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Rights, Remedies Available in Litigation by FDIC and Its Transferees under Federal Law

Feature

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As conservator or receiver, the Federal Deposit Insurance Corp. (FDIC)[1] stands in a position to prosecute any claims of the depository institution against third parties. In carrying out its duties, the FDIC stands in a favored position *vis-à-vis* limitations on the defenses, which are available to parties opposing its enforcement activities. The FDIC's favored status originates from a number of sources—including both federal common and statutory law, as reflected in the current Federal Deposit Insurance Act of 1950 (FDIA), as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA),[2] which contains a provision[3] that codifies in modified form the rule of *D'Oench, Duhme & Co. Inc. v. FDIC*,[4] negating secret agreements against the interests of the FDIC.


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Courts interpreting and applying these rules, including whether and in what circumstances the FDIC and its transferees may be considered holders in due course, are in a current state of conflict and discord, much of which can be traced to earlier U.S. Supreme Court attempts to reconcile this law. Given the magnitude of the assets currently owned by the FDIC, as well as those predicted to be seized or acquired by the FDIC over the next few years, this conflicting and confused area of law requires clarity.

Common Law and Existing Statutory Scheme

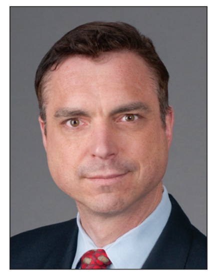
Holders in Due Course under the UCC

Section 3-302(c) of the Uniform Commercial Code (UCC) denies "holder in due course" status to holders who acquire instruments through bulk transactions. While the subsection covers the acquisition by one bank of "a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets," it provides a key limitation: Comment 5 to § 3-302(c) provides that the subsection "may be preempted by federal law if the [FDIC] takes over an insolvent bank."

The *D'Oench* Doctrine

The origins of the federal policy of extending legal protections to the FDIC and its predecessors in their role as administrators of public funds can be traced to *D'Oench, Duhme & Co. v. FDIC*. In *D'Oench*, the Supreme Court ruled that as a matter of federal common law when the government or its transferees attempt to collect on an asset acquired from an insolvent financial institution, the obligor is barred from raising defenses and affirmative claims—whether in contract or in tort—where those claims arise out of an alleged secret agreement.[5]

D'Oench: A Common-Law Defense without Limitations?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Some courts and commentators have noted with apparent alarm the amorphous and expansive reach of the *D'Oench* doctrine, as that doctrine evolved in the courts. In *Rankin v. Toberoff*,[6] the court summarized the development of the protections provided to the FDIC by *D'Oench* and concluded that the doctrine essentially provided blanket immunity to the FDIC by gradually having expanded into a "federal holder in due-course doctrine, permitting the FDIC to take assets of failed banks free of all defenses."[7]

Section 1823(e) and the "Codification" of *D'Oench* Doctrine

Congress introduced § 13(e) into the FDIA in 1950.[8] Whether Congress' action was intended to be a codification of the *D'Oench* doctrine, a partial codification, an attempt to occupy the

1 For purposes of this article, FDIC includes the now-defunct Resolution Trust Corp. and the Federal Savings and Loan Insurance Corp.
2 As codified at 12 U.S.C. §§ 1811, *et seq.*
3 12 U.S.C. § 1823(e).
4 315 U.S. 447 (1942).
5 *D'Oench, Duhme*, 315 U.S. at 457. *See also Murphy v. FDIC*, 208 F.3d 959, 962 (11th Cir. 2000) ("In a suit over the enforcement of an agreement originally executed between an insured depository institution and a private party, a private party may not enforce against a federal deposit insurer any obligation not specifically memorialized in a written document such that the agency would be aware of the obligation when conducting an examination of the institution's records.").
6 1998 WL 370305 (S.D.N.Y. 1998).
7 *Id.* at *4, n.3.
8 12 U.S.C. § 1823(e), as amended.

field and thereby pre-empt the *D'Oench* doctrine or to introduce a separate and distinct layer of regulation to the parallel state law protections has been the subject of division and discord among federal courts ever since, and continues to be so to this day.

Pursuant to § 1823(e), the FDIC is protected from unknown collateral agreements when it acquires obligations in the course of its statutory duties. Section 1823(e) applies to an agreement, which "tends to diminish or defeat the interest of the corporation [FDIC] in any asset" that the FDIC has acquired as security for a loan or by purchase or as receiver of an insured depositary institution under the FDIC's powers with respect to financially troubled institutions.[9] When the statute applies, the agreement against the FDIC is invalid unless it meets four conditions:

1. It is in writing;
2. It was executed "contemporaneously with the acquisition of the asset by the depository institution;"
3. It was approved by the institution and the approval is reflected in the minutes of the board or committee; and
4. It "has been, continuously, from the time of its execution, an official record of the depository institution."[10]

While disagreement among courts exists, most recognize that the *D'Oench* doctrine was codified—at least in part—in 12 U.S.C. § 1823(e).[11]

Pre-Emption of *D'Oench* by § 1823(e)

Whether § 1823(e) was intended by Congress to be a pure codification of the *D'Oench* doctrine is significant in terms of exploring what defenses may be available against enforcement of a note. If codification were intended, then presumably parties are limited to the rights and remedies provided in § 1823(e). If codification and/or pre-emption were not intended, then parties may look to both § 1823(e) as well as the common law as developed under the *D'Oench* doctrine.[12]

In *O'Melveny & Meyers v. FDIC*,[13] the Supreme Court, while not mentioning *D'Oench* specifically, held that with the enactment of the detailed statutory scheme FIRREA, there is no longer a place for federal banking common law.[14] Lower courts following *O'Melveny* are not in agreement on the issue of whether *D'Oench* and § 1823(e) can coexist and give rise to independent rights and defenses.[15]

In a slightly different context, the Supreme Court in *Atherton v. FDIC*[16] revisited the issue of whether a court should look to state law, federal common law or FIRREA to determine the proper standard of care applicable to the conduct of officers and directors of a federally insured bank. The Court reaffirmed that state law sets the standard of conduct, so long as the state standard is stricter than that of the federal statute. The Court held that federal common law should be created only when there is a significant conflict between a federal policy and the use of state law.[17]

Since *D'Oench* and the enactment of § 1823(e), the Supreme Court has had occasion to consider this area of law only once. In *Langley v. FDIC*,[18] the Court discussed *D'Oench* as a precursor of § 1823(e) and held that the term "agreement" in § 1823(e) should be interpreted broadly to encompass conditions on performance.[19] The Court's decision in *Langley* expanded the statute's reach by interpreting § 1823(e) to include any agreement, not simply "secret agreements" or participation in "schemes that tend to deceive."[20] Langley's broad reading of § 1823(e) overruled earlier rulings restricting the statute's reach to claims based on the parties' mutual assent, and courts following *Langley* have applied the Court's reasoning to strike defenses relating to an alleged contract, irrespective of whether the claims technically were pled in contract or tort.[21]

Despite predictions that *Atherton* had resolved the previous split in the circuits regarding whether § 1823(e) pre-empts federal common law, the division continues to this day. In the wake of *O'Melveny* and *Atherton*, the D.C, Third, Fifth, Eighth and Ninth Circuits have concluded that the *D'Oench* doctrine has been preempted.[22] While the doctrine has not been expressly disclaimed by the Seventh Circuit, that court has noted that "several recent cases have suggested that the common law *D'Oench* doctrine did not survive" subsequent statutes.[23] The Fourth and Eleventh Circuits have expressly disagreed with these decisions.[24]

The issue remains undecided in several circuits. In the Second Circuit, the court in *Rankin v. Toberoff*[25] noted that "in opinions issued subsequent to *O'Melveny,* the [Second Circuit] appears to assume the continuing vitality of *D'Oench*."[26] The First Circuit, while also undecided, has suggested the contrary.[27] As a result of this confusion, commentators have observed that "the common-law and statutory sources [often appear to] overlap and where they diverge remains open to interpretation... often, both are asserted together in blanket fashion thus blurring any distinctions which arguably exist."[28]

FDIC as "Holder in Due Course"

Separate and distinct from the *D'Oench* doctrine and § 1823(e), some federal courts have continued to explore whether the FDIC can be considered a holder in due course in particular cases pursuant to applicable state law or federal common law. The court in *Resolution Trust Corp. v. Kennelly*[29] addressed these independent analyses, noting that the parties "appear to confuse *D'Oench* and the statutory bar embodied in § 1823(e) with the related, but wholly distinct, federal holder-in-due-course doctrine." The FDIC's status

9 12 U.S.C. § 1823(e)(1).

10 12 U.S.C. § 1823(e)(1)(A), (B), (C), (D).

11 *Resolution Trust Corp. v. Murray*, 935 F.2d 89, 93 n.3 (5th Cir. 1991) (citing various authority for propositions that § 1823(e) is simple codification, is broader than or is narrower than *D'Oench*).

12 These defenses—potentially available under *D'Oench* but not pursuant to § 1823(e)—may be significant. Indeed, an entire spectrum of equitable defenses, arguably not "agreement-based," are potentially barred by judicial interpretations of § 1823(e), at least prior to *Langley v. FDIC*, 484 U.S. 86 (1987). *See* J. Michael Echevarria, "A Precedent Embalms a Principle: The Expansion of the *D'Oench, Duhme* Doctrine," 43 *Cath. U. L. Rev.* 745 (1994) (review and critique of litigation).

13 512 U.S. 79 (1994).

14 *See id.* at 85-87.

15 *See FDIC v. LeBlanc*, 85 F.3d 815, 821 (1st Cir. 1996) ("there is some disagreement as to whether *D'Oench* and section 1823(e) should be read as coextensive."); *Young v. FDIC*, 103 F.3d 1180, 1187 (4th Cir. 1997) ("Section 1823(e) [and] the common-law *D'Oench* doctrine... remain separate and independent grounds for decision.").

16 519 U.S. 213 (1997).

17 *Id.* at 222-23.

18 484 U.S. 86 (1987).

19 *See id.* at 92-93.

20 *Id.* at 93-94.

21 *See, e.g., Timberland Design Inc. v. FDIC*, 745 F.Supp. 784, 789 (D. Mass. 1990); *FDIC v. Texarkana Nat'l Bank*, 874 F.2d 264, 267-68 (5th Cir. 1989), *cert. denied*, 110 S.Ct. 837 (1990); *Adams v. Madison Realty & Dev. Inc.*, 746 F.Supp. 419, 426 (D. N.J. 1990); *FDIC v. Gulf Life Ins. Co.*, 737 F.2d 1513, 1516 (11th Cir. 1984). Pursuant to this broad reading, courts since *Langley* have held that *D'Oench* and § 1823(e) bar claims based on nondisclosures as well as those alleging affirmative misrepresentations, and that the bar extends to claims for breach of fiduciary duty, claims pled under consumer protection statutes and claims pled under the federal securities laws or the federal Racketeer Influenced and Corrupt Organization Act. *See, e.g., Timberland Design Inc. v. First Serv. Bank for Sav.*, 932 F.2d at 51; *FDIC v. Bell*, 892 F.2d 64, 66 (10th Cir. 1989); *Kilpatrick v. Riddle*, 907 F.2d 1523, 1524 (5th Cir.1990), *cert. denied*, 111 S.Ct. 954 (1991) (securities fraud claims).

22 *See Murphy v. FDIC*, 61 F.3d 34, 38 (D.C. Cir. 1995); *DiVall Insured Income Fund Ltd. Partnership v. Boatmen's First Nat'l Bank of Kansas City*, 69 F.3d 1398, 1402 (8th Cir. 1995); *FDIC v. Massingill*, 30 F.3d 601, 604 (5th Cir. 1994); *FDIC v. Deglau*, 207 F.3d 153, 171 (3d Cir. 2000) ("We agree with the Eighth, Ninth and D.C. Circuits that *D'Oench* is not applicable federal common law in light of *O'Melveny* and *Atherton*."); *Ledo Fin. Corp. v. Summers*, 122 F.3d 825, 828-29 (9th Cir. 1997).

23 *Hillman v. RTC*, 66 F.3d 141, 143 n.2 (7th Cir. 1995).

24 *See Young v. FDIC*, 103 F.3d 1180, 1187 (4th Cir. 1997) (holding that FIRREA does not abrogate *D'Oench*); *Motorcity of Jacksonville Ltd. v. Southeast Bank NA*, 120 F.3d 1140, 1143-1144 (11th Cir. 1997); *Murphy v. FDIC*, 208 F.3d 959, 964 (11th Cir. 2000).

25 1998 WL 370305 (S.D.N.Y. 1998).

26 *Id.* at *4. *See also FDIC v. Noel*, 177 F.3d 911, 914 (10th Cir. 1999), *cert. denied*, 528 U.S. 1116 (2000) (applying both *D'Oench* and § 1823(e)).

27 *FDIC v. Houde*, 90 F.3d 600, 605 n.5 (1st Cir. 1996) (noting that "continuing viability of the federal holder in due course doctrine is questionable").

28 Baxter Dunaway, *Law of Distressed Real Estate* at § 45:5 (2010) (citing *In re NBW Commercial Paper Litigation*, 826 F.Supp. 1448, 1457 (D. D.C. 1992) (FDIC asserted both common-law *D'Oench* and § 1823(e), but "provided no theory as to how the statute and the common law fit together and made no attempt to distinguish between the two statutory provisions")).

29 57 F.3d 819, 821 (9th Cir. 1995).

as a holder in due course "is irrelevant," the court concluded, "when it comes to determining whether the [defendants'] defenses and counterclaims are barred by *D'Oench* or section 1823(e)."[30]

Conclusion

There is obviously a significant and profound split among the circuits regarding the interpretation, application and effect of § 1823(e), including whether it preempts the *D'Oench* doctrine. Even within those camps, there are further splits regarding the circumstances in which the FDIC can be considered a holder in due course. As the authors of a treatise on the UCC concluded, "on the majority reading of *D'Oench* and section 1823(e), it is still important for the FDIC to achieve federal holder in due course status. A fair reading of section 1823(e) will only give it a small part of what it would like to have. A clear majority of the courts agree with this analysis and routinely find it necessary to ask whether the FDIC is a holder in due course under federal law."[31] ■

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30 *See also RTC v. Maplewood Investments*, 31 F.3d 1276, 1294 (4th Cir. 1994); *Bolduc v. Beal Bank*, SSB, 994 F.Supp. 82, 92 (D. N.H. 1998); *FDIC v. Houde*, 90 F.3d 600, 604 (1st Cir. 1996); *FDIC v. Grupo Girod Corp.*, 869 F.2d 15, 17 (1st Cir. 1989). Where the FDIC is considered a holder in due course—or accorded similar rights and defenses—courts sometimes extend that status to transferees from the FDIC. *See Federal Sav. and Loan Ins. Corp. v. Cribbs*, 918 F.2d 557, 559-60 (5th Cir. 1990); *Federal Deposit Ins. Corp. v. Newhart*, 892 F.2d 47, 50 (8th Cir. 1989); *Porras v. Petroplex Sav. Ass'n*, 903 F.2d 379 (5th Cir. 1990). Whether the FDIC acquired the failed bank's assets in its capacity as receiver or in its corporate capacity, and whether the potential defense(s) sound in contract or tort are also issues that frequently arise, but are beyond the scope of this article.

31 2 White and Summers, *Uniform Commercial Code* § 17-13, *supra*.