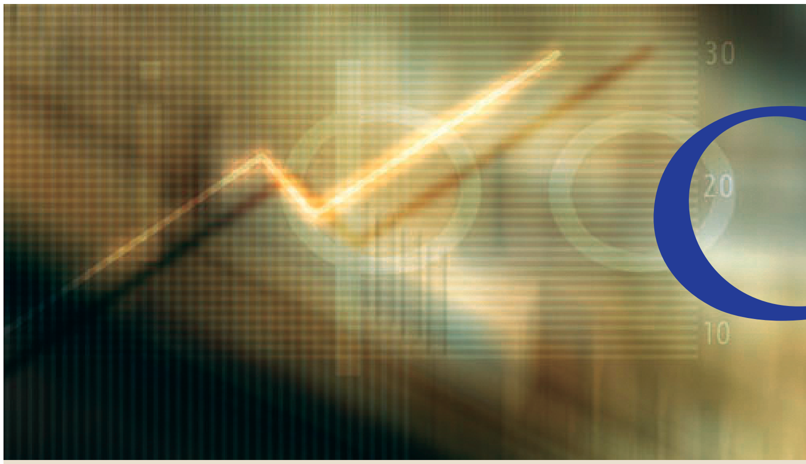

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Dealing With A Shaky Bank? Beware! D'oench, Duhme And 1823(E) Of FIRREA Are Back In The Courts

By Don Hanmer

Those of you who lived through the real estate troubles of the late 80's and early 90's will remember an old nemesis called the D'Oench, Duhme doctrine. It was used by the FDIC and other institutions that had acquired assets from a failed bank or savings and loan to defeat borrowers' defenses or counterclaims. The doctrine grew out of a 1942 case in which the maker of a demand note asserted that the bank (the payee of the note) had agreed orally not to enforce the note. After the FDIC took over the bank, the maker sought to prevent the FDIC from enforcing the note based on this unwritten agreement. The Supreme Court of the United States held that as a matter of federal common law, the borrower could not use the unwritten agreement as a defense against the FDIC because to enforce secret agreements would tend to deceive the banking authorities whose responsibility to protect the fiscal stability of financial institutions requires that they be able to evaluate a bank's assets and commitments accurately. The case probably could have been decided under a standard statute of frauds analysis, but instead the Court stated this broad doctrine. In subsequent cases, federal courts expanded the doctrine dramatically.

Subsequently, this doctrine was codified by enactment of the Financial Institution's Reform Recovery and Enforcement Act of 1989 (FIRREA). The Eighth Circuit held that FIRREA preempted D'Oench, Duhme and, therefore, the analysis of the enforceability of an agreement against the FDIC would be determined under the standards set forth in FIRREA without the consideration of the D'Oench, Duhme doctrine. However, the Eleventh Circuit held that FIRREA did not preempt the D'Oench, Duhme doctrine and it applied as well as FIRREA. The Fifth Circuit, which includes Texas, has not ruled on this issue.

Section 1823(e) of FIRREA says that the FDIC may nullify any agreement related to a loan unless (1) the agreement is in writing; (2) was executed by the institution and by any party whose interest therein was adverse to the FDIC, such as the obligor, contemporaneously with the acquisition of the asset by the institution; (3) was approved by the board or the loan committee with that approval reflected in the minutes of the relevant board or committee; and (4) has been maintained as an official record of the institution continuously from the time of its execution.

The first prong of this requirement is not exceptional and we all know agreements should be in writing if the parties expect them to be enforceable.

The other parts of the test create problems, especially in a workout context. The second prong should not create problems with new loans because a loan agreement or other loan documents would be executed contemporaneously with the acquisition of the note by the bank, the note normally being the asset that the FDIC is seeking to enforce. However, in the context of a workout, previously existing documents, including notes, are modified; the modifying documents will not have been executed contemporaneously with the acquisition of the asset unless the asset is determined to be the modified note. This might be a good reason to require the execution of an amended and restated note in connection with a workout because doing so will allow the borrower to argue that the modified documents were executed contemporaneously with the asset, i.e., the amended and restated note.

Prong three presents problems because it is difficult for a borrower to insure that the agreements have been approved by the bank's board or the appropriate loan committee and that the approval is reflected in the minutes of the board or relevant loan committee. Generally, the borrower's contact is with a loan officer. The bank's internal procedures for approving a workout are usually not the borrower's concern as long as he gets the signature of the institution from an authorized person. In fact, my prior experience with this requirement has been that when a borrower asks for copies of the minutes of the board of directors or loan committee, the request created consternation on the part of the loan officer and sometimes problems. My response has been to show them a copy of the statute. A representation in the documents that the agreement has been approved and is reflected in the minutes may be helpful but there is no guarantee that such a representation would be found to satisfy the requirement of FIRREA.

The fourth prong is even more difficult for a borrower. All a borrower can do is put a covenant in the Agreements that says the bank will retain a copy of the agreement as a part of its official records continuously from the time of its execution through the discharge of the indebtedness. However, it is not clear how a borrower could monitor compliance with this requirement.

The FDIC has developed a statement of policy setting forth guidelines for the agency's use of the FIRREA requirements and D'Oench Duhme doctrine. The policy statement provides examples of situations where, it says, the D'Oench Duhme doctrine or the statutory provisions should not be used by the FDIC without evaluation of each claim individually and often only with approval by Washington. The problem with this policy, of course, is that it does not say that the D'Oench, Duhme doctrine or the statutory provisions will not be asserted by the FDIC in the instances described but only that in order to assert them Washington approval must be obtained.

For example, the policy says that D'Oench Duhme or the statutory provision shall not be used as a defense against claims by vendors who have supplied goods and/or services to the failed institution pre-closing when there is clear evidence that the goods or services were received and that in such a case, D'Oench Duhme or the statutory provision shall not be asserted whether or not there are written records in the institution's files confirming a contract for goods and/or services. This does not mean that D'Oench Duhme or the statutory provisions may never be asserted against a vendor, but only that each claim must be examined carefully on its facts. When there is no evidence that goods or services were received by the failed institution or in other appropriate circumstances, the defenses may be asserted after approval by Washington. The policy statement then gives an example of such contracts.

In a section entitled "Diligent Party," the policy statement gives examples where the borrower or claimant took all reasonable steps to document and record the agreement or understanding with the institution and there is no evidence that the borrower or claimant participated in any activity that could likely result in deception of banking regulators regarding the assets or liabilities of the institutions. In particular, Washington approval is required in cases where the agreement is not contained in the institution's records, but where the borrower or claimant can establish by clear and convincing evidence that the agreement was properly executed by the depository institution through an officer authorized by the board of directors to execute such agreements, as reflected in its minutes of the board. Even then the Washington office may still authorize the assertion of D'Oench Duhme and the statutory provision.

We found out in the 80's and 90's that D'Oench, Duhme and FIRREA create formidable weapons in the hands of the FDIC and subsequent purchasers of assets from the FDIC. These doctrines were used to dispose of both questionable defenses and, in some cases, what appeared to be reasonable arguments or defenses of borrowers.

While these doctrines have remained in place, during a booming economy people have not worried too much about their requirements. But now the stability of many banks and financial institutions is in question and many loans are in trouble, requiring a restructuring or workout of some sort. Borrowers and other parties dealing with financial institutions need to be aware of the requirements of FIRREA and of the D'Oench, Duhme doctrine and they need to take reasonable steps to protect legitimate agreements from being ignored should their bank or financial institution fail.