks in many of the loans approved were masked by the Bank’s informal loan approval process and lax credit administration procedures. Had the Defendants heeded the repeated recommendations of examiners and auditors to improve their oversight and supervision of the lending function,

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many of the deficiencies and weaknesses in the Bank's loan portfolio would have been exposed and measures could have been taken to require additional collateral, participate out parts of loans or otherwise mitigate the Bank's growing risk exposure.

30.

Examiners and auditors were critical of the Defendants' lack of oversight and control of the loan approval process, a process which consisted of loan applications being submitted and approved through weekly email exchanges. Moreover, there were no loan approval request packages provided to LC members in advance of approval nor were there any meaningful discussions of the merits of loan requests. The LC's review of loan requests in this manner was much too cursory to enable its members to adequately identify the serious underwriting deficiencies in many of the loans and make informed lending decisions, but the LC approved them anyway. Even after being warned of the perils of such an informal approval process, the 2010 RoE noted that "the majority of the new loans approved since the previous examination were approved by the LC via email." Not surprisingly, examiners also found that "the majority of adverse loans listed for adverse classification were approved via email." It was again explained to the Defendants that "[i]n order for members to have the information necessary to make well-informed decisions, meeting minutes, reports, and loan approval request packages should be provided and reviewed prior to each approval."

31.

The Bank's excessive use of interest reserves also masked growing loan quality issues. Most of the Bank's loans were interest-only loans funded almost exclusively by Bank-funded interest reserves established at origination. Despite the Bank's regular use of interest reserves,

regulators and auditors both noted in 2008 that the Bank had virtually no policies or procedures addressing the proper use and monitoring of interest reserves. In particular, management did not (and could not) identify loans having interest reserves. Moreover, the use of interest reserves often exceeded the construction and development phase. Accordingly, the 2008 RoE recommended that the Bank develop a formal process to monitor loans with interest reserves and limit interest reserves to the C&D phase only. The Bank's 2008 audit report also recommended that interest reserves be monitored closely given the risk that "loans may appear to perform if the interest reserve keeps a troubled loan current thereby masking warning signs that would otherwise be evident."

32.

Despite being aware of the masking effect of interest reserves and adverse changes in the real estate market, the Defendants continued to rely heavily on interest reserves to keep loans current and carry borrowers that lacked the means to repay their debt. The Defendants did not implement policies addressing the monitoring and use of interest reserves, however, until February 2010, more than a year after regulators and auditors raised the issue. The Bank's unmonitored and excessive use of interest reserves during that time served only to further compound the problems created by poorly underwritten loans and dwindling demand for real estate in the Bank's lending markets. The increasing principal balances caused by the continued capitalization of interest and the decreasing property values meant the equity margin that served as the Bank's security was quickly shrinking. Moreover, interest reserves masked liquidity and delinquency problems of some borrowers by preventing the loans from becoming past due,

which in turn prevented an accurate assessment of the quality of the loans, just as examiners and auditors predicted.

33.

Major shortcomings in both policy and oversight also lead to other deficiencies in credit administration, which were a central point of concern in RoEs and audit reports from 2007 through 2010. These concerns were well-founded as credit administration was not commensurate with the size, complexity and level of risk associated with the Bank's lending practices. Regulators found that management had no formal risk-grading procedures. Instead, loans were assigned risk grades at inception, with subsequent changes communicated by email to Greenwood or Hamrick without documented justification. The 2007 RoE found that loan officers and credit administration personnel frequently failed to timely recognize problem assets and were overly optimistic in their risk assessments. As such, examiners recommended that "given the number of loans downgraded during this examination, management should review its process of assigning grades."

34.

Third-party loan reviewers were brought in each quarter to provide a more objective assessment of the risks within the Bank's portfolio and assist credit administration in their monitoring of necessary grade changes. Management, however, routinely challenged, and seldom implemented, recommendations to downgrade loan risk ratings. Greenwood even suggested firing the Bank's auditors after they questioned whether recommended loan downgrades were being implemented and considered in calculating the Bank's ALLL, which the auditors considered to be underfunded.

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35.

The lack of credit administration controls also lead to undocumented, unexplainable or inappropriate disbursement of loan proceeds. The Bank's loan policy provides that "[f]unds will be disbursed after proof of inspection, verification of work." The Defendants' failure to enforce this policy and to inspect and/or verify work in progress, however, led to loan proceeds deemed to be for "working capital" or "line of credit" purposes being diverted for unapproved purposes, including to fund interest payments and reserves on other loans.

36.

The Bank's liberal renewal policy further contributed to the masking of declines in loan quality. According to the loan policy, "the renewal process must undergo the same underwriting process as the original credit to ensure sufficient repayment capacity. Interest-only loans generally were not to be renewed; but placed on an identified repayment plan." Contrary to this policy, however, the Defendants routinely approved multiple renewals for interest-only loans and financed additional funding for interest reserves. Moreover, these renewals were often approved in reliance on stale financials and outdated appraisals, some dated over two years prior to the renewal. The 2008 RoE further found that management had renewed a number of interest-only loans without requiring any pay-down of principal. As such, examiners recommended that the Board implement a "vigorous renewal strategy" and establish controls that require such renewals to be approved as a lending policy exception. Bank auditors also "stress[ed] the need for current valuations [of collateral] given the recent significant declines in real estate values." In the face

of these admonitions the Defendants nevertheless neglected to establish criteria for obtaining reappraisals or reevaluations and continued to risk-rate and renew troubled loans based on unreliable information.

37.

The Bank's excessive and unmonitored use of interest reserves, refusal to implement recommended downgrades of loan risk ratings and reliance on outdated appraisals all prevented an accurate assessment of potentially impaired assets which in turn resulted in a significantly underfunded ALLL. Regulators found that the Bank did not even have a written ALLL policy and the Bank's ALLL methodology and quarterly calculations were not reviewed by either the LC or the Board. In the 2007 RoE, examiners recommended that "management should review its process of assigning grades and the methodology used to calculate needed reserves in order to minimize risk." In the 2008 audit report, auditors concluded that the Bank's methodology for calculating ALLL should have included greater emphasis on economic factors "given the unprecedented state of the economy." The Defendants' failure to make adjustments in the methodology used to compute the Bank's ALLL in accordance with previous recommendations lead to repeat criticisms in subsequent exams and audits and ultimately, significant capital losses. Despite the severe economic downturn in 2008, the 2009 audit noted several instances where the Bank relied on appraisals 18 months old or greater to determine specific reserves or if additional right-downs of impaired assets were necessary. The 2010 RoE 2010 similarly found that management continued to use older appraisals, incorrectly prepared appraisals and/or broker opinions in impairment analysis. Not surprisingly, "the loans adversely classified 'Loss' during [the 2010] examination totaled \$5,704,000 and more than wiped out the ALLL of 3,514,000."

38.

All of the Defendants signed RoEs in 2007, 2008, and 2010 stating that they personally reviewed each RoE. Accordingly, each knew about the past regulatory criticisms and warnings and the need to take corrective actions, but they did not do so as noted in the April 2010 RoE: “Management failed to adhere to previous recommendations to improve credit administration procedures and internal policies which were made in the previous examination reports and also by external auditors and independent third-party loan reviewers.”

39.

The Defendants were similarly aware of the softening real estate market but did not regard it as a concern. The 2008 RoE advised “that home sales in Buncombe County had declined 34% from August 2007-August 2008.” In that same RoE, examiners noted that the uncertain economic conditions underscored the importance of closely monitoring... C&D projects.” Auditors also noted the “unprecedented state of the economy” in 2008 and that “the need for updated appraisals had been magnified given the recent significant declines in the real estate market.” Moreover, the Defendants began expressing concerns over the declining real estate market as early as March 2008: “This loan [Construction Kings] scares me due to the economic conditions.” Rather than take prudent steps to position the Bank to survive a downturn in the real estate market, the Defendants turned a blind eye to known market risks and repeated regulatory warnings, and instead continued to *increase* the volume of speculative lending and CRE concentrations, especially during the June 2007 through December 2009 time period relevant to FDIC’s claims.

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40.

By September 2009, demand within the Bank's lending markets had been in a steep decline for well over a year and the Bank could no longer carry the substantial amount of nonperforming loans on its books. The Bank had no choice but to begin recognizing large losses on C&D loans. Nonaccrual loans, comprised mostly of C&D loans, increased from just over \$6,000,000 in September 2009 to \$25,462,000 by December 30, 2009.

41.

By the time the Defendants received the 2010 RoE, the die was cast for the ultimate collapse of Asheville. Only then did the Defendants begin to implement the corrective measures urged for years by regulators and auditors. The Defendants finally took action with respect to improving oversight of lending concentrations, improving the accuracy and completeness of loan underwriting and presentations, and limiting use of interest reserves. It was too little, too late, however, and the years of excess risk-taking and lack of oversight by the Defendants that fueled the Bank's unsustainable growth ultimately led to its failure on January 11, 2011.

Approval of Loss Loans

42.

The Loss Loans were approved by the LC between June 26, 2007 and December 24, 2009. Each loan and its associated losses are included in the chart below and described in further detail in the paragraphs that follow:

The 30 Loss Loans and Approval Votes											
Borrower	Loan Amount	Approval Date	Approx. Loss	Loan Approval Votes							
				Greenwood	Anderson	Hart	King	Pignatiello	Cogburn	Wilcox	
1. R.P.	\$2,700,000	June 26, 2007	\$700,250	x	x	x	x		x	x	
2. Scenic Wolf Devel.	\$600,000	Aug. 1, 2007	\$198,653	x	x	x				x	
3. Raven Ridge, LLC	\$2,120,000	Aug. 16, 2007	\$980,316	x	x				x	x	
4. Lakewood Asheville	\$288,750	Jan. 2, 2008	\$115,653	x	x		x	x	x	x	
5. Hightower Holdings	\$414,000	Jan. 15, 2008	\$264,000	x							
6. Alexander Reagan	\$150,000	Feb. 28, 2008	\$149,962	x	x		x		x	x	
7. Construction Kings	\$450,500	Mar. 17, 2008	\$65,000	x	x		x		x	x	
8. M.B.	\$160,000	April 8, 2008	\$161,452	x	x	x	x	x	x	x	
9. G.P.	\$850,000	May 15, 2008	\$150,174	x	x		x		x	x	
10. L.B.	\$359,100	June 12, 2008	\$229,707	x	x			x	x	x	
11. L.B.	\$359,100	June 12, 2008	\$259,100	x	x			x	x	x	
12. Raven Ridge, LLC	\$940,000	June 13, 2008	\$500,000	x	x		x	x		x	
13. A.R.	\$100,000	July 2, 2008	\$22,823	x			x	x	x		
14. D.P.	\$250,000	July 25, 2008	\$189,000	x	x	x		x	x		
15. Myra Place, LLC	\$673,000	Aug. 26, 2008	\$228,043	x	x		x	x	x	x	
16. M.L.	\$846,375	Sep. 3, 2008	\$214,650		x		x	x	x	x	
17. M.W.	\$1,187,000	Sep. 5, 2008	\$144,599		x		x	x	x	x	
18. M.B.	\$166,400	Sep. 12, 2008	\$149,000	x							
19. J.H.	\$48,964	Oct. 24, 2008	\$49,000	x	x	x		x	x	x	
20. Deerborne Cottages	\$1,204,734	Jan. 20, 2009	\$350,000	x	x		x	x		x	
21. Scenic Wolf Devel.	\$650,000	Mar. 26, 2009	\$208,358	x	x		x			x	
22. J.H.	\$95,000	May 11, 2009	\$95,000	x							
23. D.P.	\$522,000	Aug. 24, 2009	\$300,000	x	x			x	x	x	
24. J.H.	\$106,000	Sep. 16, 2009	\$106,000	x	x		x	x	x	x	
25. Deerborne Cottages	\$107,000	Oct. 7, 2009	\$107,000	x	x		x	x	x	x	
26. G.E.	\$82,000	Oct. 16, 2009	\$80,898	x							
27. G.E.	\$250,000	Oct. 20, 2009	\$250,000	x							
28. R.P. & J.H.	\$75,000	Nov. 10, 2009	\$75,000	x	x			x		x	

The 30 Loss Loans and Approval Votes										
Borrower	Loan Amount	Approval Date	Approx. Loss	Loan Approval Votes						
				Greenwood	Anderson	Hart	King	Pignatiello	Cogburn	Wilcox
29. D.P & K.P.	\$100,000	Nov. 18, 2009	\$49,300	x	x	x	x	x		x
30. Raven Ridge, LLC	\$488,000	Dec. 24, 2009	\$408,086	x	x		x	x		x
Total	\$16,342,173		\$6,801,024							

43.

R.P. – 4786

The LC approved a \$2,700,000 interest-only loan to R.P. on June 26, 2007. The stated purpose of the loan was to acquire 2.04 acres of investment property. The loan was secured by a first lien deed of trust on four lots on South French Broad Avenue with a combined appraised value of \$2,650,000. The Bank obtained a second lien deed of trust on three other lots which were not appraised. The LC instead relied at least in part on the unverified market values of these lots listed in R.P.'s financial statement. The primary source of repayment was the sale of the real estate.

44.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or value of the collateral - the CM contained only a cursory cash flow analysis; (2) highly leveraged borrower lacking financial wherewithal to service the loan - R.P.'s net worth was centered mainly in heavily mortgaged real estate with minimal liquidity; (3) excessive use of interest reserves on a

speculative project; and (4) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$700,250.

45.

J.H. – 5227

Greenwood approved a \$48,964 interest-only loan to J.H. on October 24, 2008. The stated purpose of the loan was to fund the purchase of real estate for investment. The loan was secured by a first deed of trust on the purchased property and improvements. The primary source of repayment was the sale of the real estate. The Bank neglected to have the collateral appraised and advanced over 80% of the purchase price in violation of the loan policy.

46.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or value of the collateral- the CM contained only a cursory cash flow and debt service analysis; and (2) highly leveraged borrower/guarantor lacking financial wherewithal to service the loan. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$49,000.

47.

J.H. – 5393

Greenwood approved another \$95,000 interest-only loan to J.H. on May 11, 2009. The stated purpose of the loan was to fund the purchase of real estate and improvements. The loan was secured by a first deed of trust on the purchased property and improvements. The primary source of repayment was the sale of the real estate. The loan was approved on the basis of an appraised market value of \$164,000 which was substantial higher than the \$90,500 purchase price paid by J.H. according to the closing documents.

48.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral - the CM contained only a cursory cash flow and debt service analysis; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan - the borrower had a debt-service-to-credit ratio (calculated by examiners) of -0.16x and beacon score of 570, which was well below the loan policy minimum score of 600; and (3) there was no inspection of the property by the Bank to verify that planned improvements were ever made. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$95,000.

49.

J.H. – 5495

Greenwood approved another \$106,000 interest-only loan to R.P. and J.H. on September 16, 2009. The stated purpose of the loan was to fund the purchase of real estate for investment. The loan was secured by a first deed of trust on the purchased property and improvements. The primary source of repayment was the sale of the real estate.

50.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral - CM only contained a cursory analysis of cash flow (2) highly leveraged borrower/guarantor lacking financial wherewithal to service the loan – R.P.’s debt service to credit ratio (calculated by examiners) was -0.16x and J.H.’s financials showed minimal liquidity of only \$5,753, and his adjusted gross income from 2008 was only \$29,141. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC’s approval and subsequent mismanagement of this loan are approximately \$106,000.

51.

R.P. & J.H.– 5542

The LC approved a \$75,000 interest-only loan to R.P and J.H. on November 10, 2009. The stated purpose of the loan was to provide funds for “operating capital and payment of property taxes” on 45 South French Bend Avenue Property. The primary source of repayment was rental income from the property. The subject property was purchased over two years earlier

with proceeds from loan number 4786 (see paragraph 43 above) but, because of the borrowers' inability to sell the property in a declining real estate market, it was converted to rental property. The CM indicated that an "incidental deed of trust" was filed on 31 & 45 South French Broad Avenue though no weight was given to its value. These lots did not provide added security in any event as they were already subject to a first lien deed of trust in connection with loan number 4786.

52.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral - borrower/guarantor contingent liabilities were not included in CM analysis and financials were not updated to reflect substantial increase in liabilities from previous loans; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service the loan - R.P.'s debt service to credit ratio was 0.98x; and (3) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$75,000.

53.

Scenic Wolf Development, LLC - 4777

The LC approved a \$600,000 interest-only loan to Scenic Wolf Development, LLC, on August 1, 2007. The stated purpose of the loan was a temporary line of credit to be used for completing 2007 planned improvements at Scenic Wolf Resort. The primary source of repayment was the sale of the collateral. According to the loan presentation, the loan was to be

secured by five lots, two of which were set to be sold with the proceeds being applied to the loan balance. The Bank neglected to secure any interest in the two lots that were to be sold, however, and the sales proceeds were not applied to the loan balance.

54.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral - the CM contained only a cursory cash flow and debt service analysis; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service the loan; and (3) the loan was presented and approved to the LC via e-mail. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$198,653.

55.

Scenic Wolf Development, LLC – 5371

The LC approved a \$650,000 interest-only loan to Scenic Wolf Development, LLC on March 26, 2009. The stated purpose of the loan was to pay off existing Bank loan number 4854, in the amount of \$301,375; provide funding for completion of the condominium structure; and provide operating capital. The loan was secured by a first lien deed of trust on 38.046 acres located in Mars Hills. The primary source of repayment was the sale of the real estate.

56.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service the

loan – the borrower/guarantor’s total exposure was \$8,807,000, and the 2007 financials showed a negative net worth and negative net income; (3) failure to order and review appraisal before approval; (4) undocumented and unexplainable disbursement of loan proceeds - approximately \$150,000 in loan proceeds were used to fund escrow accounts associated with loan numbers 4829 and 4777 (see paragraph 53 above); and (5) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC’s approval and subsequent mismanagement of this loan are approximately \$208,358.

57.

Raven Ridge, LLC – 4804

The LC approved a \$2,120,000 interest-only loan to Raven Ridge, LLC, an entity owned and/or controlled by T.Z., on August 16, 2007. The stated purpose of the loan was to provide an “acquisition and infrastructure development line of credit” on property located in Lake Lure. The loan was secured by a first lien deed of trust on 27 residential building lots (16.9 acres) in Lake Lure and a first deed of trust on one residential lot in the Lago Vista subdivision. The loan was also secured by a life insurance policy in the amount of \$2,500,000 on T.Z. The primary source of repayment was the sale of the building lots in Lake Lure. The loan was underwritten in part based on the financials of Stone Manor, an entity that was not bound by the loan agreement, which offered no collateral to the deal, and did not otherwise have any repayment obligation.

58.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the

collateral - the CM contained only a cursory cash flow and debt service analysis; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service the loan; (3) failure to order and to review up-to-date appraisal prior to approval – appraisal was prepared months earlier for another bank; (4) excessive use of interest reserves on a speculative project; and (5) the loan was presented and approved by the LC via e-mail. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$980,316.

59.

Raven Ridge, LLC – 5108

The LC approved a \$940,000 interest-only loan to Raven Ridge, LLC on June 13, 2008. The stated purpose of the loan was to refinance Asheville loan number 4805, in the amount of \$440,000, and complete the infrastructure on the property located in Lake Lure. Loan number 4805 was originally approved to fund the construction of a model home in Lake Lure. The stated need for refinancing loan number 4805 was “because the purpose had changed,” though no explanation was given as to why the loan proceeds were not used as intended, to build a model home. The primary source of repayment was the sale of the collateral. The loan was secured by a second deed of trust on the same 16.9 acres in Lake Lure that secured loan number 4804. At the time of approval, the project had experienced significant delays and cost overruns, which prompted Pignatiello to characterize the approval of this loan as “throwing good money after bad.”

60.

Other deficiencies and violations identified on this loan included: (1) incomplete and inadequate loan presentation – the CM contains insufficient and vague information concerning construction costs and project status; (2) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral - the CM contained only a cursory cash flow and debt service analysis; (3) failure to obtain a new appraisal prior to the approval and origination of the loan; (4) highly leveraged borrower/guarantor lacking financial wherewithal to service the loan; and (5) the loan was presented and approved by the LC via e-mail. The loan was charged off in full by the Bank on June 23, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$500,000.

61.

Raven Ridge, LLC – 5578

The LC approved another interest-only loan to Raven Ridge on December 24, 2009 in the amount of \$488,000. The stated purpose of the loan was to “complete payment of outstanding invoices for the property.” The primary source of repayment was the sale of the collateral. The loan was secured by the same 16.9 acres in Lake Lure that secured loan numbers 4804 and 5108. This project was in such a troubled state, it prompted Carol King to convey her “approval... with prayers.”

62.

Deficiencies and violations identified on this loan included: (1) approval of loan and advancing of additional funds to a borrower with existing troubled loans; (2) inadequate analysis

and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral - the CM contained only a cursory global cash flow and debt service analysis; (3) failure obtain an updated appraisal prior to approval and origination of loan - the appraised value of the collateral securing this loan was over two years old; (4) highly leveraged borrower/guarantor lacking financial wherewithal to service loan; (5) excessive use of interest reserves on a speculative project; and (6) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on June 23, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$408,086.

63.

Lakewood Asheville, LLC - 4928

The LC approved a \$288,750 interest-only loan to Lakewood Asheville, LLC on January 2, 2008. The stated purpose of the loan was to acquire a .71 acre lot and fund infrastructure improvements in preparation for the construction of seven cottages. The primary source of repayment was the sale of the cottages which were to be funded by separate construction loans. The loan was secured by a first lien deed of trust on property and infrastructure improvements. Two of the three individual guarantors had a combined total exposure to the Bank of over \$4.8 million with net worths of only \$850,000 which caused Pignatiello to question "how people with relatively small net worths end up owing us over \$2 million..."

64.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the

collateral - guarantor financial analysis did not include substantial existing exposure to the Bank; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service the loan - guarantors had a combined exposure to the Bank of over \$5 million; (3) excessive use of interest reserves on a speculative project; and (4) the loan was presented and approved by the LC via e-mail. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$115,653.

65.

Hightower Holdings, LLC – 4939

Greenwood approved a \$414,000 interest-only loan to Hightower Holdings, LLC on January 15, 2008. The stated purpose of the loan was to acquire commercial property for investment. The primary source of repayment was the income from the lease of the property. The loan was secured by a first lien deed of trust on property located at 455 Weaverville Highway in Asheville and an assignment of leases between Hightower Holdings, LLC and the future lessees of the collateral property. The amount of the loan exceeded Greenwood's approval authority but he approved the loan without LC review anyway.

66.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral; (2) inadequate information related to the borrower's/guarantors' ability to repay the loan – Hightower Holdings was a newly formed entity and the CM indicated the debt service ratio of the guarantors was only 0.97x; (3) failure to review appraisal prior to approval; and (4) High LTV of 89%. The loan was charged off on December 30, 2009. To date, losses suffered by

the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$264,000.

67.

Alexander Reagan, LLC – 5001

The LC approved a \$150,000 interest-only loan to Alexander Reagan, LLC on February 28, 2008. The stated purpose of the loan was an "operating line of credit" for a development and construction company. The primary source of repayment was the cash flow from business operations. The loan was unsecured.

68.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials - the CM contained only a cursory cash flow and debt service analysis; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan; and (3) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on June 30, 2010. The losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$149,962.

69.

Construction Kings, LLC – 5007

The LC approved a \$450,500 interest-only loan to Construction Kings, LLC on March 17, 2008. The stated purpose of the loan was the construction of a single family spec home in Fairview. The primary source of repayment was the sale of the collateral. The loan was secured by a first deed of trust on the lot located in Sunset Crest Estates in Fairview which the CM

valued at \$530,000. Steve Cogburn noted in his approval of the loan a concern over the declining economy and the likelihood of the Bank being “left holding two spec houses for sale.”

70.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan – Anderson noted his concern over the high LTV and the borrower’s net worth but approved the loan based on the “customers past performance;” and (3) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on December 30, 2009. To date, losses suffered by the Bank of Asheville as a result of the LC’s approval and subsequent mismanagement of this loan are approximately \$405,554.

71.

M.B. – 5040

John Hamrick and loan officer, Raynia White, approved a \$160,000 interest-only loan to M.B. on April 8, 2008. The stated purpose of the loan was for the construction of a spec home. The primary source of repayment was the sale of the collateral. The loan was secured by a first lien deed of trust on the lot located at 111 Cherry Meadows Drive in Asheville valued at \$200,000 “at completion.” The loan was initially approved with eleven monthly interest-only payments and was renewed on an interest-only basis but all interest was deferred until maturity because of the M.B.’s difficulty in even making the monthly interest payments.

72.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral – the CM contained only a cursory cash flow and debt service analysis ; (2) inaccurate and inadequate loan presentation - the CM substantially understated the borrowers' total exposure to the Bank and thus overstated their net worth; and (3) highly leveraged borrower/guarantor lacking financial wherewithal to service loan – the borrowers' total exposure to the Bank was at least \$306,222 and assets were centered in highly leveraged real estate with minimal liquidity; The Bank of Asheville foreclosed upon the property and deed transferred to the Bank on May 28, 2010. The loan was charged off by the Bank on February 26, 2010 and March 26, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$161,452.

73.

M.B. – 5207

Gordon Greenwood and John Hamrick approved a \$166,400 interest-only loan to M.B on September 12, 2008. The stated purpose of the loan was for the construction of another spec home. The primary source of repayment was the sale of the collateral. The loan was secured by a first deed of trust on the lot located at 123 Cherry Meadows Way in Asheville valued at \$208,000 at completion.

74.

Deficiencies and violations identified on this loan included: (1) inaccurate and inadequate loan presentation – total exposure did not include Bank of Asheville note 5040 which was

approved less than six months prior; (2) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral– the CM contained only a cursory cash flow and debt service analysis and minimal analysis regarding sales projections for primary sources of repayment; (3) highly leveraged borrower/guarantor lacking financial wherewithal to service loan – borrowers’ assets centered in highly leveraged real estate with minimal liquidity. The loan was charged off by the Bank on February 26, 2010 and May 26, 2010, just six months after approval. The Bank of Asheville foreclosed on the property on May 28, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC’s approval and subsequent mismanagement of this loan are approximately \$149,000.

75.

G.P.– 5065

The LC approved an \$850,000 interest-only loan to G.P. on May 15, 2008. The stated purpose of the loan was to pay off an existing note to Carolina First, in the amount of \$500,000, with the remaining funds to be used by G.P. in his commercial development projects. G.P. was then renovating part of the “700 Biltmore Project.” The primary source of repayment was G.P.’s personal income. The loan was secured by a first lien deed of trust on 102.69 acres located at 472 Shope Creek Road in Asheville with appraised value of \$1,475,000. The only appraisal obtained prior to approval was provided by the borrower. The CM states that as of the time of loan approval this property had been approved and accepted by the North American Land Trust Conservancy and G.P. had chosen to place the property in a “conservation easement restricted to recreational use with no development allowed.” A subsequent appraisal dated September 16, 2010 valued the property at \$150,174.

76.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan; and (3) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on September 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$46,175.

77.

L.B.- 5095

L.B.- 5096

The LC approved two \$359,000 interest-only loans to L.B. on June 12, 2008. The stated purpose of the loans was to acquire two residential building lots. One of the lots would be for the borrower's future residence and the other would be used for investment. The loans were secured by the two lots which were valued at \$425,000 each. The primary source of repayment was a take-out construction loan and the secondary source of repayment was the sale of the property.

78.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral – Pignatiello's approval email expressed the need "to get more accurate financial statements" in the future; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan - Anderson believed L.B.'s "net worth was marginal" and Pignatiello stated that "his balance sheet is low;" and (2) the loans were presented and approved by the LC via e-mail.

39

Loan 5095 was charged off by the Bank on June 30, 2010 and Loan 5096 was charged off by the Bank on June 30, 2010 and February 2, 2011. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of loan number 5095 are approximately \$229,707 and \$259,100 for loan number 5096.

79.

A.R.– 5120

The LC approved an unsecured \$100,000 interest-only loan to A.R. on July 2, 2008. The stated purpose of the loan was a “line of credit” for A.R.’s business, “Your Fire Source.” The primary source of repayment was the income from business operations and the secondary source of repayment was the income from “other investments” though there was no mention of what those investments were. One LC member “[could] not understand why it is unsecured.” Not surprisingly, the loan eventually had to be restructured to add collateral because of the diminishing prospects of repayment from A.R.’s business income.

80.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness – the CM did not contain cash flow analysis on A.R.’s business (2) inadequate and inaccurate loan presentation - A.R.’s full debt exposure to the Bank was not included in his personal financial statements; (3) highly leveraged borrower/guarantor lacking financial wherewithal to service loan; (4) excessive use of interest reserve – the loan was renewed multiple times with additional interest reserves despite borrower’s admission that he had no income and no way to service the monthly interest payments; (5) failure to obtain updated appraisal when loan restructured to add collateral at

modification – 2007 appraisal valued Lot 3 at \$158,400 while 2010 appraisal valued lot 3 at \$45,000; (7) release of collateral without requiring proceeds from sale of collateral to be applied to loan balance; and (7) the loan was presented and approved by the LC via e-mail. The loan was charged off on March 31, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$22,823.

81.

D.P.– 5144

The LC approved a \$250,000 interest-only loan to D.P. on July 25, 2008. The stated purpose of the loan was to provide funding for operating supplies and expenses related to the completion of the 700 Biltmore Project, which G.P. was then renovating (see paragraph 72 above). The primary source of repayment was the “cash flow” from D.P.'s law practice. The loan was secured by a second deed of trust on two properties located at 188 Cox Avenue and 42-44 Collier Avenue in Asheville having a combined appraised value of \$1,045,000. The value of the first lien held by another bank was \$600,000. A 2010 appraisal valued the properties at \$740,000.

82.

Other deficiencies and violations identified on this loan included: (1) failure to maintain credit file on borrower – the original CM and other information supporting the approval of the loan could not be located; and (2) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral - The CM contained only a cursory cash flow analysis and no analysis was done on the financial performance of D.P.'s law firm which was the primary source of repayment. The loan was charged off by the Bank on June

30, 2010 and September 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$189,000.

83.

D.P.– 5487

The LC approved a \$522,000 interest-only loan to D.P. on August 24, 2009. The stated purpose of the loan was consolidation of other Asheville loans and “cash flow” for D.P.’s law firm. The loan proceeds were used by D.P. to pay off another Asheville loan in the amount of \$102,195 and make payments on five other Asheville loans, including loan 5144 (see paragraph 78 above). The primary source of repayment was again listed as the “cash flow” from D.P.’s law firm even though the stated purpose of the loan was to improve the law firm’s cash flow position. The CM indicated that the loan was secured by a first deed of trust on a lot in The Cliffs at Walnut Cove in Arden valued at \$1,168,000; however, the Bank actually held a third lien position with prior liens on the property totaling \$450,000. In September of 2010, the property reappraised for \$837,000, which left less than \$400,000 in borrower equity in the land.

84.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or the value of the collateral - the CM contained only a cursory cash flow and debt service analysis; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan – D.P.’s exposure to the Bank was \$2,981,818 and the LC was informed, before approval, that D.P. was late in making payments on several loans; (3) inaccurate and inadequate loan presentation – the CM stated an inaccurate Bank lien position on the collateral; (4) permitting conflicts of interest to the

detriment of the Bank – D.P. was the closing agent and borrower on this loan; and (5) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$300,000.

85.

D.P & K.P.- 6536

The LC approved a \$100,000 interest-only loan to D.P. and K.P. on November 18, 2009. The stated purpose of the loan was a home equity line of credit. The primary source of repayment was the "income from business operations." The loan was secured by a second deed of trust on property located at 35 Braddock Way in Asheville. The Bank already held the first lien deed of trust on this property, which Pignatiello acknowledged before the LC approved the loan "is probably not really worth what is claimed." The LC was informed prior to approval that D.P. was unable to make several loan payments and thus this loan would be used to catch-up those loan payments. According to Pignatiello's approval email, this request "sure does raise some red flags."

86.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and creditworthiness and/or value of the collateral– D.P.'s business cash flow was used as the primary source of repayment for this loan and two other loans; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan –the D.P.'s and K.P.'s total exposure to the Bank at the time was \$3,146,900; (3) inaccurate and inadequate loan presentation – full debt exposure to the Bank not was disclosed in

D.P.'s and K.P.'s personal financial statements; (3) permitting conflicts of interest to the detriment of the Bank – D.P. was again the closing agent and borrower on this loan; and (4) the loan was presented and approved by the LC via e-mail. The loan was charged off on January 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$49,300.

87.

Myra Place, LLC – 5172

The LC approved a \$673,000 interest-only loan to Myra Place, LLC, on August 26, 2008. The stated purpose of the loan was to acquire and develop property. The primary source of repayment was the sale of the collateral. The loan was secured by a first lien deed of trust on property located at 32 East Starnes Cove Road in Asheville which the CM indicated was valued at \$841,750. The purchase price for the property paid by Myra Place, LLC, according to the closing documents, however, was only \$220,000.

88.

Other deficiencies and violations identified on this loan included: (1) highly leveraged borrower/guarantor lacking financial wherewithal to service the loan; (2) inadequate verification of borrower/guarantor financials and/or the value of the collateral - Pignatiello noted that “[the guarantor] has more liabilities than reported on his PFS;” (3) inaccurate and inadequate loan presentation – there were no sales projections or other information on the primary source of repayment, the sales of the units; (4) improper use of loan proceeds - 13 of the 16 total payments made on the loan resulted from advances on the line of credit; and (5) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on June 30, 2010. To

date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$228,043.

89.

A.L., D.L., F.L., K.L., M.L., and S.L. – 5185

The LC approved an \$846,375 interest-only loan to A.L., D.L., F.L., K.L., M.L., and S.L. on September 3, 2008. The stated purpose of the loan was to refinance a 7-lot subdivision. Proceeds of the loan were used to pay off a note to Macon Bank, Inc. in the amount of \$266,052.63. The primary source of repayment was the sale of the collateral. The loan was secured by a first deed of trust on seven lots in Hidden Ridge Subdivision in Brevard with an alleged total value of \$1,129,000.

90.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and/or the value of the collateral - the CM contained only a cursory cash flow and debt service analysis; (2) inadequate and inaccurate loan presentation – the CM contained no information on the listing price or original purchase price of the lots; and (3) the loan was presented and approved by the LC via e-mail. The loan was charged off by the Bank on June 30, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$214,650.

91.

M.W. – 5230

45

The LC approved a \$1,187,000 interest-only loan to M.W. on September 5, 2008. The Bank had originally approved a loan in September of 2007 in the amount of \$1,100,000 to purchase and improve property located at 36 Tunnel Road, which was an Arby's location. This loan refinanced that loan and provided an additional \$87,000 to cover "extra costs." The primary source of repayment was the operating revenue from an automotive dealership owned by M.W. The loan was secured by a first deed of trust on the land and improvements located at 36 Tunnel Road in Asheville which the CM valued at \$1,465,000. The actual appraised value of the property presented to the LC, however, was only \$1,050,000.

92.

Other deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials relative to the size of the loan – the CM contained only a cursory cash flow and debt service analysis; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan – the automobile dealership considered the primary source of repayment had a total exposure to the Bank of \$2,187,000 and reported a negative net worth and negative income the previous year; (3) inaccurate and inadequate loan presentation – the CM indicated the collateral was valued at \$1,465,000 when it had been appraised for only \$1,050,000; (4) The Bank advanced more than 100% of purchase price of the property – "as is" LTV ratio of 113% in violation of Loan Policy section 224-2; (5) the loan was a violation of loan policy prohibition on loans for limited-use projects such as restaurants; and (6) the loan was presented and approved by the LC via e-mail. The Bank received \$1,042,400.88 in proceeds from the sale of the property. The loan was charged off by the Bank on May 26, 2010 and June 18, 2010. To date, losses suffered by the Bank of Asheville

as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$144,599.

93.

Deerborne Cottages, LLC – 5323

The LC approved a \$1,204,734 interest-only loan to Deerborne Cottages, LLC on January 20, 2009. The stated purpose of the loan was to construct five rental cabins and develop infrastructure for cabin development. The primary source of repayment was the income from the cabin rentals. The loan was secured by a first deed of trust on property located at 6 Deerborne Lane in Weaverville which was valued at \$1,629,000.

94.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and/or the value of the collateral - the CM contained only a cursory cash flow and debt service analysis; (2) defective appraisal – the appraisal used a very aggressive cap rate of 6.0% which substantially overvalued the project; (3) the Bank advanced more than 85.2% of the cost; (4) inadequate information related to the borrower's/guarantors' ability to repay the loan; and (5) the loan was presented and approved by the LC via e-mail. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$350,000.

95.

Deerborne Cottages, LLC – 5511

The LC approved a \$107,000 interest-only loan to Deerborne Cottages, LLC on October 7, 2009. The stated purpose of the loan was to fund cost overruns in constructing five rental

cabins. The primary source of repayment was the same income from cabin rentals. The loan was secured by a second deed of trust on property located at 6 Deerborne Lane in Weaverville which was reportedly valued at \$1,629,000. The Bank already owned the first lien from the prior Deerborne Cottages, LLC loan.

96.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and/or the value of the collateral; (2) highly leveraged borrower/guarantor lacking financial wherewithal to service loan; (3) inadequate information related to the borrower's/guarantors' ability to repay the loan; (4) inadequate and inaccurate loan presentation– the CM was essentially a carbon copy of the CM for loan 5323; (5) failure to obtain a new appraisal prior to approval and origination – approval instead based on same defective appraisal used for loan 5323; and (6) the loan was presented and approved to the LC via e-mail. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$107,000.

97.

G.E.– 5514

Gordon Greenwood and John Hamrick approved an \$82,000 interest-only loan to G.E. on October 16, 2009. The purpose of the loan could not be determined. The only interest payment made was advanced from the line.

98.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials and/or the value of the collateral - the CM

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contained only a cursory cash flow and debt service analysis and the borrower's financial statement provided on April 2009 was a duplicate of his August 2008 financial statement, and income figures were taken from 2006 tax return; (2) no clear purpose for loan in violation of Loan Policy section 201-1; and (3) no clear repayment plan in violation of Loan Policy 204-1. The loan was charged off in full by the Bank on June 23, 2010. To date, losses suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$80,898.

99.

G.E.- 5518

Gordon Greenwood and John Hamrick approved a \$250,000 interest-only loan to G.E. on October 20, 2009, just four days after loan 5514. The stated purpose of the loan was to provide short-term funding for a real estate contract. The primary source of repayment was the distribution of IRA funds. The loan was secured by an assignment of an IRA distribution from the account of G.E.'s father, of which the Bank failed to secure/perfect its interest.

100.

Deficiencies and violations identified on this loan included: (1) inadequate analysis and verification of borrower/guarantor financials - borrower financial statement provided on April 2009 was a duplicate of August 2008 financial statement, income figures taken from 2006 tax return, no global cash flow analysis; (2) failure to secure/perfect Bank's interest in collateral - assignment of IRA was never perfected; and (3) violation of loan policy prohibition of loans secured by IRAs. The loan was charged off in full by the Bank on June 23, 2010. To date, losses

suffered by the Bank of Asheville as a result of the LC's approval and subsequent mismanagement of this loan are approximately \$250,000.

101.

The Defendants approved all of the Loss Loans on the merits. As LC members the Defendants were functioning effectively as officers executing policy decisions made by the Board and were required to do so in compliance with all applicable laws, regulations and Asheville's loan policy. A reasonably prudent person, in the face of regulatory warnings and a softening real estate market, would not have proceeded with "business as usual" in approving the Loss Loans given their significant deficiencies. A prudent LC member either would have voted not to approve the Loss Loans or would have taken action to protect the Bank from the associated risks before voting to approve them.

CLAIMS FOR RELIEF

COUNT I

Negligence and Gross Negligence

102.

The allegations of Paragraphs 1 through 101 of this Complaint are incorporated herein by reference.

103.

As directors and/or officers of Asheville, the Defendants owed a duty of care and diligence and fair dealing in the management, conduct and direction of the business of Asheville. The Defendants duties included, but were not limited to, the following:

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- a. To manage, conduct and direct the business and affairs of Asheville in accordance with and to ensure compliance with applicable laws, regulations, bylaws, policies, and sound and prudent banking practices;
- b. To exercise reasonable control and supervision over the officers and employees of Asheville;
- c. To maintain a proper division of authority and responsibility among the officers of Asheville to prevent the dominance of any officer in the conduct of the business and affairs of Asheville;
- d. To review carefully each report of examination of Asheville's affairs as made by the regulatory authorities and to carry out the directions and instructions contained in such reports of examination and to establish and maintain procedures to ensure no recurrence of any deficiencies set forth therein;
- e. To attend the regular meetings of the directors and the LC and actively to review and approve or disapprove each loan and/or investment;
- f. To take such action as necessary to ensure that Asheville's loans and investments were underwritten, approved, disbursed and collected in accordance with the law, regulations, bylaws and policies applicable thereto and in accordance with sound and prudent banking practices;
- g. To take such action as necessary to ensure that the officers, employees, and agents of the institution complied with the instructions and directions of the Board and DLC;
- h. To exercise independent judgment in the best interest of Asheville in the conduct of its business and affairs and to avoid conflicts of interest;
- i. To ensure that Asheville did not engage in any unsafe or unsound practices; and
- j. To perform faithfully and diligently their duties as members of Asheville's Board committees.

104.

In disregard of their duties to Asheville, the Defendants failed to exercise that degree of diligence, care, judgment, skill and good faith which ordinarily prudent persons would have exercised under similar circumstances in like positions in managing, conducting, supervising and

directing Asheville's making, supervising and administering of loans. The Defendants' failures to exercise reasonable care, skill, diligence, loyalty and good faith in the discharge of their responsibilities include, but are not limited to, the following acts and omissions:

- a. Failed to inform themselves and each other of the true condition of the assets and liabilities of Asheville and the nature of its loan portfolio, or to review and inquire adequately into Asheville's loan transactions;
- b. Failed to establish or adhere to adequate policies and procedures prescribing the conditions and limitations under which loans could be made and the underwriting and record-keeping which should be undertaken on loans, resulting in hazardous lending;
- c. Caused or permitted approval of loans with excessive LTV ratios and/or deficient or incomplete appraisals;
- d. Failed to establish or adhere to policies responsive to the numerous and repeated warnings and criticisms of federal and state banking authorities and regulators;
- e. Failed to inform themselves and each other of the nature, viability, legality and prudence of loans presented for their review, analysis, approval or ratification;
- f. Failed to establish and maintain an Allowance for Loan and Lease Losses ("ALLL") consistent with Asheville's high risk lending practices;
- g. Failed to maintain or require and supervise the maintenance of adequate loan documentation;
- h. Failed to exercise independent judgment and to act in the best interest of Asheville in entering, approving, and ratifying loans;
- i. Failed to exercise due diligence and care in the supervision of Asheville's officers and employees in the discharge of their duties;
- j. Violated or permitted violation of prudent banking practices by making or permitting loans in which the sale or liquidation of collateral security was the only method by which the loan could be repaid;
- k. Caused or permitted loans to be made to borrowers who were known or should have been known to be poor credit risks, or who were in obvious financial difficulty;

- l. Caused or permitted loans to be made on the basis of grossly inadequate or inaccurate information regarding the finances of the borrower, the value of the collateral, and/or the sources of repayment;
- m. Caused or permitted loans to be made on an under-secured basis, contrary to prudent banking practice;
- n. Caused or permitted the making and renewal of loans to borrowers or related groups of borrowers which resulted in the creation of imprudent concentrations of credit;
- o. Failed to make or cause to be made appropriate investigations into borrowers' creditworthiness, representations of values contained in the borrowers' financial statements, and the actual value of collateral given to secure loans;
- p. Caused or permitted loans to be made to borrowers or their related interests after loans made previously to these borrowers had already become nonperforming, were in default, or were classified by regulatory authorities;
- q. Failed to properly supervise loan disbursements; and
- r. Caused or permitted in excess of 100% financing for speculative ventures.

105.

Plaintiff further shows that the acts and omissions of the Defendants were so imprudent, reckless and careless as to amount to gross negligence on the part of the Defendants.

106.

As a direct and proximate result of the foregoing and other breaches, acts and omissions of the Defendants, Asheville suffered serious financial losses in excess of \$6.8 million on at least thirty (30) loans or groups of loans or transactions, referred to herein as the Loss Loans.

107.

Pursuant to provisions of applicable North Carolina and federal laws, Plaintiff is entitled to recover from the Defendants all damages sustained as a result of the negligence and gross negligence alleged herein.

COUNT II

Breach of Fiduciary Duty

108.

The allegations of Paragraphs 1 through 107 of this Complaint are incorporated herein by reference.

109.

Pursuant to applicable federal statutes, regulations and North Carolina law, directors and officers of insured financial institutions, such as Asheville, stand in a fiduciary relationship to the institutions they serve, and the depositors and shareholders thereof, and are obligated to discharge the duties of their respective positions in accordance with the standards imposed by those laws.

110.

The Defendants, individually and collectively, had a fiduciary obligation to exercise the highest degree of loyalty, care, diligence and fair dealing in the management, conduct and direction of the business of Asheville. The Defendants' duties included, but were not limited to, those set forth in Paragraph 101 of this Complaint.

111.

In addition, the Defendants, individually and collectively, owed to Asheville, and its depositors and shareholders, a duty to exercise due care and diligence in the management and administration of Asheville's affairs, and were deemed to stand in a fiduciary relation to Asheville, and were required to discharge their duties with the utmost good faith and with the diligence, care, judgment and skill which ordinarily prudent persons would exercise under similar circumstances in like positions.

112.

The Defendants, individually and collectively, breached their fiduciary duties to Asheville, and its depositors and shareholders, by not discharging their duties in good faith, and by failing to exercise that degree of diligence, care, loyalty, judgment and skill required of them in the conduct, direction, supervision and control of Asheville's business and affairs. The Defendants committed or permitted acts and omissions which resulted in severe damage to Asheville, including, but not limited to, those acts and omissions listed in Paragraphs 103 and 104 of this Complaint.

113.

As a direct and proximate result of the breaches of fiduciary duty by the Defendants, Asheville sustained losses in excess of \$6.8 million.

114.

Pursuant to provisions of applicable law, Plaintiff is entitled to recover from the Defendants all damages sustained as a result of the breaches of fiduciary duty alleged herein.

WHEREFORE, on Count I of its Complaint, Plaintiff prays for judgment jointly and severally against the Defendants for compensatory damages occasioned by their negligence and gross negligence in an amount in excess of \$10,000.00, along with interest thereon and costs, including a reasonable attorney's fee; and

On Count II of its Complaint, Plaintiff prays for judgment jointly and severally against the Defendants for compensatory damages occasioned by their breaches of fiduciary duty in an amount in excess of \$10,000.00, along with interest thereon and costs, including a reasonable attorney's fee; and

Plaintiff further prays for trial by jury and for all other legal and equitable relief to which it may show itself justly entitled.

Respectfully submitted, this 29th day of December, 2011.

/s/ John F. Bloss

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