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THE *D'OENCH, DUHME* DOCTRINE: CREATING A SUPER HOLDER IN DUE COURSE DEFENSE FOR CLAIMS ARISING OUT OF ASSETS PASSED THROUGH THE FDIC:

Its Origin, Expansion, and Current Application

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Since January 1, 2008, more than 110 banks in 29 states have collapsed, leaving the Federal Deposit Insurance Corporation ("FDIC") to assume responsibility for more than $1 trillion worth of assets. The FDIC was created during the depression to maintain consumer confidence in banks by guaranteeing deposits. In conjunction with that duty, the FDIC was also authorized to take the assets of the failed institutions into receivership and liquidate them by sale to other banks and investors. It goes without saying that these down-stream purchasers were often confronted with lawsuits brought by the former bank's customers based on transactions that may have occurred years earlier. Given the hardship in obtaining witnesses and evidence to rebut the claims, a doctrine developed over the years to assist the FDIC and its successors in combating these claims, which became known as the *D'Oench Duhme* Doctrine.

Origins of the Doctrine

In 1940, the US Supreme Court created a monster. On the heels of the Great Depression, the Court adjudicated a dispute between the FDIC in its capacity as the receiver of a failed institution and that institution's debtor. The case was called *D'Oench, Duhme & Co. v. FDIC* [1] and the Court's ruling would lead to a pro-FDIC doctrine that gave it super holder in due course status.

D'Oench, Duhme & Co. v. FDIC ("D'Oenche") featured a fraudulent agreement between a private Savings & Loan and D'Oench, Duhme & Co ("DD Company"). Under the agreement, DD Company executed several Promissory Notes in favor of the Savings & Loan with the understanding that the notes would never become payable. (The Savings & Loan was "cooking its books"). Not surprisingly, the Savings & Loan eventually failed and ultimately came under the receivership of the FDIC. Later, the FDIC, who had no knowledge of the "secret agreement" between DD Company and the Savings & Loan, filed suit against DD Company in an effort to collect on the Notes. In response, DD Company sought to introduce as a defense its secret agreement with the Savings & Loan.

> "*Always consider the available defenses that were developed first through the* D'Oench, Duhme *Doctrine...*"

In a ground-breaking ruling, the *D'Oench* Court refused to consider any evidence of the secret "side agreement". Relying on the fact that both DD Company and the Savings & Loan entered into the agreement with less than legitimate intentions, the *D'Oench* Court found that allowance of the evidence would be harmful to public policy in that such would enable DD Company to profit from its fraud at the cost of the taxpayers (aka the FDIC). Accordingly, the court held in favor of the FDIC and refused to allow DD Company to present its evidence.

Expansion of the Doctrine

After the Supreme Court's ruling, the *D'Oench, Duhme* Doctrine ("the Doctrine") became a powerful shield against various defenses raised by debtors of the FDIC. Soon, the

FDIC would cite the Doctrine as a reason to bar virtually all evidence that would impair the FDIC's right to collect on debts. The Doctrine's popularity quickly led to the creation of a body of powerful "federal common law." Citing to this ever-expanding line of federal cases, the FDIC and its successors in interest began effectively using the Doctrine to bar any "side agreements" not anticipated by the FDIC or adequately documented in the banks' files. Indeed, some courts allowed application of the Doctrine even where only innocent parties were involved.[2] Finally, the Doctrine was effectively used to bar contract and tort claims against the FDIC and its successors.[3] While more and more litigants began pushing the limits of the Doctrine, it began to take on a life of its own, one that greatly exceeded the *D'Oench* Court's goal of protecting the FDIC (and, thus, the taxpayers) from unscrupulous parties that sought to "take advantage of an undisclosed and fraudulent agreement."[4] The boundaries of the Doctrine appeared limitless.

Limitations on the Doctrine

The seemingly unfettered power of the Doctrine, however, did not last. In 1989, Congress enacted USC §1823, which codified many of the principles of the Doctrine. While USC §1823(e) expanded on a few of the protections created by the *D'Oench* decision, itself,[5] the new statute effectively reigned in many of the Doctrine's more far-reaching applications. Moreover, whereas the Doctrine barred *any* defense asserted by a borrower that participated in a scheme that could deceive the insurer, the plain language of USC §1823(e) suggests that it applies only to agreements between the borrower and the bank and, in such cases, only where the four requirements of the statute are satisfied. In essence, USC §1823(e) provided visible boundaries which the Doctrine lacked.

Dealing an even greater blow to the Doctrine, in 1994, the Supreme Court decided the case of *O'Melveney & Meyers v. FDIC.*[6] In that case, the court appeared to reverse the judicial underpinning of the *D'Oench Doctrine* by ruling that "there is no federal general common law." Thus, the FDIC and its successors could no longer look to the expansive "federal case law" that was created in the wake of the *D'Oench* decision and, instead, were forced to comply with the plain meaning of the new statute. Currently, there is a split of authority between the various Federal circuit courts as to whether the *O'Melveney* case simply limited the *D'Oench Doctrine*, or pre-empted it entirely.

Current Application of the Doctrine

While the *O'Melveney* decision and the creation of USC §1823(e) certainly limited the once powerful Doctrine, it is important to note that much of its spirit remains. Indeed, USC §1823(e) can still be used today as an effective shield to several defenses raised by debtors. Pursuant to USC §1823(e), evidence of any agreement "which tends to diminish or defeat" the interest of the FDIC-run company is barred unless such agreement is: (1) In Writing; (2) Was executed by the insolvent corporation and the person claiming an adverse interest; (3) Was approved by the insolvent corporation's board of directors; and (4) Is part of the official record of the insolvent corporation. Accordingly, where these requirements are satisfied, USC §1823(e) may still be used to preclude the introduction of evidence tending to prove: fraudulent inducement by the lender, fraudulent inducement by third parties, failure of consideration, breach of the duty of good faith, accord and satisfaction, and others.

Given the current economic climate, in which banks are failing at an increasing rate, it is important to remember the FDIC's (and, in some cases, its successors-in-interest's) available protections under USC §1823(e). While the almost limitless assurances offered by the Doctrine (and the "federal common law" which it spawned) may have come and gone, USC §1823(e) still provides many of the protections originally provided by *D'Oench*. Accordingly, despite the aforementioned limits placed on the Doctrine, many protections still exist. To avail one's self of these protections, however, one must be careful to stay within the confines crafted by USC §1823(e) and he/she may no longer look to the seemingly measureless boundaries offered by the once-mighty *D'Oench, Duhme* Doctrine.

If your business encounters a claim or defense being asserted by the customer of a loan that was passed through the FDIC, always consider the available defenses that were developed first through the *D'Oench Duhme* Doctrine and later through §1823 as a basis for rebutting these claims. Both of these tools can be effectively used to block the introduction of evidence that

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would otherwise place you or your clients in a tenuous position. If you are uncertain as whether these tools are available in a particular situation, do not hesitate to contact the authors of this article for a consultation.

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