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Might Does Not Make Right: The Call for Reform of the Federal Government's D'Oench, Duhme and 12 U.S.C. 1823(e) Superpowers in Failed Bank Litigation

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Might Does Not Make Right: The Call for Reform of the Federal Government's *D'Oench, Duhme* and 12 U.S.C. § 1823(e) Superpowers in Failed Bank Litigation

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Federal regulators have invoked the *D'Oench* Doctrine in 5,145 instances since 1989. Ninety-seven percent of the claims filed by vendors and individuals resulted in dismissal because of the *D'Oench* Doctrine.[1]

INTRODUCTION

A rash of commercial bank and savings and loan association (S&L)[2] failures has caused severe American financial crises twice in this century.[3] The first occurred during the Great Depression.[4] Then, following years of healthy and stable growth in the banking industry,[5] disaster struck again. From 1985 to 1994, 1315 national banks failed.[6] Because the federal government insured most of these institutions,[7] the costs of these failures, coupled with the failures of national S&Ls, have been estimated

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1. *The D'Oench Duhme Reform Act: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 104th Cong., 1st. Sess. 2 (1995) [hereinafter *S. 648 Hearings*] (statement of Sen. William S. Cohen (R-Maine)).

2. This Article focuses on commercial banks and S&Ls because they have accounted for the majority of the financial failures of depository institutions in the 1980s and early 1990s. Other financial institutions such as credit unions, securities firms, mutual fund brokerages, and life insurance and pension plans are omitted.

3. *See* JONATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW AND REGULATION 21-36 (1992) (comparing the extensive financial panic that occurred during the Great Depression in the early 1930s to the recent commercial banking crisis and S&L debacle of the late 1980s and early 1990s).

4. Over 10,000 commercial banks failed between 1929 and 1933. BARRY STUART ZISMAN, BANKS AND THRIFTS: GOVERNMENT ENFORCEMENT AND RECEIVERSHIP I-15 § 1.04[2] (1992).

5. From 1934 through 1942, an average of [only] 54 [commercial] banks failed each year. From 1943 until 1974 average failures per year dropped to approximately five out of 14,000 [commercial] banks. This is quite a contrast to the average of 588 failures per year between 1920 and 1929 and an average of over 2,277 [commercial banks that failed] annually from 1930 to 1933.

EDWARD L. SYMONS, JR. & JAMES J. WHITE, BANKING LAW: TEACHING MATERIALS 547 (3d ed. 1991).

6. *See* CALIFORNIA STATE BANKING DEPARTMENT, 85TH ANN. REP. 8 (1994) [hereinafter 85TH ANNUAL REPORT].

7. *See infra* notes 66-87 and accompanying text (explaining the federal government's duty in insuring depositors' deposits in financial institutions).

to range from $150 billion to $1 trillion.[8] Fortunately, a distinct downward trend in commercial bank failures began in 1990,[9] and by 1994, such failures had subsided substantially.[10] Despite the recent decline, however, the litigation resulting from the many failures of the late 1980s and early 1990s continues to wind through the courts.[11]

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8. *See infra* note 51 for an estimate of total costs.

9. Between 1982 and 1989, commercial bank failures were as follows: 1982, 42; 1983, 48; 1984, 79; 1985, 120; 1986, 138; 1987, 184; 1988, 200; and 1989, 206. SYMONS & WHITE, *supra* note 5, at 547. Beginning in 1990, however, the trend reversed. In 1990, 169 commercial banks failed; in 1991, 124 failed. MACEY & MILLER, *supra* note 3, at 628. In 1992, 120 commercial banks failed, in 1993, 42 failed, and in 1994, 13 failed. 85TH ANNUAL REPORT, *supra* note 6, at 8. While commercial bank failures decreased nationwide during these years, however, they increased in California. In 1991, only 3 of the 124 failures nationwide occurred in California. This proportion later increased: 8 of the 120 failures in 1992, 16 of the 42 failures in 1993, and 8 of the 13 failures in 1994 occurred in California. *Id.*

10. The federal government reported that only 11 national commercial banks failed in 1994, with no commercial banks failing in the fourth quarter. FEDERAL DEPOSIT INSURANCE CORP., THE FDIC QUARTERLY BANKING PROFILE, COMMERCIAL BANKING PERFORMANCE—FOURTH QUARTER, 1994. The years 1993 and 1994 also saw record profits for commercial banks. As of March 20, 1995, only two commercial banks had failed nationwide, and both were located in California. Lesia R. Bullock, *U.S. Banks Earn Record $44.7 Billion in 1994, Despite Losses on Securities*, Banking Rep. (BNA) No. 64, at 565 (Mar. 20, 1995).

11. *See S. 648 Hearings*, *supra* note 1, at 2 (estimating that the federal government has prevailed against borrowers and vendors in failed bank litigation over 5000 times since 1989). *See, e.g.*, *Bank Shareholders Sue Ex-Chairman Jailed in S&L Failure*, ORANGE COUNTY REG., Nov. 4, 1995, *available in* WESTLAW, Allnews Database (reporting a suit filed by Pacific Inland Bankcorp shareholders against the bank's founder and former Chairman Richard J. Meyer alleging abuses identical to the charges which sent him to prison in 1993); Dick Phillips, *Hurwitz Accused in S&L Loss Suit: Failure Cost Taxpayers $1.6 Billion*, PRESS DEMOCRAT, Dec. 27, 1995, *available in* WESTLAW, Allnews Database (reporting that the OTS charged Maxxam Inc. and its chairman Charles Hurwitz with unsafe and unsound acts that resulted in the collapse of United Savings Association of Texas in 1988); David G. Savage, *Supreme Court to Hear Cases on Credit Fees and S&L Bailout*, L.A. TIMES, Jan. 20, 1996, at D2 (reporting that the U.S. Supreme Court agreed to decide a $10-billion dispute growing out of the S&L crisis of the 1980s); *Supreme Court Lets Stand Ruling that Keating Must Repay Failed S&L*, THE PLAIN DEALER, Oct. 3, 1995, at 10-C (reporting that the U.S. Supreme Court, without comment, let stand rulings that financier Charles Keating must repay $36.4 million to Lincoln Savings & Loan, whose collapse in 1989 cost taxpayers $2.6 billion to pay off depositors and cost about 17,000 small investors $190 million). Additionally, "[t]here have been more court decisions and statutory amendments to this system since 1985 than during the entire period between 1933 and 1985." MACEY & MILLER, *supra* note 3, at 249 (Supp. 1994) [hereinafter MACEY & MILLER SUPPLEMENT].

One of the most notorious legal weapons the federal government uses against borrowers of failed financial institutions in this resulting litigation is a powerful federal common law estoppel doctrine known as the *D'Oench, Duhme* doctrine,[12] and its statutory analogue, 12 U.S.C. § 1823(e).[13] The federal government, through one of two federal agencies, the Federal Deposit Insurance Corporation (FDIC),[14] or the Resolution Trust Corporation (RTC),[15] employs these special legal powers[16] in actions to collect debts still owed to a federally-insured financial institution after the institution fails.[17] As originally conceived, the *D'Oench* doctrine precluded a borrower and a bank from using a secret side agreement to deceive a bank

12. The *D'Oench, Duhme* doctrine is named after the Supreme Court case that established the doctrine: D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447 (1942). *See infra* notes 92-104 and accompanying text (describing the *D'Oench* case).

13. In 1950, eight years after the Supreme Court established the *D'Oench* doctrine, Congress codified and expanded the doctrine. Federal Deposit Insurance Act, ch. 967, § 13(e), 64 Stat. 873, 889 (1950), (codified and expanded at 12 U.S.C. § 1823(e) (1994)), *amended by* The Reigle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, § 317, 1994 U.S.C.C.A.N. (108 Stat.) 2160, 2223. The four requirements are now embodied in subsection (e)(1)(A)-(D) after the recent amendment. Most cases, however, refer to the four requirements as they existed before the amendment. Prior to the amendment, subsection (e)(1)-(4) contained the four requirements. For consistency, this Article refers to the statute before and after amendment as "§ 1823(e)".

14. The FDIC is a federal agency created by Congress pursuant to the Banking Act of 1933, Pub. L. No. 73–66, § 12B(a), 48 Stat. 162, 168 (1933); Federal Reserve Act, § 8, 48 Stat. 162, 168 (1933) (codified at 12 U.S.C. §§ 1811-1835 (1994)). The FDIC insures bank deposits and serves as a "receiver," which is essentially a bankruptcy trustee for a failed financial institution. *See infra* notes 69-75 and accompanying text (explaining the role of the FDIC in failed bank litigation).

15. *See infra* note 73 and accompanying text (discussing the RTC, which serves as a receiver for failed S&Ls and savings banks). As of December 1995, however, the RTC has been dissolved and the FDIC has absorbed the RTC's receivership duties. *See infra* note 73. Unless otherwise stated, the term FDIC hereinafter will incorporate by reference the RTC.

16. *See infra* notes 91-130 and accompanying text (providing a full description of the *D'Oench* doctrine's original justifications and current operation). *See generally* Fred Galves, *FDIC and RTC Special Powers in Failed Bank Litigation*, 22 COLO. LAW. 473, 473-80 (1993) (criticizing the federal government's use of these powers in failed bank litigation).

17. A commercial bank or S&L is deemed to have "failed" when current assets are insufficient to meet its obligations. *See generally* 12 U.S.C. § 1821(c)(5) (1994) (listing the various specific grounds under which a financial institution is deemed to have failed and the appointment of a conservator can be justified).

examiner, and eventually a bank receiver such as the FDIC, about the status of the borrower's loan.[18] Currently, however, courts broadly apply this doctrine to bar many claims and defenses a borrower or vendor otherwise could have asserted before the FDIC took over.[19] Accordingly, the application of the *D'Oench* doctrine and § 1823(e) often creates an unfair windfall for the federal government.[20]

The dispute between Mrs. Rhetta B. Sweeney's family and the RTC is one of many recent examples of the inequities that the *D'Oench* doctrine and § 1823(e) create.[21] In 1987, Mrs. Sweeney, on behalf of her corporation, entered into a commercial loan agreement with ComFed Savings Bank ("ComFed"), a federally-insured S&L. Mrs. Sweeney originally requested a

18. D'Oench, Duhme & Co., Inc., v. FDIC, 315 U.S. 447, 459-60 (1942). *See infra* notes 92-103 and accompanying text (explaining the original *D'Oench* case). Many commentators still support the fundamental soundness of the original *D'Oench* doctrine. *See, e.g.*, Steven A. Weiss & Kenneth E. Kraus, D'Oench, *Protection for Private Institutions Assisting the FDIC: A Necessary Component of the Thrift and Bank Bailout*, 108 BANKING L.J. 256, 269-82 (1991) (arguing that the *D'Oench* doctrine must apply to private participants in bank bailout efforts); Stephen W. Lake, Note, *Banking Law: The* D'Oench *Doctrine and 12 U.S.C. § 1823(e): Overextended but Not Unconstitutional*, 43 OKLA. L. REV. 315, 325-36 (1990) (analyzing potential constitutional issues regarding the far–reaching powers of the FDIC); William A. MacArthur, Comment, *Who Will Stop the Rain? Repairing the Hole in the* D'Oench, Duhme *Umbrella by Protecting the FDIC Against Fraudulent Transferee Liability Under the Bankruptcy Code*, 23 LOY. L.A. L. REV. 1271, 1296-1334 (1990) (examining the conflict between the Bankruptcy Code and the federal and statutory common law FDIC "super" powers).

19. *See infra* notes 106-275 and accompanying text (explaining the doctrine's current application).

20. According to an FDIC representative, "[a] very rough estimate of the exposure which the FDIC has avoided through the use of *D'Oench* and [§] 1823(e) in just the last two years is more than $1 billion in claims and counterclaims." *See Oversight of the FDIC and the RTC's Use of D'Oench Duhme: Hearings Before the Subcommittee on Oversight of Government Management and the District of Columbia of the Committee on Government Affairs*, 104th Cong., 1st Sess. 141, 161 (1995) [hereinafter *Oversight Hearings*] (statement of John F. Bovenzi, Director, Division of Depositor and Asset Services, FDIC).

21. *See* Sweeney v. RTC, 16 F.3d 1 (1st Cir.), *cert. denied*, 115 S. Ct. 291 (1994). The Sweeneys' dispute with the RTC has been covered widely in the press. *See, e.g., World Headline News* (CNN television broadcast, July 1-2, 1994); *WBUR Boston FM 90.9* (NPR radio broadcast, July 5, 1994) (reporting the legal plight of the Sweeney family and the harsh application of the *D'Oench* doctrine by the RTC). For a full treatment of the dispute from the Sweeneys' point of view, see *Oversight Hearings, supra* note 20, at 161 (statement of Rhetta B. Sweeney).

loan of $600,000, but ComFed expressed an interest in lending much more than that amount by becoming her comprehensive lender for the entire real estate project. Accordingly, Mrs. Sweeney agreed to borrow $1.6 million.[22]

After relying on ComFed's financing commitments and spending thousands of dollars and several months preparing for the project, Mrs. Sweeney learned that ComFed intended to suspend financing. Because the project remained incomplete, Mrs. Sweeney was unable to generate any revenues. She fell into debt to ComFed and to the many contractors she had hired. ComFed then initiated foreclosure proceedings on her property.[23]

During the loan negotiations, ComFed and its lawyer had made material misstatements to Mrs. Sweeney regarding key aspects of the loan.[24] Mrs. Sweeney thus argued that ComFed never intended to lend her the full amount necessary for financing the entire project, and that ComFed engaged in fraud in extending the loan.[25] She sued ComFed in Massachusetts state court for fraud and other statutory violations.[26] Although the court first held Mrs. Sweeney liable for the $1.6 million loan, it later held that ComFed violated various state and federal laws in addition to committing fraud,[27] and awarded Mrs. Sweeney $4 million in consequential damages.[28]

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22. *Sweeney*, 16 F.3d at 2. Mrs. Sweeney also alleged that Comfed agreed to lend her an additional $900,000 for later construction financing. *Id.*

23. *Id.*

24. *Id.* at 4.

25. *Id.*

26. *Id.*

27. The various state and federal violations included the following: unfair and deceptive trade practices under the Massachusetts Consumer Protection Act, Mass. Gen. L. ch. 93A; loan-to-value violations, 12 C.F.R. § 545.32 (1996); illegal kickbacks, 18 U.S.C. § 215 (1994); knowingly and willfully falsifying and concealing a material fact, 18 U.S.C. § 1001 (1994); false entries in bank documents, 18 U.S.C. § 1005 (1994); and various other fraud statutes.

28. The timing of the two-part state court judgment is confusing. It was based on a nine count lender liability/fraud lawsuit against ComFed and ComFed's counterclaim for nonpayment on the $1.6 million loan. In March, 1990, the court awarded ComFed $2 million for the Sweeneys' breach of the note; interestingly, however, the court also awarded Mrs. Sweeney $65,000 for intentional infliction of emotional distress and reserved judgment on two counts of the fraud counts against ComFed. On January 30, 1991, some ten months later, the court then ruled on those remaining two fraud counts and found for the Sweeneys for nearly $3 million, plus costs, interest, and attorneys' fees, as well as granting an additur for the intentional infliction of emotional distress, for a total award of nearly $4 million. *Sweeney*, 16 F.3d at 2-3. *See generally*

Mrs. Sweeney never collected the damages, however. Just six weeks before the state court entered judgment, the RTC was appointed as ComFed's conservator due to ComFed's unsafe and unsound practices.[29] As the appointed conservator, the RTC stepped into ComFed's shoes in the Sweeney lawsuit. The RTC then removed the case to federal court[30] twenty days before the state court ruled on Mrs. Sweeney's final two counts. Once in federal court, the RTC used the *D'Oench* doctrine to bar all fraud claims based on any side agreements or verbal misrepresentations,[31] which formed the basis for the remaining two counts of Mrs. Sweeney's lender liability claims. The RTC obtained summary judgment on those claims and ultimately convinced the court to vacate Mrs. Sweeney's $4 million state court judgment.[32] Thus, although a state court had adjudicated ComFed the wrongdoer, the RTC used the *D'Oench* doctrine to persuade the federal court to dismiss Mrs. Sweeney's claims. The RTC, furthermore, successfully urged the federal court to retain the state court's earlier $1.6 million judgment against Mrs. Sweeney for the original loan.[33] The ruling forced Mrs. Sweeney's company into Chapter 11 bankruptcy.[34]

The recent banking disaster and Mrs. Sweeney's exemplary case highlight the need for significant reform of the federal government's powers in failed bank litigation.[35] Indeed, both

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Ex ComFed Customers Win $4 Million 'Lender Liability' Suit, BOSTON GLOBE, Feb. 26, 1991, at 46, 48 (reporting on the $4 million award).

29. *See Sweeney*, 16 F.3d at 2 n.1.

30. There were alleged procedural irregularities regarding the removal to federal court. On January 11, 1991, the RTC removed the case to federal court in Massachusetts. *Id.* at 3. Although 12 U.S.C. § 1441a(1)(3) at the time allowed for removal of RTC cases only to the U.S. District Court for the D.C. Circuit, the Sweeneys failed to object within 30 days and therefore the court held that they waived that objection. *Id.*

31. *Id.* at 4-5.

32. *Id.* at 3.

33. *Id.* ComFed had been in the process of suing its own officers for fraud when the RTC took over as conservator, but when the RTC successfully eluded the Sweeney lawsuit via the *D'Oench* doctrine, it then abandoned the officer fraud suit. ComFed v. Baldini, et al., No. 90-6712, (Mass. Dist. Ct. filed Oct. 1, 1990), *removed sub nom. And later dismissed per stipulation*, ComFed/RTC v. Baldini, et al., No. 91-CV-10032-S (D. Mass. dismissed Aug. 9, 1991).

34. Telephone Interview with Rhetta B. Sweeney (Apr. 4, 1996). The Sweeneys also face eviction from their home, as the RTC is in the process of seizing it. *Id.*

35. On June 14, 1995, the author of this Article testified before the Senate Committee on Banking, Housing and Urban Affairs on reform legislation that addresses the *D'Oench* doctrine controversy.

legal commentators[36] and the judiciary[37] have addressed this concern in recent years. A citizens' group also has formed solely

36. Numerous law review articles have criticized the *D'Oench* doctrine in the last ten years. *See generally* Richard E. Flint, *Why* D'Oench Duhme? *An Economic, Legal and Philosophical Critique of a Failed Bank Policy*, 26 VAL. U. L. REV. 465 (1992) (arguing that the application of *D'Oench* not only has been unfair to debtors but has saddled society with the cost of mounting personal bankruptcies); W. Robert Gray, *Limitations on the FDIC's* D'Oench *Doctrine of Federal Common-Law Estoppel: Congressional Preemption and Authoritative Statutory Construction*, 31 S. TEX. L.J. 245 (1990) (explaining Justice Scalia's overly broad interpretation of the term "agreement" in § 1823(e) and the nexus between *D'Oench, Duhme* and § 1823(e)); Kevin A. Palmer, *The* D'Oench *Doctrine: A Proposal for Reform*, 108 BANKING L.J. 565 (1991) (arguing for an amendment of § 1823(e) that would force borrowers to prove they had clean hands and that would impose a rebuttable presumption favoring the FDIC); Peter P. Swire, *Bank Insolvency Law Now that It Matters Again*, 42 DUKE L.J. 469 (1992) (arguing that § 1823(e) creates a "black hole" effect in which weak banks almost inevitably are forced into insolvency); Marsha Hymanson, Note, *Borrower Beware:* D'Oench, Duhme *and Section 1823 Overprotect the Insurer When Banks Fail*, 62 S. CAL. L. REV. 253 (1988) (arguing for a narrow interpretation of § 1823(e) that would reflect the limited debate given it by Congress). Perhaps one of the most scathing is also one of the most recent. *See generally* J. Michael Echevarria, *A Precedent Embalms a Principle: The Expansion of the* D'Oench, Duhme *Doctrine*, 43 CATH. U. L. REV. 745 (1994) (arguing that the *D'Oench* doctrine and its statutory and federal common law heirs should have been abandoned); *see also* Chris Atkinson, Note, *Defending the Indefensible: Exceptions to* D'Oench *and 12 U.S.C. § 1823(e)*, 63 FORDHAM L. REV. 1337 (1995) (arguing that rules allowing for logical application of *D'Oench* can only be derived by examining the interaction of exceptions and the concepts of agreement and asset).

37. Many federal judges have voiced their disdain for the harsh application of the *D'Oench* doctrine, but nevertheless reluctantly apply it. *See* FDIC v. Bathgate, 27 F.3d 850, 877 (3d Cir. 1994) (admitting that, while the *D'Oench* doctrine and § 1823(e) lead to harsh results, such results are compelled by federal precedents); FDIC v. Kasal, 913 F.2d 487, 492 (8th Cir. 1990) (agreeing that the result in the case was harsh, but unavoidable due to statutory and federal precedent constraints); L & R Prebuilt Homes, Inc. v. New England Allbank for Savings, 783 F. Supp. 11, 14 (D. N.H. 1992) (affirming, though not condoning, the FDIC's application of the *D'Oench* doctrine while empathizing with the plaintiff's resulting dilemma); Webb v. Superior Court, 275 Cal. Rptr. 581, 589 (Cal. Ct. App. 1990) (sympathizing with the plaintiff's position, but affirming application of the *D'Oench* doctrine). Judge John E. Conway created the following "fight song" of the federal regulators, sung to the tune of "Onward Christian Soldier," revealing his concern regarding the federal government's cavalier use of the powerful "*D'Oench, Duhme* doctrine" in failed bank litigation:

> Onward Banking Soldiers, marching as if to war, with *D'Oench, Duhme* and Congress we'll prevail for sure. We needn't worry, we will win the fight, since we lack accountability, we are always right.

RTC v. Ocotillo, 840 F. Supp. 1463, 1467 (D. N.M. 1993).

for the purpose of abolishing the *D'Oench* doctrine.[38] In fact, the need for reform is so acute that the FDIC itself recently enacted certain internal agency guidelines[39] in an effort to preempt congressional reform of the *D'Oench* doctrine. The FDIC's actions apparently were to no avail, however, because Congress is still considering reform.[40]

This Article considers the history and current status of the *D'Oench* doctrine, analyzes the prospects for legislative reform, and advocates further reform. Part I sets forth the general contextual framework within which financial institution failures occur and discusses the FDIC's crucial role with respect to institutional failures. Part II describes the creation of the *D'Oench* doctrine and § 1823(e), and their disturbing expansive interpretation and resulting harsh application over the years. It explains how the doctrine and statute enable the federal government, through the FDIC, to bar claims and defenses of former borrowers and others involved in lawsuits against failed financial institutions. Part II also delineates the four requirements of § 1823(e), highlighting the special problems that its strict interpretation has caused former borrowers of failed financial institutions. It then chronicles the growth and expansion of § 1823(e) and considers exemplary cases for which its application produced unfair results.

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38. Doctor David S. Hess, an irate Florida cardiologist whose negligence claim against a failed bank was barred by the operation of the *D'Oench* doctrine, founded the "Citizens and Business for *D'Oench Duhme* Reform." Dr. Hess stated before Congress that "[this] organization [has become] a 'clearing house' for other 'victims' of the *D'Oench* doctrine. In the past two years, the organization has been contacted by victims throughout the United States who became aware of the organization through the media." *Oversight Hearings, supra* note 20, at 1-2 (statement of Dr. David Hess).

39. In November 1994, the FDIC implemented internal guidelines requiring FDIC attorneys not to use the *D'Oench* doctrine and § 1823(e) in certain cases, unless they first received prior approval from FDIC headquarters in Washington, D.C. *See infra* notes 302-07 and accompanying text (discussing new guidelines).

40. On March 30, 1995, Senator William S. Cohen, a member of the Senate Subcommittee on Oversight of Government Management, introduced S. 648, called the *D'Oench Duhme* Reform Act. 104th Cong., 1st Sess. (1995). Senators Alfonse D'Amato of New York, Lauch Faircloth of North Carolina, and Robert F. Bennett of Utah are co-sponsors. As Senator Cohen stated: "When application of the law leads to gross unfairness and inequitable results, the public loses confidence in government and all of our legal institutions are degraded. Before more damage is done, we must reform the *D'Oench Duhme* doctrine and restore it to its original, narrow scope." *Oversight Hearings, supra* note 20, at 2 (statement of Sen. William S. Cohen).

Part III addresses academic reform proposals and legislative reform prospects[41] by analyzing and critiquing suggested terminology in a reform bill. This part culminates with a proposal to make the *D'Oench* doctrine and § 1823(e) more equitable to debtors of failed financial institutions, without sacrificing the FDIC's original, legitimate interests in protecting itself and the insurance funds it administers. This proposal consists of a simple disclosure and filing system requiring bankers to inform all potential borrowers of the necessity of reducing to a writing any side agreement made with, or any verbal representation made by, an institution regarding a loan. Filing that writing with the institution and its federal regulators will ensure that such side agreement or verbal representation will be recognized if the institution fails and is taken over by the FDIC.[42] This filing arrangement can be enacted in lieu of, or in addition to, more ambitious and controversial legislative reform. Before discussing reform, however, it is necessary to set forth the contextual background in which the *D'Oench* doctrine and § 1823(e) currently are applied and interpreted.

I. BANK FAILURE, THE FDIC, AND THE APPLICATION OF THE *D'OENCH* DOCTRINE AND SECTION 1823(e)

A. RECENT FINANCIAL INSTITUTIONAL FAILURES IN THE LARGER CONTEXT—INCREASING THE OPPORTUNITIES TO APPLY *D'OENCH*

> My friends, there is good news and bad news. The good news is that the full faith and credit of the FDIC and the U.S. Government stands

41. Part III uses as a backdrop S. 648, the *D'Oench Duhme* Reform Act, the Senate's recent legislative reform effort. *See infra* notes 319-23 (citing relevant portions of the Act).

42. This represents the original policy justification for § 1823(e). Langley v. FDIC, 484 U.S. 86, 91-92 (1987). A prerequisite for banks to disclose the existence of § 1823(e) and its requirements would give borrowers critical information of which they often are unaware. Currently, they often do not understand the applicability of § 1823(e) until after their institution has failed, which is too late. See *infra* Appendices A-B for sample disclosure and filing forms. Note that § 1823(e) currently requires that any side agreement be kept in the institution's official files under the unilateral control of the institution. Although the *D'Oench Duhme* Reform Act eliminates the current § 1823(e)(1)(D) requirement that the agreement must be kept as an official record in the institution's file, a disclosure requirement would serve the additional function of duly memorializing the agreement with the banking regulators. Regulators would then have immediate access to this important information which would assist them in keeping abreast of the assets in each bank's loan portfolios.

behind your money in the bank. But the bad news is that you, my fellow taxpayers, stand behind the U.S. Government.[43]

The years 1985 through 1991 marked the height of the commercial banking and S&L crisis.[44] Only the number of commercial bank failures during the Great Depression surpassed the number of commercial bank failures during those seven years.[45] S&L failures were notoriously rampant throughout this period as well.[46] By 1991, the FDIC had exhausted its entire bank insurance fund and had to request $70 billion from Congress to replenish it.[47] Meanwhile, the RTC petitioned Congress for an additional $80 billion in funding to assist with the S&L bailout.[48] These recent financial institutional failures

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43. L. WILLIAM SEIDMAN, FULL FAITH AND CREDIT: THE GREAT S&L DEBACLE AND OTHER WASHINGTON SAGAS xiii (1993). Mr. Seidman, the Chairman of the FDIC from 1985 to 1991, used this telling introductory statement in nearly every speech he gave during the commercial banking crisis and S&L debacle of the late 1980s and early 1990s. *Id.*

44. Amid all the gloom and doom, or perhaps more appropriately, "Duhme," which is pronounced "doom," about the harsh application of the *D'Oench* doctrine and financial institutional failures in general, at least one observer has found some humor in the very serious issue of bank failures. Comedian David Letterman devoted one of his "Top Ten" lists to the issue:

The "Top Ten Signs" that your bank is failing:
10. Free handful of Cheetos with every new account;
9. They hand out calendars one month at a time;
8. Security guard offers to walk you back to your office for five bucks;
7. Overhear branch manager muttering to himself, "I wonder if you can eat squirrel";
6. Free giveaway toaster is made by G.E.;
5. Teller machine replaced by fat guy with carton of twenties;
4. You glimpse inside the vault and notice it's stacked with empty soda bottles;
3. You deposit cash; an officer runs over, sticks it in his pocket and dances around yelling, "Lordy, we're having biscuits tonight!";
2. You recognize some of the tellers as carnival people;
1. [Drum roll], and the Number One Sign that your bank is failing: They can't change a twenty!

Late Night with David Letterman: The Top Ten Signs that Your Bank Is Failing (NBC television broadcast, Jan. 9, 1990).

45. ZISMAN, *supra* note 4, at I-15 § 1.04[2].

46. The number of annual S&L failures from 1982-1995 follow: 1982, 76; 1983, 54; 1984, 27; 1985, 35; 1986, 51; 1987, 47; 1988, 222; 1989, 329; 1990, 213; 1991, 144; 1992, 59; 1993, 9; 1994, 2; 1995, 2. These statistics were gathered from Mr. Brad Moore, of the Office of Statistics, FDIC, on July 24, 1995.

47. *See* Stephen Labaton, *U.S. Seeks Much Bigger Amount to Shore Up Bank Deposit Fund,* N.Y. TIMES, Mar. 22, 1991, at A1 (describing the FDIC's request for additional funding).

48. *Semi-Annual Report of the Resolution Trust Corporation, 1991: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs,* 102d Cong., 1st Sess. 18–95 (1991) [hereinafter *RTC Oversight Board Hearing*] (statement

adversely affect the economic well-being not only of bankers and financial experts, but also of every U.S. taxpayer, banking consumer,[49] and ultimately every citizen. Indeed, U.S. citizens will continue to be affected, for even though the immediate crisis appears to be over,[50] it will take many years before the debts are completely paid.[51]

Much has been written about the various causes of the bank and S&L failures.[52] During the 1980s, commercial banks saw

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of Nicholas Brady, Secretary of the Treasury).

49. All FDIC-insured financial institutions must pay insurance premiums to the FDIC to be covered in the event of failure or to receive financial assistance in the event of financial difficulties. 12 U.S.C. § 1815(d)(1)(A), (e)(2)(A) (1995). The FDIC charges annual insurance premiums based on the riskiness of the institution's activities and the general risk of failure. *See* Federal Deposit Insurance Corporation Improvements Act (FDICIA), Pub. L. No. 102-242, 105 Stat. 2236 (1991) (codified at 12 U.S.C. § 1817(b)(1)(A) (1994)) (requiring the FDIC to "establish a risk-based assessment system for insured depository institutions"). Within this system, a bank's risk-adjusted insurance premiums become part of the institution's costs and ultimately are passed along to consumers in the form of higher interest rates and service fees. *See* MACEY & MILLER SUPPLEMENT, *supra* note 11, at 275-78.

50. *See supra* notes 10-11 and accompanying text (demonstrating the general downward trend in financial institutional failures in 1990 and noting the dramatic drops in 1992 and 1994).

51. Estimates of the cost of the federal bailout reach as high as $500 billion over the next few years, and more than $1 trillion over the next several decades. KATHLEEN DAY, S&L HELL: THE PEOPLE AND POLITICS BEHIND THE $1 TRILLION SAVINGS AND LOAN SCANDAL 9 (1993). Recent bank failures have cost the FDIC nearly $5 billion for 1992 and $570 million for 1993, or approximately $1 billion less than the agency's bank insurance fund earned from premiums. NEWSDAY, Mar. 18, 1993, at 47. *But see* MACEY & MILLER SUPPLEMENT, *supra* note 11, at 249:

> The actual cost of the bailouts is hotly debated, but no one doubts that they are astronomical. Most observers put the [price] tag for the savings and loan clean up at between $150 and 175 billion in present value terms (and much more if interest payments on the debt needed to fund the bailout are included). The costs of rescuing the bank insurance fund [for commercial banks] are not yet clear. . . . [However, the] improvement in the economic health of the banking industry in 1992 and 1993 has caused the FDIC significantly to lower its estimates of the costs of bank failures.

Id. Although the Bank Insurance Fund (BIF) insuring commercial banks is currently well-funded, the Savings Association Insurance Fund (SAIF) insuring S&Ls is not. Pamela Atkins, *Hefler Says Congress Should Not Stop SAIF Exits; Main Issue Must Be Addressed,* Banking Rep. (BNA) No. 12, at 591-93 (Mar. 20, 1995).

52. *See generally* PAUL Z. PILZER & ROBERT DEITZ, OTHER PEOPLE'S MONEY: THE INSIDE STORY OF THE S&L MESS (1989) (examining the costs of bailing out the thrift industry and explaining why it did not have to happen); Fred E. Case, *Deregulation: Invitation to Disaster in the S&L Industry,* 59 FORDHAM L. REV.

their traditional customer base dwindle as corporations began to place greater emphasis on stock and bond offerings to raise funds.[53] In addition, bank regulators hindered the industry's ability to compete effectively with non-banks and foreign banks by continuing to limit their market activities,[54] securities investments,[55] and geographical expansion.[56] Banks turned

S93 (1991) (expanding upon and defining the consequences of deregulation); Carl Felsenfeld, *The Savings and Loan Crisis*, 59 FORDHAM L. REV. S7 (1991) (distinguishing between commonly stated reasons for the S&L collapse and those intrinsic to the S&L system); G. Christian Hill, *A Never Ending Story: An Introduction to the S&L Symposium*, 2 STAN L. & POL'Y REV. 21 (1990) (citing poor financial management as a major reason for failures); Irvine Sprague, *Unrelated Series of Events Led to S&L Crisis*, AM. BANKER, May 3, 1989 at 4 (claiming that a cause of the S&L debacle is a series of unrelated events, dating back twenty years).

53. *See* Roberta S. Karmel, *A Close Look at the Fiasco in the Banking System*, N.Y.L.J., Feb. 20, 1992, at 3 (describing how non-bank institutions have obtained traditional bank customers); Tom Herman, *Year-End Review of Markets and Finance: Many Expect Bonds to Continue Success Early in '87*, WALL ST. J., Jan. 2, 1987, at 3B (explaining the popularity of bonds with money managers); *Year-End Review of Markets and Finance: 1985—A Year for the Bulls*, WALL ST. J., Jan. 2, 1986, at 1B (describing the increase in stock and bond popularity during the mid-1980s).

54. *See* 12 U.S.C. § 24(7) (1994) (furnishing the primary statutory authority for allowing banks to engage in activities of any sort other than clearing checks, keeping savings accounts, and making loans, and stating specifically that "[a] national bank . . . shall have power . . . to exercise . . . all such incidental powers as shall be necessary to carry on the business of banking . . . ."). This "incidental powers" clause has been interpreted narrowly over the years. *See, e.g.*, Arnold Tours, Inc. v. Camp, 472 F.2d 427, 438 (1st Cir. 1972) (prohibiting bank's travel agency services). Recently, however, the Supreme Court expanded the incidental powers clause by giving it a very broad reading. *See* NationsBank v. Variable Annuity Life Ins. Co., 115 S. Ct. 810, 814 (1995) (calling into question the previous conclusions of the various circuits concerning the scope of the incidental powers clause by giving it a very broad reading and allowing for much greater deference to the bank regulator in interpreting it).

55. Traditional commercial banking (clearing checks, keeping savings accounts, and making loans) is supposed to be kept separate from direct investment activities, such as investing in equity and in most bond securities. Such is known as the "Glass-Steagall Wall," named after certain portions of the Banking Act of 1933, ch. 89, 48 Stat. 162 (1933) (codified in scattered sections of 12 U.S.C.). *See* S. REP. NO. 77, 73d Cong., 1st Sess. 1 (1933); 75 CONG. REC. 9887 (1932); *see also* Edwin J. Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 BANKING L.J. 483, 496 (1971) (justifying actions that keep banking and investment separate). But see Senator D'Amato's recent bill, S. 337, 104th Cong., 1st Sess. (1995), and Representative Leach's recent bills, H.R. 18 and redrafted, H.R. 1062, 104th Cong., 1st Sess. (1995), for the current legislative call for the partial abolition of the Glass-Steagall Wall. *See also* Kelly Holland et al., *Waiting for Glass-Steagall to Shatter*, BUS. WK., Mar. 27, 1995, at 166.

to riskier loans and investments which at first appeared to strengthen their dwindling loan portfolios, but then fell into even weaker financial positions when many of their risky loans defaulted.[57]

The double-digit inflation of the 1970s[58] hastened the demise of S&Ls. Faced with a portfolio of fixed-rate mortgages during a period of sustained inflation, the S&L industry lobbied successfully for a general loosening of regulations and controls to allow them to engage in seemingly more lucrative, but less stable, lending activities.[59] S&Ls exacerbated their problems by offering very high interest rates to attract needed deposits.[60]

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56. *See* MACEY & MILLER, *supra* note 3, at 387-88 ("At the federal level, the McFadden Act generally subjects national banks to the branching limitations applicable to similarly situated state banks, and the Douglas Amendment to the Bank Holding Company Act prohibits bank holding companies from acquiring subsidiary banks in other states"). With the recent passage of the Reigle–Neal Interstate Banking Efficiency Act of 1994, however, interstate banking is now certain to become a legal reality. Pub. L. No. 103-328, 108 Stat. 2338 (1994) (to be codified in scattered sections of 12 U.S.C.) . *See generally* Murray A. Indick & Satish M. Kini, *The Interstate Banking and Branching Efficiency Act: New Options, New Problems*, 112 BANKING L.J. 100 (1995) (explaining the salient features of the new act regarding interstate banking).

57. *See* MARTIN MAYER, THE GREATEST-EVER BANK ROBBERY 92-93 (1990) (discussing the effects of allowing the banking—especially the S&L—industry to engage in more and higher risk loans).

58. Timothy B. Clark, *Years of Economic Trauma Have Left a Painful Mark*, NAT'L J., Jan. 12, 1985, at 89, 91.

59. *See* LAWRENCE J. WHITE, THE S&L DEBACLE: PUBLIC POLICY LESSONS FOR BANK AND THRIFT REGULATION 61-62 (1990) (describing the "borrowing short and lending long" pattern). *See generally* Ronald L. Weaver & Andrew M. O'Malley, *The Depository Institutions Deregulation and Monetary Control Act of 1980: An Overview*, 98 BANKING L.J. 100 (1981) (summarizing the banking deregulation movement which began in 1980). S&Ls were further deregulated by the Garn–St. Germain Depository Institutions Act of 1982, Pub. L. No. 97–320, 95 Stat. 132 (1982) (codified at 12 U.S.C. § 1843(c)(8) (1994)). The goal was to allow S&Ls to engage in more under–regulated, lucrative, and higher risk loan activities in an effort to compete with commercial banks. The result in many cases, unfortunately, was that the "foxes were left to guard the chicken coups." Case, *supra* note 52, at S109 (demonstrating how home mortgages comprised 86% of an average S&L's assets in 1965, and how that percentage dwindled to just 35% by 1988).

60. This phenomenon was referred to as the "brokered deposit problem." A brokered deposit occurs when a depositor asks a broker to search nationwide for the highest current interest rate being offered on deposits and then makes a deposit in that particular financial institution to take advantage of that rate. *See generally* MACEY & MILLER, *supra* note 3, at 262-63 (describing this process and congressional attempts to regulate brokered deposits more stringently). *See, e.g.*, Franklin Sav. Ass'n v. Director, OTS, 934 F.2d 1127, 1133-35 (10th Cir. 1991) (detailing an instance in which brokered deposits led to the failure

The combination of low returns on fixed rate mortgages, uncertain returns on risky loan portfolios, and high interest rate payments on brokered deposits inevitably caused many S&Ls to fail.[61]

Probably the most notorious cause of the crisis, for both commercial banks and S&Ls, was the negligent management of these financial institutions during the 1980s, together with unprecedented director and officer fraud and insider abuse.[62] One state S&L commissioner may have summarized the situation best when he quipped: "The best way to rob a bank is to own one."[63]

Regardless of the causes of the financial institutional crisis,[64] the federal government, principally through the FDIC,

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of an S&L in the 1980s); *see also* Paul Hemp, *Mass. Bank in Brockton Is 11th Bank Failure of '92*, BOSTON GLOBE, Aug. 1, 1992, at 31 (discussing the failure of Massachusetts Bank and Trust Company). In 1989, however, Congress regulated brokered deposits in response to the crisis. Currently, depository institutions that are not "well capitalized may not accept funds obtained, directly or indirectly, by or through any deposit broker for deposit into one or more deposit accounts." 12 U.S.C. § 1831f(a) (1994); *see* Jonathan R. Macey & Geoffrey P. Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1199–1202 (1988) (further criticizing brokered deposits).

61. Between 1989 and 1991 alone, over 600 S&L failures completely depleted the RTC's resources. *RTC Oversight Board Hearing*, *supra* note 48, at 9-75, 93-141 (1991) (statement of Nicholas Brady, Secretary of the Treasury).

62. *See generally* DAY, *supra* note 51, at 9 (arguing that the causes of the crisis had a number of sources, including the regulators, politicians, and former directors and officers of the failed financial institutions); STEPHAN PIZZO ET AL., INSIDE JOB: THE LOOTING OF AMERICA'S SAVINGS AND LOANS (1989) (detailing the downfall of the thrift industry and the players involved); Office of the Comptroller of the Currency, *An Evaluation of the Factors Contributing to the Failure of National Banks: Phase II*, 7 OFF. COMPTROLLER CURRENCY Q.J. 9, 9 (1988) (detailing policies and procedures of banks' management and board of directors as major reasons for failed banks); James J. White, *The S&L Debacle*, 59 FORDHAM L. REV. S57 (1991) (arguing that simple accounting concepts can provide insight into the demise of the thrift industry); James S. Granelli, *Forecast Is Now $3.4 Billion to Litigate Lincoln Savings*, L.A. TIMES, Oct. 31, 1993, at 1, 1 (describing officials' negligent management and abuses).

63. DAY, *supra* note 51, at 373 (quoting William Crawford, California S&L Commissioner).

64. Indeed, the debate over the causes is one where ideological finger-pointing will go on for many years. At its most basic level, that debate involves "pro-free market forces" advocates on one side—those who tend to advocate less government regulation while heaping much of the blame for the crisis on the bank regulators and examiners themselves and on the entire outdated banking regulatory framework in general. *See, e.g.*, Macey & Miller, *supra* note 60, at 1153; Weaver & O'Malley, *supra* note 59, at 101, 116. At the

was left to pay for it. That burden eventually fell, and continues to fall, on U.S. taxpayers. It is in this context then—the resolution process and federal bailout of these failed financial institutions—that the federal government employs the *D'Oench* doctrine and § 1823(e) against former borrowers and creditors in failed bank litigation.

B. BANK FAILURE, THE FDIC, AND THE ROAD TO *D'OENCH*

An understanding of the development of the *D'Oench* doctrine and § 1823(e) begins with the creation of the FDIC during the Great Depression.[65] Congress established the FDIC to eliminate bank runs, which occur when risk-averse depositors withdraw entire accounts from their financially-troubled institutions, causing them to become insolvent or to fail.[66] Today, the FDIC discourages bank runs by insuring deposits in each institution up to $100,000 per depositor.[67] This insurance eliminates depositors' risk-related reasons to withdraw all of their deposits simultaneously, and thus makes "bank runs" unlikely.

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other end of the political spectrum are the "pro-regulatory forces" advocates—those who place the blame for the crisis squarely on the lax regulation wrought by the deregulation movement. *See* Ronald R. Glancz, *Thrift Industry Restructured: An Overview of FIRREA*, 36 FED. B. NEWS & J. 472, 472-73 (1989) (arguing that the S&L failures are part of the legacy of deregulation); *see also* Helen A. Garten, *Banking on the Market: Relying on Depositors to Control Bank Risks*, 4 YALE J. ON REG. 129, 131–32 (1986) (rejecting the argument that depositor discipline will cause banks to control their risk-taking); *see generally* Helen A. Garten, *Regulatory Growing Pains: A Perspective on Bank Regulation in a Deregulatory Age*, 57 FORDHAM L. REV. 501, 521-37 (1989) (analyzing the shift in regulatory strategy that has accompanied deregulation of banking).

65. By 1933, the political and economic need for the creation of reliable federal deposit insurance was so great that the bill to create deposit insurance passed in the House after just forty minutes of debate and was approved by the Senate just hours thereafter. *See* FED. DEPOSIT INS. CORP., FEDERAL DEPOSIT INSURANCE CORPORATION: THE FIRST FIFTY YEARS 38 (1984).

66. A bank run occurs when many of the bank's customers try to withdraw their money in a short period of time. Because the liquidation value of even a healthy bank may be less than the value of its outstanding deposits, a bank run can exhaust a bank's assets in a short period of time, leading to the failure of the bank. . . . Because of their sudden and violent nature, bank runs were described traditionally in terms of irrational behavior; a series of bank runs may be called a financial *panic*.

THE NEW PALGRAVE DICTIONARY OF MONEY AND FINANCE 171 (Peter Newman et al. eds., 1992).

67. 12 U.S.C. § 1821(a)(1) (1994). Thus, a depositor with a $1 million dollar deposit in one institution is at risk of losing $900,000; that same depositor, however, could insure all of the $1 million by depositing $100,000 at ten different FDIC-insured financial institutions.

In addition to *preventing* bank failures,[68] the FDIC also plays a role *after* a bank fails, when it is appointed as a "receiver." When a bank or S&L fails, its primary federal regulator[69] declares it officially "insolvent." The regulator then appoints a receiver[70] or conservator[71]—usually the FDIC[72] for commercial banks and the RTC for S&Ls through 1995.[73] Thus, in

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68. *See* K.A. Randall, *The Federal Deposit Insurance Corporation: Regulatory Functions and Philosophy*, 31 LAW & CONTEMP. PROB. 696, 702 (1966) ("The FDIC does not merely engage to reimburse the depositor for the loss of his deposits but undertakes to minimize bank failure [and preserve] public confidence in banks.").

69. In the case of federal commercial banks, the Office of the Comptroller of the Currency (OCC) is the primary regulator. 12 U.S.C. §§ 191, 203(a) (1994). The FDIC also has indirect closure powers. 12 U.S.C. § 1821(c)(2), (d)(10). The primary regulator for S&Ls is the Office of Thrift Supervision (OTS). 12 U.S.C. § 1464(d)(2)(A) (1994).

70. If it is acting in its "receivership" capacity, the FDIC behaves much like a bankruptcy trustee, marshaling the assets and determining the liabilities of the failed institution. A receiver is appointed for the purpose of liquidation: "collecting assets and paying creditors." SYMONS & WHITE, *supra* note 5, at 604. 12 U.S.C. § 1821(d) grants to the FDIC and RTC the traditional functions of a common law conservator or receiver. For example, much like a trustee in bankruptcy, the FDIC is provided with an automatic stay pending litigation. 12 U.S.C. § 1821(d)(12)(B) (1994). Also, much like a bankruptcy trustee, the FDIC has the power to repudiate contracts. 12 U.S.C. § 1821(e)(1) (1994); *cf.* 11 U.S.C. § 363 (1994) (discussing powers of a common law bankruptcy trustee).

71. If it is acting in its "conservatorship" capacity, the FDIC maintains the going concern value of the institution in an attempt to nurse the institution back to health by overseeing its operation. *See* 12 U.S.C. § 1821(d)(2)(B), (D) (1994) (discussing the FDIC's responsibility to take action necessary to put the insured institution into a sound condition, including operation of the institution).

72. The OCC must appoint the FDIC as receiver and the FDIC must accept the appointment as receiver. 12 U.S.C. §§ 191, 1821(c)(2)(A)(ii) (1994). However, the OCC *may* appoint the FDIC as conservator and the FDIC *may* accept the conservatorship appointment. 12 U.S.C. §§ 203(a), 1821 (c)(2)(A)(I). The FDIC may be appointed receiver by state-chartered institutions as well. 12 U.S.C. § 1821(c)(3)(A)-(B) (1994).

In either its receivership or conservatorship capacities, the FDIC behaves very differently than when it acts in its "corporate" role as an insurer charged principally with the responsibility of insuring deposits. *See supra* note 67 (explaining the FDIC's role in its corporate capacity which entails reimbursing each depositor at each institution up to $100,000); *see also* 12 U.S.C. § 1817 (1994) (providing that a financial institution, for an annual insurance fee, can obtain FDIC deposit insurance and/or financial/operational assistance should the institution fail or need assistance during the coverage period).

73. In late 1995, the RTC ceased to exist and all of its responsibilities were transferred to the FDIC. *See* 12 U.S.C. § 1441a(b)(4)(A) (1994) (describing the FDIC's powers as the same as the RTC's). Before 1989, the appointed receiver or conservator of a failed S&L was the Federal Savings and Loan Insurance

1996, the FDIC became the receiver of S&Ls. As receiver, the FDIC assumes all of the legal responsibilities of the failed institution, including the right to pursue, and the duty to defend, all pending or potential legal claims and liabilities. One of the FDIC's fundamental responsibilities is to collect the financial institution's remaining assets, primarily borrowers' loan obligations,[74] in an effort to meet its liabilities.[75]

However, when the FDIC attempts to recover a debt still owed to the institution, it often will face a borrower's counterclaims or defenses. Such claims and defenses usually are based on either (1) alleged verbal side agreements or special arrangements the borrower made with the institution,[76] or (2) the borrower's alleged reliance on negligent or intentional verbal

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Corporation (FSLIC). In 1989, Congress abolished the FSLIC, which by then had insufficient funds to reimburse depositors due to the S&L crisis, by enacting the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183. The Act also abolished the primary regulator of S&Ls—the Federal Home Loan Bank Board (FLHBB, coyly pronounced "FLUB" by critics and detractors). In their stead, Congress created the OTS to act as the primary regulator of S&Ls and other thrift institutions, and the RTC to act as a receiver and conservator in the place of the FSLIC (as well as to act as receiver or conservator for state-chartered savings associations). However, the insuring responsibilities of FSLIC flowed not to the newly created RTC, but to the FDIC. As a result, the FDIC currently administers two insurance funds: (1) the Bank Insurance Fund (BIF) — formed under FIRREA § 211(5), codified at 12 U.S.C. § 1821(a)(5)(B) (1994)—and (2) the successor to the FSLIC fund, the Savings Association Insurance Fund (SAIF) (perhaps a good omen in that the acronym is pronounced "safe")—formed under FIRREA § 211(6), codified at 12 U.S.C. § 1821(a)(6)(A) (1994).

74. FINANCIAL INSTITUTIONS 72 tbl. 3-1 (Richard I. Robinson ed., 3d ed. 1960) (demonstrating how loans constitute 41.3% of a bank's total assets, which is the largest percentage of any asset).

75. *See* 12 U.S.C. §§ 1821(d)(3), (13) (1994) (requiring the FDIC to maximize the returns on remaining assets and minimize the loss realized in the resolution of cases). 12 U.S.C. § 1821(d)(2)(B)(ii) provides that the FDIC, as conservator or receiver, may collect all obligations and money due to the institution. Similarly, 12 U.S.C. § 1821 (d)(2)(D)(ii) states that in its capacity as conservator, the FDIC may take appropriate action to carry on the business of the institution and preserve its assets and property. *See* FDIC v. Bank of Boulder, 865 F.2d 1134, 1136-37 (10th Cir. 1988) (describing the FDIC's use of purchase and assumption transactions to avoid problems associated with full-scale liquidation); Gunter v. Hutcheson, 674 F.2d 862, 865-66 (11th Cir.), *cert. denied*, 459 U.S. 826 (1982) (same). *See generally* Michael B. Burgee, *Purchase and Assumption Transactions Under the Federal Deposit and Insurance Act*, 14 FORUM 1146 (1979) (describing how the FDIC functions when taking over a failed bank).

76. *E.g.*, Robinowitz v. Gibraltar Sav., 23 F.3d 951, 954-57 (5th Cir. 1994), *cert. denied*, Robinowitz v. RTC, 115 S. Ct. 725 (1995) (dismissing a suit alleging breach of oral representations regarding a failed S&L's intentions to continue funding for a project based on *D'Oench*).

misrepresentations made by the institution.[77]

These types of counterclaims and defenses are common in collection and lender liability cases. A borrower often alleges that before or during the repayment period, he and the lending institution reached a verbal "understanding" or side agreement that modified their original written loan agreement. For instance, borrowers frequently assert that the parties agreed to revise the interest rate or the time of repayment,[78] establish the liquidation procedures for collateral,[79] or extend, modify, or renew the debt obligation—agreements that changing business circumstances make necessary or desirable.[80] Alternatively, borrowers may claim that there was poor communication between the lender and the borrower or even intentional deceit on the part of the lender at the inception of the loan. For example, a borrower might allege that her lender promised to extend additional or unrelated financing or that it induced her to borrow more funds than originally requested.[81] She then would argue that the financial institution negligently or intentionally misled her and that she therefore should not be liable for the remaining debt obligation.[82]

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77. *E.g.*, FDIC v. Bathgate, 27 F.3d 850, 869 (3d Cir. 1994) (refusing to enforce an oral extension agreement against the FDIC).

78. *See, e.g.*, Reisig v. RTC, 806 P.2d 397, 400 (Colo. Ct. App. 1991) (dismissing a suit based on fraud, where the institution allegedly changed the fixed-rate financing to a variable interest rate).

79. *See, e.g.*, Abrams v. FDIC, 944 F.2d. 307, 310 (6th Cir. 1991) (holding that a bank president's alleged promise not to collect any deficiency remaining under loan and contract entered into after borrower defaulted could not prevent the FDIC from relying on literal words of loan and contract to collect deficiency), *appeal after remand*, 5 F.3d. 1013 (6th Cir. 1993).

80. *See* Deborah Addis, *Comment: Tide May be Turning to Banks in Lender Liability Lawsuits*, AM. BANKER, May 25, 1993, at 4 (noting a trend toward court rulings in favor of banks in lender liability lawsuits); A. Barry Cappello & Frances E. Komoroske, *Lender Liability Based on Undue Control Over a Borrower*, TRIAL, Dec. 1992, at 1, 19 (suggesting that lenders risk liability based on undue control when they become involved in borrowers' business affairs); Mark A. Cohen & Paul J. Marfinek, *Lender Liability Suits Facing Major Drop-Off*, MASS. LAW. WKLY., Feb. 7, 1994, at 1 (noting a decline in the number of lender-liability claims during the last several years).

81. *See, e.g.*, Simms v. Biondo, 816 F. Supp. 814, 821 (E.D.N.Y. 1993) (dismissing a claim based on an oral representation about the value of mortgaged property).

82. *See, e.g.*, McCullough v. FDIC, 788 F. Supp. 626, 627 (D. Mass. 1992) (barring a suit by purchasers of condominium units against the FDIC based on the bank's failure to disclose the existence of a state environmental cleanup order affecting the subject property).

Side agreements or verbal misrepresentations can, and often do, constitute perfectly viable claims or defenses when the borrower makes them against a solvent financial institution.[83] The statute creating the FDIC, however, requires the minimization of taxpayer cost.[84] The FDIC, then, *must* resolve a failed institution in the manner that is least costly to its insurance fund. This is a powerful incentive for the FDIC to employ the *D'Oench* doctrine and § 1823(e) to deny otherwise valid borrower claims and defenses, to dismiss claims, and thus to save money.[85] Even with respect to a former *creditor* or vendor of a failed financial institution—such as a bank's landlord or provider of janitorial services—the *D'Oench* doctrine and § 1823(e) powers prohibit many of these types of otherwise viable counterclaims or defenses.[86] Fueled by its desire and statutory duty to spare its own insurance fund, the FDIC takes cover behind the statutory "least cost resolution" requirement to justify using *D'Oench* whenever it can, despite the inequitable results and windfall recoveries it obtains in failed bank litigation.[87]

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83. Such actions are known as "lender liability" actions because borrowers are able to defend and often obtain damages on claims that their lenders acted negligently in making the loan in the first place, negligently failed to continue to provide financing after the initial loan was made, or generally violated the law during the term of the loan such that the borrower should not be held liable for the remaining loan obligation. *Lender Liability Cases Dominate 1987's List of Largest Verdicts*, INSIDE LITIG., May 1988, at 9-10; *see generally* Cappello & Komoroske, *supra* note 80, at 19 (warning that lenders may expose themselves to lender liability claims based on undue control when they become involved with borrowers' business operations).

84. 12 U.S.C. § 1823(c)(4)(A)(ii) (1994).

85. *See infra* Part II (explaining in detail how the *D'Oench* doctrine and § 1823(e) operate in actual practice to prohibit many claims and defenses that a former borrower would have against the failed financial institution in a collection action).

86. *See* Adams v. Madison Realty & Dev., Inc., 937 F.2d 845, 858 (3d Cir. 1991) (holding that the *D'Oench* doctrine and § 1823(e) prohibit a creditor from asserting a side agreement, or any verbal misrepresentation, as a claim against the FDIC standing in the shoes of the failed financial institution); *see also* Hawke Ass'n v. City Fed. Sav. Bank, 707 F. Supp. 423, 428 (D. N.J. 1991) (holding the plaintiff did not satisfy the requirements of § 1823(e)). *But see* Cote d'Azur Homeowners Ass'n v. Venture Corp., 846 F. Supp. 827, 831 (N.D. Cal 1994) (showing that *D'Oench* does not apply to creditors in *non-lending* transactions). The *D'Oench Duhme* Reform Act would make it impossible to apply *D'Oench* to these kinds of cases under the vendor and tort exceptions explicit in the reform bill. *See infra* Part III (analyzing and critiquing likely terminology in a reform bill and proposing statutory reform measures).

87. *See S. 648 Hearings*, *supra* note 1, at 52-53 (arguing that *D'Oench* and § 1823(e) are necessary components of the FDIC's arsenal against former

Significant statutory reform of § 1823(e) therefore is necessary to alleviate these injustices.

II. THE EXPANSION AND FUNCTION OF THE *D'OENCH* DOCTRINE AND SECTION 1823(e)

A. FROM SOUND POLICY TO OVERGROWN SUPERPOWER

Recall from the introduction that a federal court dismissed Mrs. Sweeney's valid claims against her lender when it became insolvent and the RTC took its place in the litigation.[88] Certainly this result is not what the 1942 Supreme Court envisioned when it decided the *D'Oench* case, nor what the 1950 Congress intended when it enacted § 1823(e).[89] Courts, after the creation

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borrowers and creditors of failed financial institutions).

> [Without] the *D'Oench* doctrine and § 1823(e), the FDIC would have difficulty enforcing many valid obligations owed to the failed financial institution because it often cannot rebut allegations of unwritten agreements or arrangements as effectively as the failed institution. After an institution fails, the FDIC does not have ready access to its officers and employees. In such circumstances, the receiver frequently is unable effectively to counter allegations that the institution entered into written agreements or challenge the terms of such alleged agreements. The ability of the FDIC to enforce the obligations due to the failed institution in reliance upon the written records of loans and other assets prevents fraudulent claims and unnecessary legal expense.

Id. at 53 (statement of Sharon Powers Sivertsen, Assistant General Counsel, FDIC). Of course, this argument assumes that *all* claims are invalid simply because the FDIC might have difficulty meeting its burden of proof as a receiver substituted for the failed financial institution in the lawsuit. However, all substituted parties are still required to present evidence and carry their burden of proof at trial. Should the fact that the burden is a bit onerous on the government be a justification to create and apply a harsh doctrine and statute in order to summarily bar the claims and defenses of a party-opponent? This seems to reduce the search for justice to a simple inquiry concerning whether the FDIC is involved in the lawsuit against a former debtor or vendor.

88. *See supra* text accompanying note 32.

89. Most commentators agree that the *D'Oench* doctrine has been greatly expanded from its equitable underpinnings. *See, e.g.*, Warren Dennis, *The Rise and Expansion of the* D'Oench *Doctrine*, 767 ALI-ABA 157, 177 (1992) ("With guidance from the Supreme Court in *Langley*, the *D'Oench* doctrine has expanded far beyond its foundation in the *D'Oench* decision."); *see also* Echevarria, *supra* note 36, at 746 ("Through the course of subsequent case law, *D'Oench* has been dramatically expanded in its application and now essentially precludes the assertion of fraud defenses or causes of action against successors to failed banks and savings and loan institutions."); Flint, *supra* note 36, at 466-67 ("In the last fifty years the *D'Oench* doctrine has been greatly expanded by the courts."); Hymanson, *supra* note 36, at 255 ("Although the *D'Oench, Duhme* doctrine is rooted in equitable principles, many courts have lost sight of its source and have applied the doctrine as a blanket protection of the FDIC.").

of *D'Oench* and § 1823, began interpreting them to such an expanded degree that they now work injustice upon thousands of individuals who simply have had the misfortune of dealing with financial institutions that eventually failed.[90]

1. The Original Policy Goals of the *D'Oench* Doctrine

Despite harsh results in many modern applications, the *D'Oench* doctrine originally sprang from legitimate policy concerns.[91] To understand these concerns, it is important to consider the facts of the original case. D'Oench, Duhme & Company, a securities dealer, sold bonds to Belleville Bank & Trust Company on which D'Oench later defaulted.[92] To protect its image and to enable the bank to hide the past due bonds on its books, D'Oench executed non-negotiable promissory notes to the bank to cover the value of the defaulted bonds. D'Oench and the Belleville Bank understood, however, that these promissory notes were never to be collected. In fact, the parties included a receipt with the notes, stating: "[T]his note is given with the understanding it will not be called for payment. All interest payments to be repaid."[93]

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90. *See infra* notes 234-261 and accompanying text (setting forth the many claims and defenses barred by the *D'Oench* doctrine and § 1823(e)).

91. The three main policy concerns of *D'Oench*, as presented by a representative of the FDIC before the Senate Banking Committee, include:

> First, the *D'Oench* doctrine ensures that regulators can rely on a financial institution's records for supervisory purposes and in order to protect the deposit insurance funds they administer. . . . Second, the *D'Oench* doctrine promotes careful consideration of lending practices, assures proper recordation of various financial activities, and protects against collusive or erroneous structuring or restructuring of terms, especially just before the institution fails. Third, the *D'Oench* doctrine protects the innocent depositors and creditors of a failed institution, including the FDIC, from absorbing the losses resulting from agreements that do not appear in the records and books of the institution and helps to facilitate the quick return of a failed institution's assets to the community.

S. 648 Hearings, *supra* note 1, at 52 (statement of Sharon Powers Sivertsen, Assistant General Counsel, FDIC). *But see* Echevarria, *supra* note 36, at 771 (suggesting that when the *D'Oench* case was decided the Supreme Court was more concerned with asserting the existence of a federal common law in the wake of Erie R.R. v. Tompkins, 304 U.S. 64 (1938), than with expanding the powers of the FDIC); *see also Oversight Hearings*, *supra* note 20, at 4 (arguing *D'Oench* was primarily a case working out some of the implications of federal common law under *Tompkins,* rather than the basis for the sweeping banking doctrine it has become) (statement of Professor Michael P. Malloy).

92. D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447, 454 (1942).

93. *Id.* Note that D'Oench paid certain interest payments on the notes in order to keep them from defaulting and then executed renewal notes in 1933. *Id.*

The FDIC later obtained one of these notes as collateral for a $1,000,000 loan it made to the failing Belleville Bank. When it attempted to collect on the note, D'Oench claimed that the note was unenforceable for lack of consideration. Although this would have been a valid defense against Belleville Bank, the Supreme Court held that D'Oench could not raise the defense against the FDIC because D'Oench participated in a scheme to make the bank appear more financially solid than it actually was.[94] As the Court stated, "one who gives such a note to a bank with a secret agreement that it will not be enforced must be presumed to know that it will conceal the truth from the vigilant eyes of the bank examiners."[95]

The *D'Oench* Court devised a strict test for secret agreements with a bank to conceal the true state of the bank's assets:

> The test is whether the note was designed to deceive the creditors or the public authority or would tend to have that effect. It would be sufficient in this type of case that the maker lent himself to a scheme or arrangement whereby the banking authority on which [the FDIC] relied in insuring the bank was or was likely to be misled.[96]

Such a test, the Court noted, reflected the federal policy of protecting the FDIC from misrepresentations concerning the integrity of bank portfolios that it insures.[97]

An FDIC representative has summarized *D'Oench*'s policy justifications as follows:

> The public policies achieved by [using *D'Oench*] lie at the core of the ability of the FDIC and other bank regulators effectively to supervise open banks and to resolve the failures of failing banks. The ability to rely upon the records of a failed bank in order to evaluate its assets and liabilities is essential to protect the deposit insurance funds and the public interest in a sound banking system.
>
> The public policies achieved by *D'Oench* and section 1823(e) include insuring the ability of bank regulators to accurately evaluate the books and records of open or failed institutions, the validity of the asset information provided on Call Reports submitted by banks to regulators, fairness to the creditors and depositors of a failed bank, and protection of the deposit insurance funds.[98]

This statement illustrates that bank examiners must be able to *rely on a bank's written records* about the existence of any side

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94. *Id.* at 459.
95. *Id.* at 460.
96. *Id.*
97. *Id.* at 459.
98. *Oversight Hearings*, *supra* note 20, at 143 (statement of John F. Bovenzi, FDIC).

agreement that may impair or affect the value of any bank asset. Such reliance is necessary to fulfill the government bank examiners' duty to ascertain the value of the loans both while the financial institution is solvent, and especially at the time the institution fails and is being seized by the FDIC.[99] Inspecting loan files will not make federal examiners aware of oral side agreements or verbal understandings related to those loans.[100] In the case of an FDIC seizure of an insolvent institution, where its examination and loan valuation process must be performed as quickly and efficiently as possible, sometimes in only a few days or even a few hours, discovery is even less likely.[101] Thus, the *D'Oench* case, which arose in the context of on-site bank examinations by the government, should have a limited holding grounded primarily in estoppel and equity.[102] *D'Oench*'s main emphasis is on the "secret agreement" between the debtor and the bank.[103] In fact, the separate concurring opinion of Justice Jackson grounded *D'Oench* on equitable

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99. *Id.*

100. *See* Gunter v. Hutcheson, 674 F.2d 862, 872 (11th Cir.) (explaining that the FDIC, having acquired the note for value in good faith as part of a purchase and assumption agreement, had a complete defense to the fraud claims raised), *cert. denied*, 459 U.S. 826 (1982).

101. *See* Fidelity Sav. & Loan Ass'n v. FHLBB, 540 F. Supp. 1374, 1380 (N.D. Cal.), *reversed*, 689 F.2d 803 (9th Cir. 1982) (explaining how a seizure and closure of an insolvent financial institution occurs over a weekend similar to a police raid), *cert. denied*, 461 U.S. 914 (1983); *see also* FDIC v. Bank of Boulder, 865 F.2d 1134, 1136-37 (10th Cir. 1988) (explaining how the various ministerial functions that take place during the seizure of a failed bank must take place as quickly and efficiently as possible to have the closed bank operating again under new management within a few days).

102. *See* Palmer, *supra* note 36, at 569 (explaining that "the clear rationale of the *D'Oench* doctrine was that the borrower should be estopped from asserting his defense because of his unclean hands. *D'Oench* was never intended to reach those cases where an innocent borrower is defrauded and did not materially participate in the fraud."); *see also* Hymanson, *supra* note 36, at 275 (viewing *D'Oench* as an equitable estoppel case that applies to any defense a borrower may assert, but that must be tempered with the equitable principles of insolvency law).

103. > [F]or the *D'Oench* doctrine to bar a defendant's wrongful act as a defense to an obligation on a note as against the corporation, three elements are required: there must be a secret arrangement; there must be a possibility that the corporation [the FDIC] could suffer loss (but proof of such loss is not required); and the borrower need not have fraudulent intent, it is enough that his actions might cause the authorities to be misled.

Jack S. Sacks, *Red Alert: The* D'Oench *Doctrine's Expansion Can Cause Financial Ruin for Borrowers When Insured Lenders Become Insolvent*, 17 NOVA L. REV. 1405, 1410 (1993) principles and would not have allowed the FDIC to recover absent a "secret agreement" made to deceive the bank's receiver.[104] Estoppel and equity principles dictate that the *D'Oench* doctrine should apply only when the borrower, along with the bank, seeks to deceive bank examiners, because no injustice results therefrom. Unfortunately for many borrowers in the last decade, however, the *D'Oench* doctrine has become divorced from its original equitable underpinning.[105]

2. The Common Law Judicial Expansion of the *D'Oench* Doctrine

Until 1980, courts construed the *D'Oench* doctrine narrowly by adhering to the original equitable requirements of the *D'Oench* case.[106] During this period of relative calm, *D'Oench* was used simply as a tool to prevent secret agreements between the borrower and his financial institution.[107] Consistent with *D'Oench*, cases during this period usually prohibited claims only by borrowers who had engaged in fraudulent behavior.[108] Because few banks failed between 1950 and the early 1980s,[109]

104. D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447, 474 (1942) (Jackson, J., concurring).

105. *See infra* notes 111-261 (describing the expansion of the *D'Oench* doctrine through judicial common law and statutory interpretation).

106. For example, in FDIC v. Meo, 505 F.2d 790, 792 (9th Cir. 1974), the court relied on Justice Jackson's concurrence in *D'Oench* to rule that *D'Oench* did not apply to a notemaker who is "wholly innocent" of the bank's wrongful conduct. *Meo* would have limited the application of *D'Oench* to its equitable roots, but the decision was hardly followed after the late 1970s. In fact, most commentators refer to *Meo* as an historical footnote or "dead law." *See, e.g.*, Michael J. Barry, *Ways Around the Wrath: Exploring the Remaining Exceptions to the* D'Oench, Duhme *Doctrine and Section 1823(e)*, 54 U. PITT. L. REV. 1127, 1134-37 (1993) (arguing that subsequent case law rejected the *Meo* equitable exception).

107. FDIC v. Alker, 151 F.2d 907, 908-09 (3d Cir. 1945), *cert. denied*, 327 U.S. 799 (1946) (barring a debtor from asserting a claim against the FDIC that the lender agreed not to collect on a promissory note or demand possession of collateral if the debtor paid all interest payments).

108. *See Meo*, 505 F.2d at 792 (concluding that *D'Oench* did not apply to a wholly innocent borrower); *see also* First Empire Bank v. FDIC, 572 F.2d 1361, 1369-71 (9th Cir.) (holding that the FDIC, when it acts as a receiver, must be controlled by the equitable principles of receivership, and therefore refused to apply the *D'Oench* doctrine), *cert. denied*, 439 U.S. 919 (1978), *cert. denied*, 452 U.S. 906 (1981); Hymanson, *supra* note 36, at 284 (citing *First Empire Bank* as a pre-1980's case that used equitable principles in applying the *D'Oench* doctrine).

109. Between 1943 and 1974, the number of bank failures per year in the United States never exceeded ten. With the exception of 1975 (14 failures) and

however, relatively few substantive decisions interpreted the *D'Oench* doctrine.[110] Thus, before 1980, as a matter of judicial interpretation, the *D'Oench* doctrine remained largely unchanged from the original holding in the *D'Oench* case, primarily because bank failures and general problems in the banking industry were too few to give the courts many opportunities to apply the doctrine.

The judicial expansion of *D'Oench* accelerated in the early 1980s, however. The increase in bank failures spurred many courts to apply *D'Oench* more broadly to protect the FDIC's financial insurance interests.[111] One of the most critical common law expansions occurred when various courts began ruling that the FDIC's knowledge of a "secret" side agreement was irrelevant.[112] Side agreements of which the FDIC was aware, however, could not deceive or mislead the FDIC. Thus, these rulings, which allowed courts to bar claims and defenses based on agreements that clearly were no secret, represented a

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1976 (17 failures), the number of bank failures from 1944 to 1981 per year still did not exceed ten. FED. DEPOSIT INS. CORP., 1989 ANNUAL REPORT 101 tbl. 122 (1990); *see also supra* note 5 (discussing trends in bank failures from 1920 to 1974).

110. Most commentators, in fact, simply skip the period from 1950 (the enactment of § 1823(e)) to the early 1980s (the beginning of the rash of bank failures) in the analysis of the growth and expansion of the *D'Oench* doctrine. This is due to the dearth of case law interpreting the doctrine and statute during this period. *See, e.g.*, Echevarria, *supra* note 36, at 771 n.178 (noting that from 1942 to 1970 only one federal appellate decision was decided substantively under *D'Oench*).

111. To the extent that banks were failing and the FDIC needed to obtain and protect assets (former loans) owed to the institution, the *D'Oench* doctrine and the application of § 1823(e) served to defeat many claims and defenses of former borrowers and creditors and therefore lowered the overall cost of the bailout. *See Oversight Hearings*, *supra*, note 20, at 35 (statement of John F. Bovenzi, FDIC Director Division of Depositor & Asset Services); *see also* Chatham Ventures, Inc. v. FDIC, 651 F.2d 355 (5th Cir. 1981) (using *D'Oench* as authority in protecting the FDIC's interests), *cert. denied*, 456 U.S. 972 (1982); Sacks, *supra* note 103, at 1428 ("Today, it is generally accepted that *D'Oench* bars affirmative claims as well as defenses arising from a scheme or arrangement likely to deceive bank examiners.").

112. *See, e.g.*, FDIC v. Krause, 904 F.2d 463, 466 (8th Cir. 1990) (precluding defense of accord and satisfaction between borrower and lender even though evidence of agreement existed in bank records according to affidavit of the failed bank's president); FDIC v. Wood, 758 F.2d 156, 162 (6th Cir.) ("The FDIC cannot, therefore, be charged with knowledge of a defense merely because that information could be found in the bank's files."), *cert. denied*, 474 U.S. 944 (1985); FDIC v. Merchant's Nat'l Bank, 725 F.2d 634, 640 (11th Cir.) (determining that the FDIC is not imputed with knowledge of an agreement which bank examiners may have discovered), *cert. denied*, 469 U.S. 829 (1984).

significant departure from the *D'Oench* doctrine's original policy justification.[113]

The judicial extension did not stop with making the FDIC's knowledge of any side agreement irrelevant. Courts also decided that the FDIC could assert the *D'Oench* doctrine even when the former lending institution *defrauds* an innocent borrower. For example, in *FDIC v. Hatmaker*,[114] the borrower had a close working relationship with the bank and therefore agreed to sign a *blank* promissory note after the lender promised to write in the agreed-upon loan amount of $12,000.[115] Although the borrower received the $12,000 pursuant to their agreement, the lender actually inserted "$60,000" as the loan amount to make the bank's books appear stronger financially.[116] When the bank failed, the FDIC successfully used the *D'Oench* doctrine to collect the full, imaginary $60,000 and block the innocent borrower's defense that he had repaid in full the actual $12,000 loan.[117] Consequentially, where the *D'Oench* doctrine once was used only to protect the innocent FDIC against a borrower's fraud, the FDIC now could use it to benefit from a $48,000 fraud that a bank perpetrated against an innocent borrower.[118]

Finally, although borrowers are affected by *D'Oench* in significantly larger numbers, and thus have been the focus of this Article, creditors perhaps have been subject to the most highly publicized abuses of *D'Oench*.[119] In one such case, a bank asked a roofer to complete a job for a property that the bank had taken over. When the bank failed, the FDIC refused to pay the roofer because his agreement did not comply with the requirements of § 1823(e).[120]

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113. *See* D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447, 456 (1942) (explaining the federal policy protecting the FDIC and public funds).

114. 756 F.2d 34 (6th Cir. 1985).

115. *Id.* at 35-36.

116. *Id.*

117. *Id.* at 36.

118. *Id.*

119. *See* Peter A. Brown, *Workers Holding Bills Owed by Failed Banks Left Holding the Bag*, SCRIPPS HOWARD NEWS SERVICE, Weekend Release, May 7-8, 1994; Stephanie Finucane, *Small Business Alert: Have You Been D'Oenched by the FDIC?*, FAIRFIELD COUNTY BUS. J., Feb. 14, 1994, 13, 13.

120. Brown, *supra* note 119. Another example of a subcontractor who had completed work on properties financed by failed institutions but was never paid for goods and services is Ramins & Sons, Inc. v. RTC, No. CIV.A.92-4919, 1993 WL 210551 (E.D. Pa. June 15, 1993) (mem.) (regarding a Pennsylvania roofer who never received the $11,000 in repairs he completed on a property that the

3. The Common Law Expansion of the *D'Oench* Doctrine: The Federal Holder in Due Course Doctrine

The Federal Holder In Due Course (HIDC) doctrine represents yet another judicial expansion of the *D'Oench* doctrine's application, because it, like the *D'Oench* doctrine, allows the FDIC to acquire the assets of a failed institution without being subject to the debtor's personal defenses.[121] Technically *D'Oench* did not apply in some cases where a failing bank fraudulently induced borrowers to purchase its stock.[122] *D'Oench* applied only to "agreements," and courts did not interpret borrowers' claims of tortious misrepresentations as agreements.[123] *D'Oench* also did not apply because the borrowers did not engage in deceit. The FDIC thus had to argue that it was an HIDC to obtain a result consistent with *D'Oench.*

RTC subsequently sold).

David Hess, of "Citizens & Business for *D'Oench Duhme* Reform," summarized *D'Oench's* power against creditors as follows:

> [I]f a bank fails and the FDIC steps in, a claim against the bank may be worthless because it isn't based on a written "agreement" approved by the board of directors and kept as an official record. This affects thousands of small businesses that perform services for banks (carpenters, computer vendors and window washers among others), as well as innocent plaintiffs in personal injury or other tort lawsuits against banks.

Finucane, *supra* note 119, at 13.

121. Various cases have applied the HIDC doctrine. *See, e.g.,* FSLIC v. Murray, 853 F.2d 1251, 1256-57 (5th Cir. 1988) (applying the HIDC doctrine to FSLIC); FDIC v. Wood, 758 F.2d 156, 160 (6th Cir.) (using HIDC to bar state usury law defense), *cert. denied,* 474 U.S. 944 (1985). Actually, FDIC v. Rockelman, 460 F. Supp. 999 (E.D. Wis. 1978) appears to be the first case to apply the HIDC doctrine. In *Rockelman,* the Court was very concerned with more than forty cases it was handling from the failure of one bank, so the Court found that Congress intended to clothe the FDIC in HIDC status to shield it from many ordinarily available defenses. *Id.* at 1003.

122. Gunter v. Hutcheson, 674 F.2d 862, 871-73 (11th Cir.), *cert. denied,* 459 U.S. 826 (1982); *see, e.g.,* FDIC v. Cremona Co., 832 F.2d 959, 964 (6th Cir. 1987) (holding that § 1823(e) does not bar properly recorded side agreements but that the HIDC doctrine bars them for lack of knowledge), *cert. denied,* 485 U.S. 1017 (1988); *Wood,* 758 F.2d at 159 (holding that *D'Oench* may or may not bar state usury law defenses, but that the HIDC doctrine does bar them); New Conn. Bank & Trust Co. v. Stadium Management Corp., 132 B.R. 205, 208-10 (D. Mass. 1991) (stating that the *D'Oench* doctrine does not bar impairment of collateral claim because it is not an agreement, but that the HIDC doctrine does bar such a claim, as long as it is a negotiable instrument).

123. *But see* Langley v. FDIC, 484 U.S. 86, 87 (1987) (extending the interpretation of the term "agreement" in § 1823(e) to include tortious misrepresentations as well as formal contractual agreements).

The FDIC is not qualified to become a regular HIDC under the Uniform Commercial Code (UCC)[124] because when it acquires assets from a failed institution, it normally does so in a liquidation,[125] as a receiver in a purchase and assumption transaction,[126] or when it buys assets at face value to assist a failing institution.[127] None of these methods of acquisition meets the UCC's requirement of acquiring assets "in the ordinary course of business."[128] Nonetheless, courts decided that the FDIC qualified as a federal HIDC.[129] By creating a

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124. A holder in due course must take the instrument for value, in good faith, and without notice of any defense or claim against the instrument. U.C.C. § 3-302(a)(2) (1987).

125. The deposit payoff is the banking law equivalent of a simple liquidation. When an institution fails, the FDIC as insurer (in its "corporate capacity") pays off all of the insured depositors immediately in cash or by transferring the deposits to another institution (it may also pay off the uninsured depositors if it believes that doing so will minimize the costs of the resolution). The FDIC in its corporate capacity is then "subrogated" to—stands in the shoes of—the former depositors and has a claim against the receivership along with other creditors. Meanwhile, the FDIC as receiver marshals the assets and distributes them ratably to all creditors (including itself) according to their order of priority. At the conclusion of the process the former institution has disappeared completely, although its assets and liabilities remain in the economy in other hands.

MACEY & MILLER, *supra* note 3, at 644.

126. *See supra* notes 69-75 (discussing the FDIC's role in receivership). The purchase and assumption transaction has become the preferred method for dealing with bank failures because depositors are paid off completely and the transaction can be conducted with great speed, usually overnight. *See* Hymanson, *supra* note 36, at 260-61 (noting that a purchase and assumption transaction is the most common method of dealing with bank failures and that typically the FDIC will keep the assets that are difficult to collect and sell the rest to other banks, or form a bridge bank, while the FDIC in its receivership capacity pursues the bad assets); *see also* Barry, *supra* note 106, at 1128 (explaining that the FDIC may engage in a "Purchase & Assumption transaction" when a bank fails).

127. *See* Hymanson, *supra* note 36, at 262-63 (citing the FDIC's handling of the Continental Illinois Bank in 1984). Perceiving that the Continental Illinois Bank was "too big to fail," the FDIC infused the bank with a large amount of capital and purchased a large number of non-performing loans from it. *Id.* In this and similar bailouts, the FDIC works in its corporate capacity because the bank in question has not yet failed, so the FDIC has not been appointed as receiver or conservator. *Id.*

128. The FDIC is not considered a holder in due course because the assets are not received in the ordinary course of business; instead, the FDIC receives the assets of a failing institution in bulk. U.C.C. § 3-302(c).

129. *But see* RTC v. Oaks Apartments Joint Venture, 966 F.2d 995, 1001-02 (5th Cir. 1992) (holding that a $2 million debt "or so much thereof as may be advanced" was not a sum certain, making the note non-negotiable and therefore

special federal HIDC status, courts allowed the FDIC to preclude the borrowers' claims of tortious misrepresentation—the same result as if the *D'Oench* doctrine itself applied.[130] Although the federal HIDC doctrine may be largely irrelevant in the wake of the general common law and statutory expansions of *D'Oench* and § 1823(e), courts occasionally refer to the HIDC doctrine as part of the overall *D'Oench* doctrine. It thus exemplifies the continuing expansion of the application of *D'Oench*.

4. The Expansion of the *D'Oench* Doctrine by Legislation: Section 1823(e)

a. *D'Oench Codification Through the 1950 Enactment of Section 1823(e)*

The statutory expansion of the *D'Oench* doctrine began in 1950, when Congress codified the doctrine in 12 U.S.C. § 1823(e).[131] Congress's codification, however, ultimately did more to dismantle the reasoning of *D'Oench* than to codify it. This legislation enlarged the *D'Oench* doctrine's scope by failing to include the requirement of deceit on the part of the borrower. Although the legislation harmonized the *D'Oench* doctrine with the statute of frauds by requiring a writing to uphold an agreement,[132] it excluded an integral part of the doctrine's

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making the HIDC doctrine inapplicable to the RTC); Desmond v. FDIC, 798 F. Supp. 829, 839-41 (D. Mass. 1992) (finding that a variable interest rate note was not negotiable so the FDIC did not qualify as an HIDC). *But see generally* Firstsouth v. Aqua Constr., Inc., 858 F.2d 441, 443 (8th Cir. 1988) ("[T]he federal law is evolving toward the view that FSLIC as receiver enjoys the status of [an HIDC] regardless of the manner in which it acquires notes and comparable instruments."); Flint, *supra* note 36, at 469-70 (arguing that courts created the HIDC doctrine as a mere fiction to expand the *D'Oench* doctrine).

130. *See* Gunter v. Hutcheson, 674 F.2d 862, 873 (11th Cir.) (determining that as a matter of common law the FDIC had a complete defense to state and common law fraud claims if the FDIC otherwise acquired the note in good faith), *cert. denied*, 459 U.S. 826 (1982).

131. Section 1823(e) amended the Federal Deposit Insurance Act, *supra* note 13, ch. 967, § 2(13), 64 Stat. 888 (1950) (codified as amended at 12 U.S.C. § 1823(e)).

132. The underlying purpose of a statute of frauds is to provide an incentive to reduce agreements to writing.

> A writing [has] several functions. Its original purpose was evidentiary, providing some proof that the alleged agreement was actually made. Another function was a cautionary one; by bringing home to the promisor the significance of his act and preventing ill-considered and impulsive promises. The final function a writing serves is that of channeling. It allows the ability to mark off unenforceable agreements from enforceable ones.

original purpose by barring otherwise valid claims and defenses of *innocent* borrowers.

As enacted in 1950, § 1823(e) invalidated any agreement that impaired the FDIC's interest in an acquired asset unless: (1) the agreement was in writing; (2) the bank and the borrower or creditor executed the agreement contemporaneously with the bank's acquisition of the asset; (3) the bank's board of directors or loan committee approved it; and (4) it was continuously maintained in the bank's official records.[133] Section 1823(e) thus gives borrowers a means to enforce legitimate side agreements in the event of bank failure despite *D'Oench*.

Given the dearth of legislative history on § 1823(e), it is unclear whether Congress originally enacted § 1823(e) to codify *D'Oench*, limit its scope, or expand its reach.[134] Representative Francis Walters, co-sponsor of the legislation, offered the following guidance during the floor debate on the bill:

> It was never the intention of Congress to give to the FDIC a stronger position than that of the bank, and the adoption of the amendment, my amendment [§ 1823(e)], is offered to prove heretofore it was the intent of Congress that any agreement in the absence of fraud is binding on the FDIC.[135]

Commentators disagree on the significance of Walters' statement. Some commentators argue that it limits § 1823(e) to the fraud requirement present in the original *D'Oench* case,[136] while others essentially ignore it, arguing that the specific language of § 1823(e) speaks for itself.[137] This disagreement

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E. ALLEN FARNSWORTH, CONTRACTS § 6.1 (1982) [hereinafter FARNSWORTH ON CONTRACTS].

133. 12 U.S.C. § 1823(e).

134. *See, e.g.,* Hymanson, *supra* note 36, at 270 ("[S]ection 1823(e) was added as an amendment to a much larger bill covering other aspects of the FDIC's operation, without the benefit of public hearings or congressional debate, and without an explicit statement of congressional intent to preempt the *D'Oench, Duhme* doctrine.").

135. 86 CONG. REC. 10,732 (1950) (statement of Rep. Walters).

136. *See, e.g.,* Echevarria, *supra* note 36, at 768-69 (arguing that the comments of Representative Walters demonstrate that Congress was not interested in expanding the FDIC's existing powers, but in defining them more rigidly); Robert W. Norcross, *The Bank Insolvency Game, the* D'Oench *Doctrine, and Federal Common Law*, 103 BANKING L.J. 316, 328 (1986) (arguing that Congress intended to limit *D'Oench*'s application with § 1823(e)).

137. *See, e.g.,* FDIC v. O'Neil, 809 F.2d 350, 353 (7th Cir. 1987) (concluding that § 1823(e) faithfully preserved, yet extended and clarified, the basic elements of *D'Oench*); Gray, *supra* note 36, at 251-52 (discounting the comments of Representative Walters, and instead relying upon the plain meaning of § 1823(e)); *see also* Flint, *supra* note 36, at 468 n.8 (arguing that Representative

has caused controversy and confusion among courts as well as commentators regarding whether § 1823(e) "superseded" *D'Oench*,[138] or whether Congress merely codified *D'Oench* without preempting it.[139] The most practical way to understand the interplay between *D'Oench* and § 1823(e), however, is to perceive the two as having merged into a single, powerful doctrine with the common law's flexibility for expansive application and the rigidity of a statute for strict enforcement purposes.[140] This hybrid of simultaneous flexibility and rigidity serves as the interpretive foundation upon which courts subsequently have expanded the application of the *D'Oench* doctrine in a manner never contemplated in 1942 or 1950.[141]

Walters' statements do not mar the plain words of § 1823(e) and dismissing this recourse to legislative history when the statutory language of § 1823(e) is unambiguous).

138. *See, e.g.*, Gunter v. Hutcheson, 674 F.2d 862, 871-72 (11th Cir.) (noting that § 1823(e) "superseded" *D'Oench*), *cert. denied*, 459 U.S. 826 (1982). Indeed, the issue has continuing relevance, as the D.C. and Eighth Circuits recently held that § 1823(e) completely preempted the *D'Oench* doctrine. *See* Murphy v. FDIC, 61 F.3d 34, 38-39 (D.C. Cir. 1995) (holding that the passage of § 1823(e) preempted *D'Oench* and citing O'Melveny & Myers v. FDIC, 114 S. Ct. 2048, 2052 (1994) for the proposition that FIRREA, also possibly preempted *D'Oench*); DiVall Insured Income Fund Ltd. Partnership v. Boatman's First Nat'l Bank, 69 F.3d 1398, 1401-02 (8th Cir. 1995) (holding that § 1823(e) preempted *D'Oench*). *See generally* Edgar Class, *The Precarious Position of the FDIC After* O'Melveny & Myers v. FDIC, 9 ADMIN. L.J. AM. U. 373, 399-402 (1995) (discussing the implications of *O'Melveny*). Recent reports concerning the imminent demise of the *D'Oench* doctrine have been premature, however, for these courts did not reject § 1823(e) or the principles upon which the *D'Oench* doctrine is based.

139. *See* Sacks, *supra* note 103, at 1411 ("The majority of jurisdictions view section 1823(e) as a codification of the *D'Oench* doctrine but not a preemption." (citation omitted)).

140. *Oversight Hearings*, *supra* note 20, at 14-15 (arguing that this is the proper way to conceive of the *D'Oench*/§ 1823(e) doctrine) (statement of Professor Michael P. Malloy); *see* Dennis, *supra* note 89, at 168-69 (citing seven cases that used the *D'Oench* doctrine as a unified doctrine and arguing that "[d]espite some apparent differences between the common law and statutory sources, by interpreting the *D'Oench* decision and § 1823(e) together, often juxtaposing case law arising under each (particularly when finding that both apply), courts have merged jurisprudence from the two sources into a single '*D'Oench* doctrine'"); *see also* Robert J. Stillman, *Enforcing Agreements with Failed Depository Institutions: A Battle with the FDIC/RTC Superpowers*, 47 BUS. LAW. 99, 101 n.19 (1991) ("*D'Oench* and section 1823(e) have been construed in tandem, and the statute's specific requirements have been incorporated into the common law through the *D'Oench* doctrine.").

141. *See infra* Part II.C. (building upon this conceptual foundation in explaining and analyzing the common law judicial expansion of the scope of both the *D'Oench* doctrine and § 1823(e)).

b. *The Expansion of the D'Oench Doctrine by Judicial Interpretation of Section 1823(e)*

The United States Supreme Court revisited *D'Oench* and implicitly approved prior judicial expansion in 1987 in *Langley v. FDIC*.[142] In *Langley*, borrowers executed a promissory note to the bank in exchange for a large portion of land. After they failed to pay the first installment due on the promissory note, the bank sued to collect.[143] The Langleys claimed that the bank orally misrepresented the actual size and value of the land.[144] They also claimed the bank fraudulently induced them to sign the promissory note[145] and that § 1823(e) did not apply because the bank's oral misrepresentations were not "agreements" within the meaning of § 1823(e).[146]

The Langleys' plight did not sway a single Justice. The unanimous Court, in an opinion by Justice Scalia, first decided to interpret broadly the term "agreement" as set forth in § 1823(e). It then concluded that a bank's express oral warranty is an "agreement" subject to the strict requirements of § 1823(e).[147] Finally, the Court ruled that fraud in the inducement is not a defense to § 1823(e).[148] Justice Scalia viewed this interpretation of § 1823(e) as necessary to allow federal and state examiners to rely on the bank's records because most failed bank liquidations are conducted overnight.[149] He also viewed this broad application of § 1823(e) as necessary to ensure mature consideration of all unusual transactions by senior bank officials, and to prevent fraud and collusion between a borrower and a failing bank.[150]

Langley thus expanded the *D'Oench* doctrine by interpreting § 1823(e) to include *any* agreement, not simply "secret agreements" or participation in "schemes that tend to deceive."[151] In effect, *Langley* now allows the FDIC to use the *D'Oench* doctrine to prevent a borrower from bringing forward a legiti-

142. 484 U.S. 86 (1987).
143. *Id.* at 88.
144. *Id.* at 89.
145. *Id.* at 93.
146. *Id.* at 90-91.
147. *Id.* at 91.
148. *Id.* at 93.
149. *Id.* at 91-92.
150. *Id.* at 92.
151. *Id.*

mate fraud claim against a bank even though the borrower has not engaged in any culpable conduct. As such it represents a critical change in the overall interpretation of the *D'Oench* doctrine. Moreover, by defining a bank's duty not to make verbal misrepresentations to a borrower as an "agreement" within § 1823(e), *Langley* moved away from the customary definition of "agreement" as something more akin to a contract than a tort.[152] *Langley*, therefore, has allowed courts to apply § 1823(e) as a strict liability statute without *D'Oench*'s equitable underpinnings.[153]

c. *The 1989 Legislative Expansion of Section 1823(e) by FIRREA's Application of Section 1823(e) to Additional Parties*

Congress again revisited and expanded § 1823(e) in 1989. As originally enacted, § 1823(e) applied only to the FDIC in its *corporate insurer capacity*, when it purchases assets of a failed bank for which it is not acting as a receiver.[154] That section made no mention of its application to the FDIC as a *receiver* of a failed financial institution.[155] In 1989, however, Congress

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152. *Id.* at 92-93. "An agreement is the meeting of *two* or more minds; a coming together in opinion or determination; the coming together in accord of *two* minds on a given proposition." BLACK'S LAW DICTIONARY 67 (6th ed. 1990) (emphasis added) [hereinafter BLACK'S].

153. The Langleys could not have lent themselves to a scheme because they did not know of a scheme, so the court in *Langley* came to the wrong decision with respect to the *D'Oench* case. *See* Hymanson, *supra* note 36, at 310 (discussing *Langley* as an example of analyzing § 1823(e)); *see also* Jane Depper Goldstein, Langley v. FDIC: *FDIC Superpowers—A License to Commit Fraud*, 8 ANN. REV. BANKING L. 559, 580-81 (1989) (expressing deep concern over the expansion of the *D'Oench* doctrine by *Langley* and arguing both that *Langley* has endorsed a policy whereby the FDIC can recoup the public's losses from a few unfortunate individuals who have significant liability and that the FDIC, backed by insurance premiums and a 90% rate of recovery, is better positioned to bear the loss).

154. *See* FDIC v. Ashley, 585 F.2d 157, 161 (6th Cir. 1978) ("The FDIC was authorized by 12 U.S.C. § 1823(e) to act in its corporate capacity to purchase certain assets of a closed bank"); *accord* FDIC v. Blue Rock Shopping Ctr., Inc., 766 F.2d 744 (3d Cir. 1985).

> [The] FDIC insures bank deposits; as an insurer one of [the FDIC's] primary duties is to pay the depositors of a failed bank. In the course of fulfilling this duty, [the] FDIC frequently purchases the assets of a failed bank and then attempts to collect on them to minimize the loss to the insurance fund.

Id. at 748.

155. Before 1989, § 1823(e) applied only to assets "acquired by [the FDIC] under this section, either as security for a loan or by purchase [with no mention

directly addressed the issue in the FIRREA,[156] a comprehensive statute significantly changing the regulatory landscape of the banking industry in response to the banking crisis and S&L debacle of the late 1980s.[157]

FIRREA widened the purview of § 1823(e) to apply to the FDIC *in its receivership capacity*, as well as its corporate

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of FDIC as receiver]." 12 U.S.C. § 1823(e) (1988) (amended 1989 & 1994). This result was confirmed in 1982 in the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 113(m)(2), 96 Stat. 1469, 1474 (1982) (codified as amended at 12 U.S.C. § 1823(e) (1994)), which revised § 1823(e) but did not extend it to the FDIC as receiver. The pre-1989, pre-FIRREA language of § 1823(e) reflected the dichotomy between the FDIC in its corporate form and the FDIC in its receivership capacity, and the idea that the FDIC had to choose between liquidating a failed institution (as FDIC-Receiver) or pursuing other means to assist it such as purchasing some of its failed assets (which it could do as FDIC-corporate).

156. *See supra* note 73 (describing the adoption of FIRREA). *See generally* Lake, *supra* note 18, at 322 (calling FIRREA the "most fundamental reorganization of financial institution regulation since the Great Depression."). Lake describes the primary purposes of FIRREA as:

> (1) to promote a safe and stable system of affordable housing finance, (2) to improve the supervision of savings associations, (3) to place Federal Deposit Insurance funds in sound financial condition for the future, (4) to provide funds from public and private sources to deal expeditiously with failed financial institutions, and (5) to strengthen the enforcement powers of federal regulators of financial institutions.

Id.

157. *See generally* Swire, *supra* note 36 (analyzing the sweeping legislative and regulatory reforms brought about by FIRREA); Anthony C. Providenti, Jr., Note, *Playing with FIRREA, Not Getting Burned: Statutory Overview of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 59 FORDHAM L. REV. S323 (1991) (same). FIRREA first abolished the FSLIC. FIRREA, *supra* note 73, § 401(a)(1), 103 Stat. 183, 354 (1989) (repealing 12 U.S.C. §§ 1724-1730). The FSLIC was created in 1934, Act of June 27, 1934, ch. 847, tit. IV, § 402, 48 Stat. 1256 (repealed 1989), to perform functions for thrifts analogous to the functions performed by the FDIC for banks, such as insuring deposits. *See supra* notes 66-74 (discussing the functions of the FDIC). FIRREA also abolished the FHLBB. FIRREA, *supra* note 73, § 401(a)(2), 103 Stat. 183, 354 (1989) (repealing 12 U.S.C. § 1437). FHLBB, recall, chartered federal thrifts before FIRREA created the OTS to take its place. *Id.* § 301, 103 Stat. 183, 278 (1989) (codified as amended at 12 U.S.C.A. § 1462(a) (West Supp. 1996)). FIRREA also granted the FSLIC's powers to the FDIC. H.R. CONF. REP. NO. 222, 101st Cong., 1st Sess. 394 (1989), *reprinted* in 1989 U.S.C.C.A.N. 432, 433; *see* FIRREA, *supra* note 73, §§ 202, 209(1), 103 Stat. 183, 188, 216 (1989) (codified as amended at 12 U.S.C. §§ 1811(a), 1819 (1994)) (amending the FDIC's duties and powers to include S&Ls). FIRREA also created the RTC to administer the assets of insolvent thrifts. *Id.* § 501, 103 Stat. 183, 369 (1989) (codified as amended at 12 U.S.C. § 1441a(b)(1)(A), (b)(3)(A), (1994)); *see supra* note 73 (highlighting these major changes).

form.[158] This expansion had far-reaching implications because the FDIC's *D'Oench* powers now can be invoked whenever it is appointed or is acting as a receiver of a failed institution.[159] Additionally, the original § 1823(e) did not apply to the FSLIC, the predecessor to the RTC, in either its corporate or receivership capacity.[160] Although some courts began to apply § 1823(e) to the FSLIC before 1989,[161] FIRREA affirmatively expanded the statute's reach to include the RTC in its receivership capacity.[162] This tripled the application of § 1823(e)

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158. Section 1823(e) now refers to "[n]o agreement which tends to diminish or defeat the interest of the [FDIC] in any asset acquired by it under this section [corporate]. . . *or [acquired by it] as receiver of any insured depository institution* . . . ." 12 U.S.C. § 1823(e)(1) (emphasis added). FIRREA thus modified the first sentence of § 1823(e) to allow the FDIC its protections in either its corporate or its receivership form. FIRREA, *supra* note 73, § 217(4), 103 Stat. 183, 256 (1989) (codified as amended at 12 U.S.C. § 1823(e) (1994)).

159. Although § 1823(e) did not include the FDIC in any form other than its corporate capacity until FIRREA expanded it to FDIC-Receiver in 1989, courts began to apply it to FDIC-Receiver even before this statutory expansion. *See* FDIC v. McClanahan, 795 F.2d 512 (5th Cir. 1986). There, the debtor signed a blank promissory note with the understanding that terms would be filled in later. *Id.* at 516. The bank falsely told the debtor that his loan had been turned down, but kept the promissory note on its books. *Id.* at 514. When the bank failed, the FDIC, in its receivership capacity, successfully used the *D'Oench* doctrine to prevent the debtor from asserting his defenses. *Id.* at 516. To expand the *D'Oench* doctrine in this way the court had to rely on common law flexibility of the *D'Oench* case, but the court dropped the equitable background of *D'Oench* and applied the rigid four-part test of § 1823(e). *Id.*

160. Congress did not refer to the FSLIC in § 1823(e). It referred only to the FDIC. *See* 12 U.S.C. § 1823(e) (1994).

161. These decisions were based upon two early post-*D'Oench*, pre-§ 1823(e) cases. *See* FSLIC v. Third Nat'l Bank, 153 F.2d 678, 680 (6th Cir.) (citing *D'Oench*), *cert. denied*, 329 U.S. 718 (1946); FSLIC v. Kearney Trust Co., 151 F.2d 720, 725 (8th Cir. 1945) (citing *D'Oench* in an FSLIC case). *But see* Gray, *supra* note 36, at 276-77 (arguing that these two cases are not compelling because *D'Oench* was cited only for jurisdictional and choice of law purposes rather than on the merits). Other cases expanded on the concept that *D'Oench* applies to the FSLIC. *See, e.g.*, FSLIC v. Two Rivers Ass'n, 880 F.2d 1267, 1274 (11th Cir. 1989) (holding that the FSLIC has duties and powers "parallel" to those of the FDIC). It was not until the passage of FIRREA, however, and its abolishment of the FSLIC, that the matter was put to rest. *See supra* notes 73, 157 (describing the creation of FIRREA and abolition of the FSLIC). Still, prior to the passage of FIRREA a majority of courts applied the *D'Oench* doctrine to the FSLIC as well as the FDIC. Lake, *supra* note 18, at 316-17 n.14.

162. *See* FIRREA, *supra* note 73, § 217(4), 103 Stat. 183, 256 (1989) (amending § 1823(e) to extend coverage to the FDIC when acting in its receivership capacity); *id.* § 21A(b)(4) (assigning the RTC, when acting as a receiver, the same rights and duties exercised by the FDIC in its receivership capacity). The RTC has no "corporate capacity," as the FSLIC's insuring corporate function was absorbed by the FDIC, not the RTC. *See supra* notes 73,

because *D'Oench* and § 1823(e) are now available to use against those individuals who have a dispute with: (1) a failed S&L (by the RTC);[163] (2) a failed commercial bank (by the FDIC-Receiver);[164] and (3) a commercial bank in financial trouble (by the FDIC in its corporate capacity).[165]

FIRREA also amended other banking code sections to allow successor institutions and transferees of the FDIC to employ *D'Oench* and § 1823(e) powers. These amendments removed the disincentive on the part of successor institutions and transferees to assume assets and liabilities of failed institutions by putting the successor or transferee on equal footing with the FDIC. For example, *D'Oench* and § 1823(e) now can be invoked by "bridge banks,"[166] successor institutions organized by the FDIC to absorb the remaining assets of a failed bank.[167] With the old bank dissolved, and the bridge bank using the *D'Oench* shield against claims, wronged individuals of the old bank have no avenue for relief.[168]

The statutory changes outlined above explicitly expanded the scope of § 1823(e)'s application. But by 1989, when FIRREA was passed, judicial interpretation already had expanded significantly the scope of both *D'Oench* and the original

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157 and accompanying text (noting that FIRREA assigned certain functions of the FSLIC to the FDIC).

163. *See supra* note 73 and accompanying text (discussing the role of the RTC in its receivership capacity).

164. *See supra* notes 72, 155 and accompanying text (discussing the role of the RTC in its receivership capacity).

165. *See supra* note 154 and accompanying text (discussing the role of the FDIC in its corporate capacity).

166. Bridge banks are

> temporary institutions organized by the FDIC in order to take over the operations of a failed bank and preserve its going concern value while the FDIC seeks a more permanent solution to its problems. . . . Bridge banks, under 12 U.S.C. § 1821(n), are designed as temporary repositories of the business of a failed institution during a period in which the FDIC or RTC is attempting to arrange a permanent resolution of the institution. [They] are generally required to terminate operations within two years, wither by purchase and assumption transaction with a solvent institution, "privatization" through sale of stock to nongovernmental entities, or dissolution by means of a receivership.

MACEY & MILLER, *supra* note 3, at 648-49.

167. 12 U.S.C. § 1821(n)(4) (1994).

168. *See* Bell & Murphy and Assocs. v. Interfirst Bank Gateway, N.A., 894 F.2d 750, 754-55 (5th Cir.) (allowing a bridge bank, if authorized by FDIC to acquire the assets and liabilities of a failed financial institution, to invoke the *D'Oench* doctrine and § 1823(e) against a former debtor of the failed institution), *cert. denied,* Bell & Murphy and Assocs. v. FDIC, 498 U.S. 895 (1990).

§ 1823(e).[169] Consequently, although evidence of specific intent to give an expansive reading of the *D'Oench* doctrine may have been lacking both at *D'Oench*'s inception and at the enactment of § 1823(e), FIRREA's failure to restrain this expansive trend in 1989 demonstrated Congress's implicit approval of judicial interpretation to that point.[170]

5. The Common Law Expansion of the *D'Oench* Doctrine: Allowing Additional Parties to Take Advantage of *D'Oench*

Even before Congress extended the parties who can use *D'Oench* and § 1823(e) to include the RTC, bridge banks, and the FDIC as receiver, courts had stretched the application of § 1823(e) to include some of these additional parties. Moreover, even private parties, in certain circumstances, now can take advantage of *D'Oench* and § 1823(e). For example, a private solvent financial institution often will purchase some or all of a failed bank's assets from the FDIC.[171] Because the remaining

169. *See infra* Part II.C. (detailing the common law, judicial expansion of the *D'Oench* doctrine and the judicial interpretation of § 1823(e)). Note that much of that expansion occurred before FIRREA's passage in 1989.

170. *See* Sherman v. Hamilton, 295 F.2d 516, 520 (1st Cir. 1961) ("It is a well settled rule of statutory interpretation that when a statute has been the subject of judicial construction and the statute is substantially reenacted, there is a strong indication of an intent to adopt the construction as well as the language of the former enactment."), *cert. denied*, 369 U.S. 820 (1962). *But see* FCC v. Columbia Broadcasting Sys., 311 U.S. 132, 137 (1940) ("We are not, however, willing to rest decision on any doctrine concerning the implied . . . construction upon reenactment of a statute. The persuasion that lies behind that doctrine is merely one factor in the total effort to give fair meaning to language."). In response to the argument regarding implied expansion by silence, is the retort that FIRREA was not a "substantial" reenactment of § 1823(e), but only a mere modification of it. In any event, Congress certainly had the chance to limit the scope of application of § 1823(e) as it was being interpreted by the courts in 1989, but did not do so. There is an argument therefore that FIRREA represents congressional approval of the courts' common law judicial expansion of *D'Oench* and § 1823(e).

171. This is known as a "purchase and assumption" transaction.

> In purchase and assumption transactions, a solvent depository institution purchases assets and assumes liabilities of the failed institution. In some respects the purchase and assumption transaction resembles a merger of the failed institution into a solvent one, with the solvent institution paying something for the goodwill of the failed institution as well as for any regulatory advantages (such as relaxation of restraints on geographic expansion) that the transaction may offer. The FDIC makes up the remaining shortfall by cash assistance to the acquiring institution.

MACEY & MILLER, *supra* note 3, at 646; *see also* FDIC v. Bank of Boulder, 911 F.2d 1466, 1470 (10th Cir. 1990) (describing a purchase and assumption assets include loan obligations, the private bank usually enforces those obligations through collection actions. When the private institution attempts to collect from the former debtor, cases have ruled that the debtor often is precluded from raising any claim or defense against the institution. In such situations, the private institutions essentially have "stepped into the shoes" of the FDIC.[172]

Sound policy reasons support this particular extension from the standpoint of the original *D'Oench* doctrine. If such private parties could not take advantage of *D'Oench*, purchasing a loan from the FDIC would include assuming the risk that the debtor could avoid repaying the loan by alleging a secret agreement or verbal misrepresentation by the original bank.[173] *D'Oench* and § 1823(e) now free private parties[174] of such risk.[175]

B. FORM OVER SUBSTANCE AND THE INTERPRETIVE STRAIGHTJACKET OF 12 U.S.C. § 1823(e)

Section 1823(e) appears to provide a "safe harbor"[176] for borrowers wishing to protect the enforceability of their oral side agreements or verbal understandings. As primarily post-*Langley*

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transaction), *cert. denied*, 499 U.S. 904 (1991).

172. *See* Porras v. Petroplex Sav. Ass'n, 903 F.2d 379, 381 (5th Cir. 1990) (holding that claims and defenses barred as to FSLIC by *D'Oench* and 1823(e) are also barred as to a private party who purchased assets of the failed institution from the receiver).

173. Weiss & Kraus, *supra* note 18, at 274.

174. G. Douglas Welch, D'Oench, Duhme *Protections Extend to Private Parties Who Purchase a Failed Institution's Assets from the FSLIC:* Porras v. Petroplex Savings Association, *903 F.2d 379 (5th Cir. 1990)*, TEX. TECH L. REV. 237, 253 (1991).

175. *See, e.g.*, Dennis, *supra* note 89, at 174 n.36, 182 (noting that *D'Oench* recently has been applied to the Bridge Savings Association, the Farm Credit Administration, and the Securities Investor Protection Corporation and noting that courts have taken the once "pristine" *D'Oench* doctrine to "unforeseen territory" by applying it to parties such as those purchasing the assets of a failed institution). The author relies upon FDIC v. Newhart, 892 F.2d 47 (8th Cir. 1989), as proof of his claim. In *Newhart*, the FDIC purchased assets of a failed institution in its corporate capacity as part of a purchase and assumption transaction. *Id.* at 48. When the FDIC sued Newhart to recover on the failed assets, the purchaser substituted in place of the FDIC and continued the suit. *Id.* The court ruled this permissible, labeling the purchase and assumption transaction a valuable tool for the FDIC and stating that a contrary ruling would "emasculate" the use of the purchase and assumption transaction. *Id.* at 50.

176. The term and concept of a "safe harbor" are borrowed from Peter P. Swire, *Safe Harbors and a Proposal to Improve the Community Reinvestment Act*, 79 VA. L. REV. 349, 349 (1993).

case history illustrates, however, it is often impossible for borrowers to satisfy all of the stringently interpreted requirements of § 1823(e).[177] The hyper-technical requirements of § 1823(e),[178] no less than the *D'Oench* doctrine itself, thus often serve as a barrier for former borrowers opposing the FDIC.

1. The Writing Requirement

The first and most elemental requirement of § 1823(e)'s "categorical recording scheme"[179] is a writing.[180] A writing requirement is an historically and legally sound method of record keeping and prudent loan consideration.[181] For that reason, no commentator or policy maker has proposed dismissing this requirement in favor of relying on the mere word of the

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177. *See* Langley v. FDIC, 484 U. S. 86, 94-95 (1987) (construing the requirements of § 1823(e) narrowly when determining whether a borrower has entered into an enforceable side agreement or arrangement with the institution that will be later recognized by the FDIC and not prohibited by the *D'Oench* doctrine and refusing to engraft an equitable exception upon the plain terms of the statute such that borrower culpability is no longer required); Beighley v. FDIC, 868 F.2d 776, 782 (5th Cir. 1989) (holding that the four § 1823(e) requirements are "certain and categorical"); FDIC v. Cardinal Oil Well Servicing Co., 837 F.2d 1369, 1372 (5th Cir. 1988) (noting that Congress erected a "stout barrier" when it enacted § 1823(e)); RTC v. J.B. Centron Dev. Co., 637 N.E.2d 23, 27 (Ohio Ct. App. 1993) (holding that § 1823(e) affords no equitable exceptions where the agreement does not meet the four requirements). This does not necessarily mean, however, that a borrower cannot benefit from a strict application of § 1823(e). In a recent Third Circuit case, the court held that *D'Oench* does not apply to claims against bank subsidiaries. *See* Lesal Interiors, Inc. v. Echotree Assoc., L.P., 47 F.3d 607, 613 (3d Cir. 1995). The court refused to infer that "depository institutions", as required by § 1823(e)(2) (now (e)(1)(B)) includes bank subsidiaries. *Id.* This case raised the conflict between § 1823(e) and FDIC rules requiring bank subsidiaries to maintain independence. *Id.* at 613 & n.7.

178. Similar attention could be focused on strictly *D'Oench Duhme* cases rather than just § 1823(e). The use of the phrase *D'Oench* for purposes of this exposition refers to the overall application of *D'Oench* and § 1823(e) as a single doctrine.

179. *Langley*, 484 U.S. at 95.

180. 12 U.S.C. § 1823(e)(1)(A) provides that "[n]o agreement which tends to diminish or defeat the interest of the [Federal Deposit Insurance] Corporation in any asset acquired by it . . . either as security for a loan or by purchase . . . shall be valid against the Corporation unless such agreement *(A) is in writing. . . .* " (emphasis added).

181. *See Langley*, 484 U.S. at 91-92 (noting that the requirements of § 1823(e) allow bank examiners to rely on a bank's records and ensure that bank officials properly considered loans that the bank issued).

bank and borrower.[182] Although this basic requirement is logically necessary, no consensus yet exists regarding what constitutes an agreement "in writing" within the meaning of § 1823(e)(1)(A).

In *RTC v. J.B. Centron*,[183] for example, appellants argued that the terms of a proposed loan workout[184] outlined and approved by the S&L's loan committee constituted a writing under § 1823(e).[185] The agreement was in writing, had been approved by S&L officials, and would have been formally executed if the lender had not changed management and altered the terms of the workout agreement.[186] Despite this formality, the trial court ruled, with great dissatisfaction, that § 1823(e) did not protect the borrower against the RTC: "No writing exists that encompasses any final agreement. Therefore appellant has not established that his agreement is a writing under section 1823(e)."[187] The court interpreted § 1823(e)'s "in writing" requirement to mean that the side agreement must be a formally executed, binding written contract to be enforceable against the RTC. Similarly, the Eleventh Circuit held that a written document that states the terms of the agreement and is kept in the lender's files is insufficient to satisfy the writing requirement.[188] The court construed § 1823(e) to include only formally executed agreements and rejected a claim that a written lien

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182. One of the stated purposes of the *D'Oench Duhme* Reform Act, as introduced, is "to return the D'Oench doctrine to its original purpose by continuing to bar the enforcement of *unrecorded* agreements." S. 648, 104th Cong., 1st Sess. (1995) (emphasis added). The amended language retains the writing requirement. *Id. See also* FDIC v. Hamilton, 939 F.2d 1225, 1230 n.5 (5th Cir. 1991) (rejecting appellant's argument that pursuant to local banking customs, a farmer and his bank both understood the lending arrangement despite the fact that such was not memorialized in writing).

183. 637 N.E.2d 23 (Ohio Ct. App. 1993).

184. A loan workout refers to modifications in the loan agreement arrived at between the borrower and lender usually due to changed economic circumstances of the borrower. So, for example,

> the parties typically will agree on such matters as the revision of the interest rate or the time of repayment; the liquidation procedures of collateral prior to collection; or other similar extensions, modifications or renewals of the debt obligation which may be necessary or desirable due to changing business circumstances.

Galves, *supra* note 16, at 473.

185. *Centron*, 637 N.E.2d at 27.

186. *Id.* at 25-26.

187. *Id.* at 28.

188. Twin Constr., Inc. v. Boca Raton, Inc., 925 F.2d 378, 383-84 (11th Cir. 1991).

subordination consent signed by the lender constituted a writing.[189]

The Fifth Circuit took a broader approach in determining what may serve as evidence of the existence of a writing. That circuit allows borrowers to introduce a series of documents that make reference to an alleged agreement to prove the existence of a written agreement if the documents are signed and kept in the bank records.[190] In reaching this conclusion, the Fifth Circuit applied basic contract law principles and held that multiple documents, when read as a whole, could prove that a sufficient written agreement existed between the parties.

As the preceding discussion highlights, the Fifth and Eleventh Circuits disagree on the propriety of using general contract principles to decide what satisfies the writing requirement. Regulators obviously would prefer the Eleventh Circuit's approach, which simplifies and hastens the task of examining the bank records. Borrowers, in contrast, would prefer the Fifth Circuit's more relaxed and open approach. In either event, the existing uncertainty over how to prove that there is a written and executed side agreement makes it difficult for borrowers to

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189. *Id.* at 383. Section 1823(e)(1)(B) requires approval by the institution's loan committee or board of directors. The *Twin Construction* court addresses this requirement as it relates to execution to clarify what type of writings satisfy Subsection (1)(A). In *Twin Construction,* the owner of a shopping mall obtained a construction loan from Vernon S&L. *Id.* at 380. The owner hired the appellant contractors to build the mall. *Id.* When the owner failed to pay for the work performed, the appellants requested that Vernon S&L subordinate its lien as the lender in favor of that of the appellants. *Id.* Vernon refused to comply, however, despite the existence of a written consent form to do so which Vernon kept in its files. *Id.* Later, when Vernon failed and the FSLIC became the receiver, the FSLIC successfully argued that the appellants' claim based on the consent form was barred because it had not been executed. *Id.* at 381. *See also* Franklin Asaph Ltd. Partnership v. FDIC, 794 F. Supp. 402, 408 (D.D.C. 1992) (holding that evidence of an unexecuted agreement found on the bank's books, along with documents reflecting loan committee approval of the agreement, did not to meet the statutory requirements for a writing under § 1823(e)).

190. *See* Bank One Texas Nat'l Ass'n v. Morrison, 26 F.3d 544, 548 (5th Cir. 1994) (stating that loan applications, supporting bank documents, and banks' own internal memoranda are relevant to determine parties' intent with respect to a loan guarantee); RTC v. Daddona, 9 F.3d 312, 317 (3d Cir. 1993) (holding that documents such as letters, appraisals and loan committee minutes did not create a genuine issue of material fact as to the existence of an enforceable written agreement); Beighley v. FDIC, 868 F.2d 776, 782-83 (5th Cir. 1989) (allowing appellants to introduce 71 documents to prove that a writing existed), *reh'g denied* (Apr. 27, 1989).

know what is required to memorialize their side agreements.[191]

2. The Contemporaneous Requirement

Section 1823(e)'s second element requires that the agreement be executed contemporaneously with the acquisition of the asset by the depository institution and the borrower.[192] This requirement promotes sound lending practices and prevents fraudulent schemes,[193] such as the insertion of new terms through collusion with bank employees, when a bank appears headed for failure.[194] Because many courts have held that nothing short of same day execution satisfies the contemporaneous requirement,[195] however, borrowers have been left wonder-

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191. See *infra* Part III.E. for a full explanation of the advantages of a disclosure and filing system. In short, uncertainty would be reduced because borrowers would be made aware of the application of § 1823(e) and its requirements whenever they obtain a loan.

192. 12 U.S.C. § 1823(e)(1)(B) provides that the agreement must have been "executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution."

193. Such as that found in the *D'Oench* case. *See supra* notes 92-93 and accompanying text (discussing the facts of *D'Oench*).

194. *See, e.g.*, RTC v. Midwest Fed. Sav. Bank of Minot, 4 F.3d 1490, 1492-93 (9th Cir. 1993).

195. *See, e.g.*, Cardente v. Fleet Bank, 796 F. Supp. 603, 610-11 (D. Me. 1992) (refusing to accept that several loan documents constituted a single closing binder going into effect at the same time, and implying that nothing short of *same day execution* would satisfy the contemporaneous requirement). In *Cardente*, a commitment letter was issued on April 12, 1988; the lease was entered into on May 19, 1988; and two weeks later, on June 2, 1988, defendants executed and delivered to the bank the loan closing documents, including the note, mortgage and agreement. *Id.* at 607.

> Under section 1823(e)(2) [now (e)(1)(B)], an agreement not executed by the bank *"contemporaneously* with the acquisition of the asset" by that bank cannot serve to defeat the FDIC's interest in that asset. *See, e.g.*, FDIC v. P.L.M. Int'l, Inc., 834 F.2d 248, 253 (1st Cir. 1987) (release agreement dated April 17, 1983, was not executed contemporaneously with the letter of guaranty dated December 31, 1981); FDIC v. Cremona Co., 832 F.2d 959, 962 (6th Cir. 1987) (Partnership Agreement dated April 12, 1974, was not executed contemporaneously with the acquisition of any of the notes by the bank . . . and presented to and signed by the defendant at the same time as one of the notes), *cert. dismissed*, 485 U.S. 1017 (1988) [parallel citations omitted]; FDIC v. La Rambla Shopping Center, 791 F.2d 215, 220 (1st Cir. 1986) (the 1968 lease that is the subject of Defendant's counterclaim was not executed contemporaneously with the note that evidences the 1970 loan); Fleet Bank of Maine v. Steeves, 785 F. Supp. 209, 215 (D. Me. 1992) ("[T]he Agreement was executed approximately nine months before the First Note and more than two years before the Equity Line Agreement. It therefore fails to meet the second requirement under Section

ing whether § 1823(e) bars *all* modifications of loan agreements.[196]

Most modifications involve side agreements executed months or even years after the underlying loan transaction. For example, releases of personal guaranties almost always occur *after* the transaction to which they relate. As such, these releases could *never* meet the "contemporaneous" requirement of § 1823(e).[197] Yet this type of side agreement would be unnecessary if it were made contemporaneously with the original loan, because it then would be merely a separate provision of the original loan agreement. By ruling that "contemporaneous" acquisition is synonymous with "same day execution," courts reach inane results under the guise of doing justice.[198]

In response to this troubling interpretation, many borrowers have advanced equitable arguments to satisfy the contemporane-

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> 1823(e)(2)."); FDIC v. Friedland, 758 F. Supp. 941, 943 (S.D. N.Y. 1991) (investment agreement dated May 10 1984, was not executed contemporaneously with acquisition on the same date of a promissory note by the bank and, therefore, said agreement was not binding on FDIC under 1823(e)).

Id. at 611; *see also* RTC v. J.B. Centron Dev. Co., 637 N.E.2d 23, 28 (Ohio Ct. App. 1993) (finding that the contractor's workout agreement, in which the terms of repayment were simply restructured, did not satisfy the contemporaneous requirement).

A similar result was reached in FDIC v. Virginia Crossings Partnership, 909 F.2d 306 (8th Cir. 1990). There, a bank solicited two individuals to buy a housing project facing foreclosure, informing the individuals that an application for tax exempt financing of the project had been made to the city redevelopment agency. *Id.* at 307-08. Based on these representations, the individuals accepted the bank's offer and term of personal guaranty, and formed a partnership. In its acceptance, the newly formed partnership included a letter stating its understanding that the personal guaranties would be greatly reduced once the city granted the tax exempt financing. *Id.* at 308. Despite a call for equity by the partnership, the court found that this letter was not executed contemporaneously with the making of the note, and therefore was unenforceable under § 1823(e). *Id.* at 309. The court rejected the appellants' argument that "where the parties sufficiently evidence their awareness and acceptance of the written terms of a 'side' agreement at a time prior to approval by senior bank officials and execution of the final documents, the purpose of mutual contemporaneous execution is met." *Id.*

196. *See infra* notes 197-208 and accompanying text (discussing modifications and the requirements of § 1823(e)).

197. Thomas B. Hudson, *The RTC and FDIC Use the* D'Oench Duhme *Doctrine to Wipe Out Claims by Parties Against the Failed Banks and Thrifts*, MAG. OF BANK MGMT., Mar. 1992, at 64.

198. Of course, some courts realize that they are not doing justice and have gone to great lengths to complain about this within their opinions. *See supra* note 37 and accompanying text.

ous requirement. Borrowers challenging this portion of § 1823(e) have cited the dicta provided in *FDIC v. Manatt*[199] for support. In a footnote, the *Manatt* court questioned the assertion that the contemporaneous requirement would defeat a valid accord and satisfaction entered into by the bank, reasoning that such an agreement is never contemporaneously executed with the initial documents incurring the debt.[200] The judge surmised that "[s]urely Congress did not mean to preclude banks from getting something of value by an accord and satisfaction rather than nothing at all."[201] A federal district court also acknowledged that such an intent would be contrary to general business practice and common sense, but nonetheless held that alleged commitment letters given months after the asset was acquired by the bank did not satisfy § 1823(e).[202]

The Ninth Circuit's opinion in *RTC v. Midwest Federal Savings Bank of Minot*,[203] however, embraced the sound policy of *Manatt*, challenging the logic and commercial practicality of same day execution despite *Langley*.[204] In *Minot*, lenders executed a commitment letter more than two months before the final loan documents.[205] In a victory for common sense, and despite overwhelming case law to the contrary, the *Minot* court held that in the nature of a large real estate loan, "contemporaneous" may mean up to several months.[206]

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199. 922 F.2d 486 (8th Cir. 1991).

200. *Id.* at 488 n.4. The court footnoted its discussion of § 1823(e)(2) because the contemporaneous requirement was not at issue. The court ruled that the transfer of seven notes did not complete a valid accord and satisfaction, thereby eliminating the need to consider § 1823(e)(2). *Id.* at 489.

201. *Id.* at 488 n.4. However, this reasoning was not critical to the ultimate holding of the case.

202. RTC v. Crow, 763 F. Supp. 887, 893-95 (N.D. Tex. 1991). The court also properly deferred to the legislature in stating that "[t]he Wisdom of an Act of Congress is an issue we do not consider." *Id.* at 894 n.6 (quoting FDIC v. Manatt, 922 F.2d 486, 490 (8th Cir. 1991) (Gibson, J., concurring)). Of course, the wisdom, or perhaps more appropriately, the lack thereof, is precisely why this provision must be reconsidered and reformed.

203. RTC v. Midwest Fed. Sav. Bank, 4 F.3d 1490 (4th Cir. 1993).

204. *Id.* at 1501.

205. *Id.* at 1492.

206. *Id.* at 1500-01 (applying the *Manatt* dicta rationale to side agreements made *before* the acquisition of the final loan asset is made). The *Minot* court stated the following:

> We find *Manatt* persuasive and agree that satisfaction of the contemporaneousness requirement should be considered in light of commercial reality. General business practice requires more leniency than a few days when dealing with loans of this magnitude. Moreover,

As the *Minot* court recognized, the contemporaneous requirement has become nothing more than an arbitrary barrier to fair claims and defenses of borrowers. Because most judicial interpretations of this contemporaneous requirement reduce the amount of work that the receiver has to do in order to determine the status of an asset, the government has found the requirement to be an ideal tool to obtain quick summary judgments against former borrowers.[207] Governmental convenience certainly is not a sound reason for denying otherwise legitimate claims and defenses of borrowers. Clarification of the contemporaneous requirement is necessary so that future judges will not have to perform such intellectual and definitional contortions as those in *Minot* to apply § 1823(e) in a commercially reasonable and just way.[208]

3. The Requirement to Obtain the Approval of the Bank Board or Loan Committee

Section 1823(e)'s third requirement is that the financial institution must consider, approve, and record any side agreement to the loan transaction.[209] Courts consult the minutes of either the board of director's meeting or the institution's loan committee to determine whether the lender has complied. Reviewing the minutes should show that senior officials prudently considered the loan before it was made[210] and should

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> a Commitment Letter is part and parcel of this type of loan agreement. Therefore, we cannot say as a matter of law that a period of between two and three months under these circumstances rendered the Commitment Letter not contemporaneous. On the facts of the instant case, we conclude the Commitment Letter was contemporaneous with the preparation of the final loan documents in the sense that it takes several months to put together loans of this nature.

Minot, 4 F.3d at 1501; *see also* Erbafina v. FDIC, 855 F. Supp. 9, 12 (D. Mass. 1994) (finding a contemporaneous execution of a Loan Commitment Letter dated two days before the promissory note, despite the arguments of the FDIC).

207. If the otherwise legitimate agreement is not executed essentially on the same day as the underlying loan, the FDIC can escape responsibility for that agreement when it steps into the shoes of the failed bank. As such, collection on the loan once again becomes an easy windfall victory, instead of an uncertain and perhaps expensive collection lawsuit.

208. *See infra* notes 328-34 and accompanying text (arguing for execution in the ordinary course of business, rather than contemporaneously).

209. 12 U.S.C. § 1823 (e)(1)(C) provides that no agreement is valid against the government unless it "was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee. . . ."

210. Langley v. FDIC, 484 U.S. 91, 92 (1987).

protect against collusive reconstruction of loan terms by bank officials and borrowers.[211] This requirement thus ensures that any purported side agreement has the formal authority of the financial institution to execute the loan.

The problem, however, is that few borrowers know that an agreement must be documented in the official bank board or loan committee minutes for the agreement to be enforceable against the FDIC or RTC.[212] For example, in *RTC v. Wilson*,[213] thrift officials convinced Wilson to consolidate his partnership's existing loans with an additional personal loan, with the new consolidated loan bearing Wilson's name only.[214] Thrift officials assured Wilson, orally and in writing from the Executive Vice President of the thrift, that he would be responsible for only 50% of the consolidation loan.[215] This letter, representing a side agreement, never appeared in the meeting minutes of either the loan committee or the board of directors.[216] Applying the strict language of § 1823(e), the court held for the RTC, noting that "undocumented side agreements with a failed institution taken over by the FDIC are legally inadmissible to diminish or defeat the interests of the FDIC."[217]

Other courts have read even more stringent formalities into this requirement. In *RTC v. Ruggiero*,[218] the court found that although the "draft" minutes of a board meeting reflected the approval of the side agreement, the final, "official" board minutes did not, and therefore § 1823(e)'s requirement was not met.[219] Though the omission was merely clerical in nature, the court nonetheless concluded that the draft minutes represented only "unofficial" acts of the board, and as such failed to constitute an

211. *Id.*; *see also* D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447, 456-57 (1942) (noting that a secret agreement between a stockholder and a bank to defeat the rights of the bank creditors or receivers is indefensible).

212. The disclosure system proposed in Part III.E. directly addresses this problem by requiring banks to disclose to borrowers the existence and requirements of § 1823(e).

213. 851 F. Supp. 141 (D. N.J. 1994).

214. *Id.* at 143.

215. *Id.*

216. *Id.* at 145.

217. *Id.* at 144 (quoting Central W. Rental Co. v. Horizon Leasing, 967 F.2d 832, 841 (3d Cir. 1992)).

218. 977 F.2d 309 (7th Cir. 1992).

219. *Id.* at 316.

"official" act of the bank.[220] The statute, however, does not require that agreements be reflected in the "official" minutes. Instead, the court read this additional requirement into the statute.[221]

If other courts follow this trend, a sophisticated borrower, who has sufficient legal insight to request a copy of the board minutes to protect her agreement,[222] nonetheless might have an unenforceable agreement if that borrower failed to certify that the minutes were "official" and not draft minutes. Unrepresented and less sophisticated borrowers[223] have even less opportunity to meet § 1823(e)'s requirements.

A court's current interpretation of this requirement can lead to additional harsh results. For example, certain loans are

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220. *Id.*

221. *Id.* Indeed, there is a good argument against the court's decision to infer the term "official" for this subsection: had Congress meant for the side agreement to make it into only "official" minutes, it easily could have added the word "official" as it did in the next subsection (subsection (4) (now (1)(D)) requiring the agreement to be continuously an "official" record. *See* Thorne v. Jones, 57 N.W.2d 240, 241 (Mich. 1953). According to the *Thorne* court:

> It is elementary that statutes in *pari materia* are to be taken together in ascertaining the intention of the legislature, and that courts will regard all statutes upon the same general subject matter as part of 1 system. 'In the construction of a particular statute, or in the interpretation of any of its provisions, all acts relating to the same subject, or having the same general purpose, should be read in connection with it, as together constituting one law.'

Id. (quoting Remus v. City of Grand Rapids, 265 N.W. 755, 756 (Mich. 1936)). Of course, even if a lending institution records the side agreement in the loan committee or board minutes, it is important to remember that the agreement still must satisfy all four requirements—§ (e)(1)(A)-(D) of the statute. *See* 12 U.S.C. § 1823(e)(1)(A), (B), (D) (requiring a valid side agreement to be in writing, executed contemporaneously, and a continuous and official bank record); *see also* Inn at Saratoga Assocs. v. FDIC, 856 F. Supp. 111, 111 (N.D.N.Y 1994) (granting summary judgment motion against borrower whose side agreement satisfied § 1823(e)(3) (now (1)(C)) but not § 1823(e)(1), (2) and (4) (now (1)(A), (B), and (D)).

222. Requesting a copy of the side agreement from the bank is the essence of one academic reform proposal regarding the importance of proper recordation. *See* David Lawrence III, D'Oench *Spells Doom in Litigation Against Federal Banking Agencies*, 68 FLA. B.J. 36, 36 (1994). The problem with this call for proper recordation, however, is that it still leaves the ultimate authority with the lending institution to determine whether the agreement remains an "official" part of the bank's files.

223. Although the disclosure system proposed in Part III may not completely ensure that every unsophisticated borrower will fully understand all of the intricacies of § 1823(e), it would be a vast improvement from the status quo of providing absolutely no disclosure or warning about the harsh requirements of § 1823(e).

approved by the vote of an "executive committee" or other committee of the board. Section 1823(e), however, includes only "board" or "loan committee" minutes. Hence, a strict interpretation of the statute again would find the requirement not satisfied. Additionally, the statute fails to clarify whether the minutes need to reflect all specific terms of the agreement or merely that an agreement exists.[224] Again, such a stringent interpretation might render an otherwise valid written side agreement unenforceable for lack of detail in the appropriate minutes. This requirement of § 1823(e), then, rather than ensuring that actual side agreements are properly approved by bank officials, often gives the FDIC another legal technicality through which it can escape responsibility for an otherwise valid side agreement.

4. The Continuous and Official Recordation Requirement

Section 1823(e)'s final and perhaps most egregious element is that a valid side agreement, from the time of its execution, must be continuously maintained as an official record of the bank.[225] Borrowers have no way to ensure compliance with this requirement. Whether a lending institution keeps an agreement in its official files, and whether the institution keeps it there continuously, are factors over which the borrower simply has no control, as banks do not allow customers to inspect their official files.[226] Because borrowers must rely on the *unilateral* actions of the financial institution to meet this requirement, they remain at the mercy of their institution's honest filing mistakes or dishonest behavior.

For example, assume federal agents are scheduled to examine a bank. Bank employees naturally want the bank's loan portfolio to appear as strong as possible, with no contingent

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224. Stillman, *supra* note 140, at 112.

225. In order for a side agreement to be valid and enforceable, it must have "been, continuously, from the time of its execution, an official record of the depository institution." 12 U.S.C. § 1823(e)(1)(D).

226. There is no way a borrower can ensure that the bank is fulfilling its duty to keep the side agreement continuously in the official bank records in compliance with § 1823(e)(1)(D). *See* Hudson, *supra* note 197, at 64 (suggesting that the borrower obtain a certificate from the bank stating that the agreement has been executed, approved by the appropriate committee, recorded in the committee minutes, and kept continuously in the bank's official records). Although this is probably "better than nothing," it is cumbersome, unrealistic and still does not ensure the bank's compliance.

liabilities or collection weaknesses evidenced by § 1823(e) side agreements.[227] A dishonest bank officer thus might physically remove a particular side agreement from the bank's official files to hide the weakness of the underlying loan. Alternatively, in a less sinister plot, bank employees might misfile or lose the document. In either event, the result is the same: the bank's federal regulatory examiners charged with analyzing the bank's books and loans for general "safety and soundness"[228] never see the missing side agreement. Consequently, the examiners would not record or acknowledge the side agreement, and § 1823(e) would not allow the borrower to rely on it in a lawsuit against the FDIC.

If this hypothetical bank were to fail, the FDIC, as receiver, would be responsible for seizing the bank, assessing the value of the loan assets, and reopening the bank under new management as quickly as possible.[229] The congressional directive to resolve failed institutions with the least cost to the insurance fund,[230] coupled with the blanket protection of the *D'Oench* doctrine and

227. "Performing" loans, those in which the borrower has not defaulted, is paying on time, and is not requesting a modification lowering the interest rate or a principle reduction, are obviously much stronger assets for the bank than those where a borrower has obtained a reduction in interest and/or principal payments, or is being allowed to make late payments or other favorable treatment pursuant to a side agreement or alleged verbal representations made by bank officials. Recall that, in the *D'Oench* case itself, the bank's whole incentive for engaging in the secret side agreement with D'Oench was to hide nonperforming assets in an effort to bolster the strength of the bank's balance sheets. D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447, 454 (1942).

228. Bank examiners have the power to terminate any activity of a bank that they find to be "unsafe or unsound" administration of bank affairs. *See* 12 U.S.C. § 1818(b) (empowering the federal banking agency to issue a cease-and-desist order against a lending institution for an "unsafe or unsound" practice). In order to assess whether a bank is engaging in such activities, periodic examinations of the bank must take place. *See* 12 U.S.C. § 378(2)(c) (requiring lending institutions to submit to periodic examinations by banking authorities).

229. This assumes that it is not a straight liquidation payout. *See supra* notes 154-59 and accompanying text (describing the FDIC's general duties as a receiver of a failed bank and methods of resolution). Note also that the other banking regulators, such as the OCC and OTS, lack any incentive to look beyond the official bank records precisely because they are aware of the operation of *D'Oench* and § 1823(e) which do not require them to do so. *See supra* note 69 (explaining these agencies' duties and responsibilities as regulators and examiners of financial institutions). So as long as *D'Oench* and § 1823(e) are in operation, the regulators have no duty, responsibility, or incentive to look beyond the official bank records.

230. *See supra* notes 68-87 and accompanying text (discussing the intent for the FDIC to resolve failed institutions).

§ 1823(e), encourages bank examiners to look only to the official bank loan files in their collection actions. In limiting its inspection to the few files that are considered official, the FDIC later could claim "honestly" that it never saw the side agreement either during a routine examination or when reviewing the bank's loan files after seizure. Moreover, the FDIC even may argue that because an officer removed the agreement, the agreement was not "continuously an official bank record" and thus is unenforceable. As this hypothetical demonstrates, the FDIC has no incentive to determine the existence of otherwise valid side agreements unless they reside in the bank's "official" files.[231]

This unbending interpretation of § 1823(e)(1)(D) can lead to unfair results even when the FDIC is aware of the agreement. For example, a bank officer might remove a side agreement temporarily, but long enough that examiners never see it or record it during subsequent on-site examinations of the bank's files. Although the officer later returns the agreement to the "official" files, it is no longer a "continuous" record because its continuity has been interrupted. The FDIC thus could physically possess the agreement, but still argue that the agreement's lack of continuity in the files precludes its use in litigation. Alternatively, bank records clearly could refer to an agreement filed elsewhere. In one such case, other documents in the bank's files referenced the agreement at issue. However, the court strictly adhered to § 1823(e), reasoning that reference to an agreement was not sufficient to enable the RTC to make an overnight evaluation of the thrift's remaining assets.[232]

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231. *See* FDIC v. Manuel de Jesus Velez, 678 F.2d 371, 375 (1st Cir. 1982) (determining that even records kept in the bank president's personal safe still do not satisfy § 1823(e)(1)(D)).

232. RTC v. McCroy, 951 F.2d 68, 72 (5th Cir. 1992). In *McCroy*, an agreement that limited the liability of the general partners for a real estate purchase had been fully executed, but was stored in the files of the bank's attorney, who kept offices on the same floor and in the same building as the bank. *Id.* at 70; *see also* Bowen v. FDIC, 915 F.2d 1013 (5th Cir. 1990) wherein the court states:

> The doctrine means that the government has no duty to compile oral histories of the bank's customers and loan officers. Nor must the FDIC retain linguistics and cryptologists to tease out the meaning of facially unencumbered notes. Spreadsheet experts need not be joined by historians, soothsayers, and spiritualists in a Lewis Carroll-like search for a bank's unrecorded liabilities.

Id. at 1016.

These cases suggest that courts favor governmental expediency at the expense of equity and justice,[233] when justice actually should seek to avoid these kind of results. The law should not punish an innocent borrower by rendering an otherwise valid written side agreement unenforceable against the FDIC simply because of the bank's illegitimate or negligent actions in failing to comply with § 1823(e)'s administrative directive to keep the side agreement as a continuous, official bank record. The law should seek to punish wrongdoers who violate a legal duty, not innocent bystanders for actions over which they have no control or responsibility.

C. THE COMMON LAW AND STATUTORY EXPANSION OF THE *D'OENCH* DOCTRINE AND SECTION 1823(e) IN GENERAL: PUTTING IT ALL TOGETHER

The congressional expansion of *D'Oench* through § 1823(e) and FIRREA, the creation of the federal HIDC doctrine which extends *D'Oench*'s application to various additional parties, and the judicial expansion of *D'Oench* through stringent interpretation of § 1823(e) have multiplied the number and scope of claims and defenses the *D'Oench* doctrine prevents. Not surprisingly, the *D'Oench* doctrine's cumulative effect has been overwhelming. This section catalogues many of the claims and defenses now barred by the *D'Oench* doctrine and § 1823(e), as well as those few claims and defenses that have managed to escape their purview.

Following is a list of affirmative claims and defenses that the *D'Oench* doctrine and/or § 1823(e) prohibit:[234]
1) Absence of direct dealing with the failed institution;[235]

233. Even when the FDIC clearly is aware of the side agreement, courts have held that the agreement is unenforceable under § 1823(e). *See* FDIC v. Gardner, 606 F. Supp. 1484, 1487 (S.D. Miss. 1985) (determining that even though the FDIC produced agreement in discovery and thereby revealed that it must have found it in the bank's records, the agreement nonetheless was insufficient).

234. This list is not intended to be exhaustive, but rather is illustrative of the wide number of defenses asserted. Most of these defenses were compiled from the following sources: Barry, *supra* note 106, at 1134-48; Dennis, *supra* note 89, at 174-77; Galves, *supra* note 16, at 474; Gray, *supra* note 36, at 276-77; Sacks, *supra* note 103, at 1428.

235. *See* Robinowitz v. Gibraltar Sav., 23 F.3d 951, 956 (5th Cir. 1994) (applying *D'Oench* to wholly owned subsidiaries of a failed bank), *cert. denied*, 115 S. Ct. 725 (1995); Adams v. Madison Realty & Dev. Inc., 937 F.2d 845, 857-58 (3d Cir. 1991) (applying *D'Oench* to notes acquired by the RTC through the

2) Accord and satisfaction;[236]
3) Breach of condition precedent;[237]
4) Breach of a fiduciary duty and breach of duty of good faith and fair dealing;[238]
5) Conspiracy;[239]
6) Constitutional challenges: procedural due process and uncompensated taking of private property;[240]
7) Deceptive trade practices;[241]
8) Doctrine raised for the first time on appeal;[242]
9) Failure of consideration;[243]

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closure of a failed bank, even though the failed bank purchased notes in a secondary market).

236. *See* Public Loan Co., Inc. v. FDIC, 803 F.2d 82, 85 (3d Cir. 1986) (finding that § 1823(e) bars a defense of oral accord and satisfaction when a debtor claims he paid the bank the full amount owed on a letter of credit but the bank did not return the posted letter); FDIC v. Hoover-Morris Enters., 642 F.2d 785, 787-88 (5th Cir. Unit B. Apr. 1981) (holding under Georgia state law that unexecuted accord and satisfaction is not a valid defense).

237. D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447, 449 (1942).

238. *See* Texas Refrigeration Supply, Inc. v. FDIC, 953 F.2d 975, 983 (5th Cir. 1992) (applying the *D'Oench* doctrine to oral promises made by a bank to apply a debtor's receivables to further finance the debtor, even though the bank applied receivables to debt reduction because the debtor's breach of fiduciary duty claim was based on an oral promise); Timberland Design, Inc. v. First Serv. Bank for Sav., 932 F.2d 46, 50 (1st Cir. 1991) (barring a debtor from asserting a claim of oral agreement, even if the claim is based in tort).

239. *See In re* 604 Columbus Ave. Realty Trust, 968 F.2d 1332, 1345-46 (1st Cir. 1992) (prohibiting a debtor from raising a claim that the lender's kickback scheme siphoned funds from a trust).

240. *See* California Hous. Sec., Inc. v. U.S., 959 F.2d 955, 960 (Fed. Cir.) (ruling that the RTC's possession of a debtor's offices is not a Fifth Amendment taking), *cert. denied*, 113 S. Ct. 324 (1992); Chatham Ventures, Inc. v. FDIC, 651 F.2d 355, 362 (5th Cir. Unit B July 1981) (holding that a debtor was not deprived of constitutional rights when the FDIC asserted the *D'Oench* doctrine and retroactively altered the debtor's substantive rights), *cert. denied*, 456 U.S. 972 (1982).

241. *See Texas Refrigeration*, 953 F.2d at 983 (ruling that *D'Oench* unequivocally bars a deceptive trade practice claim). *But see* FSLIC v. Mackie, 962 F.2d 1144, 1150-51 (5th Cir. 1992) (determining that where the deceptive trade practice is clear from the a written agreement, the *D'Oench* doctrine does not bar the defense).

242. Lemaire v. FDIC, 20 F.3d 654, 656-57 (5th Cir. 1994) (allowing the RTC to raise the *D'Oench* doctrine for the first time on appeal if the FDIC had no opportunity to raise the issue at the trial court), *cert. denied*, Scales v. FDIC, 115 S. Ct. 723 (1995); Baumann v. Savers Fed. Sav. & Loan Ass'n, 934 F.2d 1506, 1512-14 (11th Cir. 1991) (allowing the *D'Oench* doctrine to be raised for the first time on appeal, as long as the RTC was not a proper party at the trial level), *cert. denied*, 112 S. Ct. 1936 (1992).

243. D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447, 460 (1942); CMF Virginia Land L.P. v. Brinson, 806 F. Supp. 90, 94 (E.D. Va. 1992) (allowing a

10) Fraud, fraudulent inducement, and misrepresentation;[244]
11) Oral or written side agreements, promises, or understandings;[245]
12) Homestead exemption (simulated sale);[246]
13) Knowledge or imputed knowledge of side agreements by regulatory agencies or examiners;[247]
14) Laches;[248]
15) Mitigation of damages;[249]
16) Debt instrument modification after borrower's execution;[250]
17) Mutual mistake;[251]
18) Negligence;[252]
19) No actual reliance by FDIC or RTC;[253]

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purchaser of assets from the RTC to bar the defense of lack of consideration on a loan guaranty by asserting the *D'Oench* doctrine).

244. FDIC v. Payne, 973 F.2d 403, 407 (5th Cir. 1992) (prohibiting debtor's fraudulent inducement defense, and holding that an innocent borrower defense no longer exists); FSLIC v. Lafayette Inv. Properties, Inc., 855 F.2d 196, 198 (5th Cir. 1988) (barring a fraud claim); Langley v. FDIC, 484 U.S. 91, 93 (1987) (barring a fraud claim).

245. *D'Oench,* 315 U.S. at 459; Savers Fed. Sav. & Loan Ass'n v. Amberley Huntsville, Ltd., 934 F.2d 1201, 1207 (11th Cir. 1991) (blocking a debtor from asserting a defense based on an oral or written side agreement that was not part of the initial transaction and that did not appear in the bank's records).

246. Templin v. Weisgram, 867 F.2d 240, 242 (5th Cir.) (disallowing a defense of simulated sale even if all parties enter into the side agreement), *cert. denied,* 493 U.S. 814 (1989).

247. Twin Constr., Inc. v. Boca Raton, Inc., 925 F.2d 378, 383 (11th Cir. 1991) (stating that the FSLIC's actual knowledge of an S&L's obligation relating to a construction contract did not prevent the use of the *D'Oench* doctrine); FDIC v. Merchants Nat'l Bank, 725 F.2d 634, 640 (11th Cir. 1984) (ruling that the FDIC is not imputed with knowledge which bank examiners may have discovered; knowledge irrelevant).

248. FDIC v. Fonseca, 795 F.2d 1102, 1109 (1st Cir. 1986) (blocking the defense of laches to actions brought by the FDIC in its corporate capacity); *see also* RTC v. Hecht, 818 F. Supp. 894, 900 (D. Md. 1992) (allowing the RTC to use the *D'Oench* doctrine against a defense of laches).

249. FSLIC v. Musacchio, 695 F. Supp. 1044, 1053 (N.D. Cal. 1988) (ruling that a banking agency need not mitigate damages when using the *D'Oench* doctrine).

250. FSLIC v. Murray, 853 F.2d 1251, 1255 (5th Cir. 1988) (applying the *D'Oench* doctrine where signature pages were signed in blank and later appended to documents other than those the maker intended).

251. FDIC v. Dureau, 261 Cal. Rptr. 19, 23 (Cal. Ct. App. 1989) (barring a claim that a debtor did not read the document before signing it).

252. RSR Properties, Inc. v. FDIC, 706 F. Supp. 524, 531-33 (W.D. Tex. 1989) (barring debtors' negligence or other tort actions against a bank).

253. FDIC v. First Nat'l Fin. Co., 587 F.2d 1009, 1012 (9th Cir. 1978) (determining that a showing of actual reliance by the FDIC as a receiver is not required under the *D'Oench* doctrine).

21) Non-promissory note debt instruments;[254]
22) Promissory or equitable estoppel and waiver;[255]
23) Securities law violations;[256]
24) Setoff;[257]
25) Tying arrangements;[258]
26) Undue influence, duress, and coercion;[259]
27) Unjust enrichment;[260] and
28) Usury that is evident on the face of the document.[261]

Neither the *D'Oench* doctrine nor § 1823(e) have, as yet, overcome the following defenses:[262]

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254. FDIC v. Laanen, 769 F.2d 666, 667 (10th Cir. 1985) (per curiam) (prohibiting an assumption agreement carried on a bank's books).

255. Texas Refrigeration Supply, Inc. v. FDIC, 953 F.2d 975, 983 (5th Cir. 1992). *But see infra* note 266 and accompanying text (noting that courts apply estoppel theory to the FDIC's or RTC's own misconduct).

256. Gunter v. Hutcheson, 674 F.2d 862, 865-66 (11th Cir.); FDIC v. Investors Assocs. X, Ltd., 775 F.2d 152, 155-56 (6th Cir. 1985) (preventing a debtor from asserting securities law violations as a defense), *cert. denied*, 459 U.S. 826 (1982).

257. Mainland Sav. Ass'n v. Riverfront Assocs., 872 F.2d 955, 956 (10th Cir.) (disallowing setoff claims based on fraud, gross negligence, reckless conduct, breach of agreement to fund, and breach of implied covenant of fair dealing), *cert. denied*, 493 U.S. 890 (1989). *But see infra* note 264 and accompanying text (listing cases recognizing an exception in the limited situation where the setoff claim is based on the breach of a bilateral obligation arising from the instrument the FDIC seeks to enforce).

258. Newton v. Uniwest Fin. Corp., 967 F.2d 340, 346-47 (9th Cir. 1992) (preventing a defense based on an illegal tying agreement); NCNB Texas Nat'l Bank v. King, 964 F.2d 1468, 1470-71 (5th Cir. 1991) (per curiam) (precluding defenses based on oral agreements that violate the Bank Tying Act), *cert. denied*, 504 U.S. 956 (1992).

259. FSLIC v. Musacchio, 695 F. Supp. 1044, 1052 (N.D. Cal. 1988). *But see* Desmond v. FDIC, 798 F. Supp. 829, 836-39 (D. Mass. 1992) (allowing a debtor's duress claim where the lender forced the debtor's counsel to renegotiate due to a conflict at a crucial point during negotiations to gain an unfair bargaining position).

260. FDIC v. Gulf Life Ins. Co., 737 F.2d 1513, 1518 (11th Cir. 1984).

261. Union Fed. Bank v. Minyard, 919 F.2d 335, 336 (5th Cir. 1990) (per curiam) (holding that the *D'Oench* doctrine bars claims of usury when usury is not evident on the face of the document); FDIC v. Leach, 772 F.2d 1262, 1266 (6th Cir. 1985). *But see infra* note 273 and accompanying text (noting that the *D'Oench* doctrine has not overcome the defense of usury that is not apparent on the face of the document).

262. This list is meant to demonstrate the small number of defenses remaining. Most of these defenses were compiled from the following sources: Barry, *supra* note 106, at 1134-48; Dennis, *supra* note 89, at 174-77; Galves, *supra* note 16, at 474; Gray, *supra* note 36, at 276-77; Sacks, *supra* note 103, at 1428.

1) Asset deemed not to exist;[263]
2) Bilateral agreements;[264]
3) Conversion;[265]
4) Equitable estoppel;[266]
5) Equitable subordination of mechanic's liens;[267]
6) Fraud in the factum;[268]

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263. FDIC v. Nemecek, 641 F. Supp. 740 (D. Kan. 1986). In *Nemecek*, the bank and borrower recorded an accord and satisfaction before the bank's insolvency. *Id.* at 742. The Court held that FDIC as receiver never acquired the debt obligation as an asset from the failed land bank and therefore the *D'Oench* doctrine did not apply. *Id.* at 742-43. *Accord* FDIC v. McFarland, 33 F.3d 532, 538-39 (1994) (disallowing the application of the *D'Oench* doctrine to bar the debtor from asserting a guaranty has been satisfied if the release is in writing and reflected in the bank's records).

264. RTC v. Oaks Apartments Joint Venture, 966 F.2d 995, 1000-01 (5th Cir. 1992) (prohibiting the application of the *D'Oench* doctrine where the very document the RTC seeks to enforce against the debtor imposes obligations on the lender which the lender has breached); Howell v. Continental Credit Corp., 655 F.2d 743, 746 (7th Cir. 1981) (holding that the *D'Oench* doctrine is inapplicable where the document the FDIC seeks to enforce "facially manifests *bilateral* obligations and serves as the basis of [the other party's] defense").

265. RTC v. Wellington Dev. Group, 761 F. Supp. 731, 738 (D. Colo. 1991) (ruling that the RTC could not assert the *D'Oench* doctrine if the institution did not apply funds to reduce the debtor's note, and instead converted funds to its own use).

266. FDIC v. Blue Rock Shopping Ctr., Inc., 766 F.2d 744, 753-54 (3d Cir. 1985) (preventing the FDIC from asserting the *D'Oench* doctrine to protect the FDIC from the consequences of its own misconduct, since it would be aware of its misconduct and should not profit from it); FDIC v. Harrison, 735 F.2d 408, 411-12 (11th Cir. 1984) (holding that the FDIC is subject to equitable estoppel ensuing from acts and representations of FDIC agents). *But see* FDIC v. Patel, 46 F.3d 482, 486 (5th Cir. 1995) (finding that the FDIC is not bound by a misrepresentations by a bank which purchased a note through a purchase and assumption transaction from the FDIC in its receivership capacity, and then gave the note to the FDIC in its corporate capacity to begin collection, since the *D'Oench* doctrine barred the debtor's claim).

267. FSLIC v. Dillon Constr. Co., 681 F. Supp. 1359, 1364 n.4 (E.D. Ark. 1988) (allowing a first lender to assert an equitable subordination defense following the FDIC's attempt to foreclose on a home without allowing the first lender to collect on the improvements because the first lender was wholly innocent of any attempt by debtor, who built a home on a lot other than the one specified in the loan agreement, to deceive the FSLIC); *In re* C.P.C. Dev. Co. No. 5, 113 B.R. 637, 641 (Bankr. C.D. Cal. 1990) (determining that a creditor fraudulently induced by the debtor to subordinate its claim to that of another creditor was not barred by the *D'Oench* doctrine from asserting a claim for equitable subordination and fraudulent nondisclosure).

268. *See* Langley v. FDIC, 848 U.S. 91, 93-94 (1987) ("[T]he real defense of fraud in the factum - that is, the sort of fraud that procures a party's signature to an instrument without knowledge of its nature or contents - would take the instrument out of § 1823(e)."); FDIC v. Turner, 869 F.2d 270, 273-74 (6th Cir. 1989) (stating that where a guarantor is defrauded as to the essential terms of

7) Non-loan transactions;[269]
8) Payment;[270]
9) Torts affecting the value or disposition of collateral;[271]
10) Transactions between solvent institutions;[272]
11) Usury that is not evident on the face of the document;[273]
12) Void liens;[274] and
13) Judicially voided debt instruments.[275]

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a guaranty, there is fraud in the factum and the *D'Oench* doctrine is inapplicable).

269. John v. RTC, 39 F.3d 773, 776 (7th Cir. 1994) (ruling that where a bank fraudulently induced the purchase of a home through a third party and did not disclose that the house had subsided, § 1823(e) does not apply to the purchase contract).

270. FDIC v. Bracero & Rivera, Inc., 895 F.2d 824, 827-30 (1st Cir. 1990) (determining that where a borrower paid the outstanding balance on a note to a bank and received credit voucher from the bank, the FDIC could not claim that the note was still valid simply because it had not been stamped "paid, canceled, void, or otherwise," and a deed subsequently executed; rather, the note was invalidated by acts independent of a secret agreement and the note therefore was not an asset protected by § 1823(e)); FDIC v. Grupo Girod Corp., 869 F.2d 15, 18 (1st Cir. 1989) (holding that the FDIC's actual knowledge of the payment of a promissory note by a borrower where a ledger at a bank is stamped "paid" may prevent the FDIC from asserting the *D'Oench* or HIDC doctrines).

271. Texas Refrigeration Supply, Inc. v. FDIC, 953 F.2d 975, 981 (5th Cir. 1992) (stating that a lender's obligations to accelerate payment only for good cause and to dispose of collateral only in a commercially reasonable manner are "implicit in every promissory note" and are not barred by the *D'Oench* doctrine); New Conn. Bank & Trust Co. v. Stadium Management Corp., 132 B.R. 205, 209-10 (D. Mass. 1991) (allowing an impairment of collateral claim because the *D'Oench* doctrine's purpose is not to protect "negligent acts by lender").

272. First Interstate Bank of Tex. v. First Nat'l Bank of Jefferson, 928 F.2d 153, 155-56 (5th Cir. 1991) (ruling that a solvent institution may not use the *D'Oench* doctrine to bar the enforcement of a transaction between two solvent institutions simply because it has not been reported to the FDIC).

273. *But see* FDIC v. Wood, 758 F.2d 156, 161-62 (6th Cir.) (finding that whether or not the usury is evident from the face of the document, the FDIC's HIDC power bars debtor from asserting this), *cert. denied*, 474 U.S. 944 (1985).

274. FDIC v. RepublicBank, Lubbock, 883 F.2d 427, 429 (5th Cir. 1989) (disallowing the FDIC's use of the *D'Oench* doctrine to invalidate a first lien that was not reflected in a bank's records and then to assert a second lien, because the second lien was at all times subordinate to the first lien under Texas law). *But see* Buchanan v. FSLIC, 935 F.2d 83, 85 (5th Cir.) (stating that although a lien was void under state law because its express recital was not fulfilled, the *D'Oench* doctrine barred the borrower's defense that the lien was void because she "lent herself to a scheme" by signing it), *cert. denied*, Buchanan v. First Gibraltar Bank, FSB, 502 U.S. 1005 (1991).

275. Grubb v. FDIC, 868 F.2d 1151, 1158 (10th Cir. 1989) (holding that the FDIC could not enforce notes against a debtor where previously a federal court voided liens due to securities law violations); Olney Sav. & Loan Ass'n v. Trinity

Recently, some courts have complained bitterly about the harshness of the *D'Oench* doctrine, and have refused to expand it further.[276] If the *D'Oench* doctrine truly is reaching its final expansion, now is an excellent time to consider its reform.[277]

III. THE CALL FOR SIGNIFICANT REFORM OF THE D'OENCH DOCTRINE AND SECTION 1823(e)

A. RESISTING THROWING THE BABY OUT WITH THE BATH WATER

Moderation in temper is always a virtue.[278]

In light of the severe injustice caused by the expansive application of the *D'Oench* doctrine and § 1823(e), it is tempting to call for the complete legislative repeal of § 1823(e) and the

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Banc Sav. Ass'n, 885 F.2d 266, 275 (5th Cir. 1989) (holding that § 1823(e) does not apply where a court judgement has been entered prior to the FDIC acquiring the note).

276. *See, e.g.*, Murphy v. FDIC, 38 F.3d 1490 (9th Cir. 1994) [hereinafter *Murphy II*]. There, the Ninth Circuit, *en banc*, reversed an earlier decision of the Ninth Circuit, Murphy v. FDIC, 12 F.3d 1485 (9th Cir. 1993) [hereinafter *Murphy I*], which had upheld the use of the *D'Oench* doctrine by the FDIC to prevent the payment of a standby letter of credit issued by a bank to a parent company. The Ninth Circuit ruled that a standby letter of credit issued by a failing bank was a liability, not an asset, and that § 1823(e) therefore did not apply. *Murphy II*, 38 F.3d at 1500. The court based its decision, oddly enough, on the idea that the *D'Oench* doctrine cannot be used against a claimant who is innocent of participating in any misleading scheme. *Id.* at 1498. However, as Harris Ominsky notes, FIRREA may yet be used to greater effect in the future against burdensome contracts, leases, and letters of credit. *Letters of Credit Withstand FDIC Rejection*, UCC BULL., Mar. 1995, at 1-3. Similarly, in E.I. Du Pont de Nemours and Co. v. FDIC, 45 F.3d 458 (D.C. Cir. 1995) [hereinafter *Du Pont II*], the court refused to reconsider its earlier decision in E.I. Du Pont de Nemours and Co. v. FDIC, 32 F.3d 592 (D.C. Cir. 1994) [hereinafter *Du Pont I*]. The 1995 decision left intact the 1994 decision that prevented the FDIC from asserting the *D'Oench* doctrine against a claim that the bank had entered into an escrow agreement with Du Pont. *See Du Pont I*, 32 F.3d at 598 ("Despite the FDIC's suggestion to the contrary, we think the *D'Oench* doctrine must have some boundaries. . . . . when one bears in mind what is at stake here, namely the negation of potentially valid state law claims . . . ."). The court, in the 1994 decision, had ruled that even if the escrow agreement had been in the bank's files, the FDIC would not have been apprised of the bank's potential liability for breach of fiduciary duty. *Id.* at 600. The court, interestingly, suggested that it knew of no other court that had applied the *D'Oench* doctrine where a regulator had not, or was not likely to be misled. *Du Pont II*, 45 F.3d at 459.

277. *See infra* Part III (discussing possible reform of the *D'Oench* doctrine).

278. Thomas Paine, *The Rights of Man,* 1791, *quoted in* BARTLETT'S FAMILIAR QUOTATIONS 341:8 (16th ed. 1993).

total elimination of the *D'Oench* doctrine.[279] Such a hasty reaction, however, merely would reverse the problems rather than solve them. Deceitful borrowers once again would be able to defraud the FDIC, because the FDIC would have no protection from alleged secret side agreements with financial institutions.[280] Returning to a pre-*D'Oench* and pre-§ 1823(e) world would prevent banking regulators from quickly ascertaining whether the institution's assets are subject to secret side agreements or other contingent liabilities,[281] either during a routine examination or during a bank closure and seizure of assets. Also, private, solvent third-party banks would be less willing to purchase assets from the FDIC, or would do so only at a very low price to protect themselves from the risk of being unable to determine the value of the assets at the time of purchase.[282] Finally, legitimate claimants and creditors of the institution would receive reduced claims as a result of deceitful borrowers who defrauded the FDIC.[283] That is, the FDIC would suffer potential fraud by borrowers and bankers, while some deceitful borrowers would receive the illegitimate windfall. Merely shifting injustice, however, does not eradicate it. Therefore, although tempting, such a quick-fix solution would be

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279. *See, e.g.*, Flint, *supra* note 36, at 484 (calling for this drastic step).

280. The purpose of the *D'Oench* doctrine was to protect the FDIC from deceit and fraud. D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447, 469 (1942).

281. *See supra* note 87 (quoting the Assistant General Counsel of the FDIC as stating that the *D'Oench* doctrine allows the FDIC to enforce obligations due to failed institutions).

282. *See supra* notes 172-75 and accompanying text (discussing how private parties benefit from the *D'Oench* doctrine); *see generally* Barry S. Zisman & Marguerite N. Woung, *The Superpowers of the FDIC/RTC and Their Availability to Third Parties*, 108 BANKING L.J. 516 (1991) (discussing this possibility).

283. As the receiver for the failed financial institution, the FDIC has a legal obligation to the other creditors to protect the receivership estate for the benefit of the institution's creditors. If the FDIC as receiver pays unsubstantiated claims, other claimants and creditors of the receivership estate, such as vendors who provide services to the institution before it failed, will receive less. Creditors will also receive less if the FDIC cannot enforce valid obligations owed to the failed institution. There is a limited pool of assets in each receivership of a failed institution and anything that reduces the value of the assets or increases the number of claimants will reduce the recoveries for creditors.

S. 648 Hearings, *supra* note 1, at 11 (statement of Sharon Powers Sivertsen, Assistant General Counsel, FDIC).

unwise and unwarranted.[284]

Fortunately, we do not have to be prisoners beholden to either of these two polar extremes. The *D'Oench* doctrine and § 1823(e) should be reformed to pursue justice for wronged, innocent borrowers, while maintaining reasonable protection for federal banking agencies, U.S. taxpayers, other legitimate claimants and creditors of failed institutions, and the financial institutions themselves. The critical policy reform question thus becomes: how can we keep what is "good" about *D'Oench* and § 1823(e), while simultaneously discarding what is "bad"? Furthermore, how do we do so without causing injustice to banking customers, banking agencies, or financial institutions?

B. PRACTITIONER AND ACADEMIC PROPOSALS: COPING WITH THE MADNESS

Some commentators have suggested certain practical ways for borrowers to cope with the current state of *D'Oench* by attempting to comply with § 1823(e)'s strict requirements. Robert J. Stillman suggests that borrowers sign and record all agreements with the bank, and then insist that the bank deliver a certificate confirming factual compliance with the requirements of § 1823(e).[285] Stillman also advises borrowers to obtain a continuing written pledge from the bank stating that the institution will maintain the side agreement as part of the official bank files.[286] Finally, Stillman counsels borrowers to request that the bank deliver a legal opinion from its attorney verifying the bank and borrower's legal compliance with the requirements of § 1823(e).[287] Similarly, Professor Sacks proposes that borrowers create a substantial "paper trail," evidencing the existence of a valid, legally binding side agreement.[288] To assist the borrower in creating this paper trial, Sacks advises

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284. *See* Sacks, *supra* note 103, at 1434-39 (recommending limits to the expansion of *D'Oench* rather than its complete elimination).

285. Stillman, *supra* note 140, at 112.

286. *Id.*

287. *Id.*

288. Sacks, *supra* note 103, at 1436. Professor Sacks advises borrowers to obtain: (1) a copy of the loan approval by board or loan committee; (2) an opinion of bank counsel that the board or loan committee was empowered to act; (3) a statement in agreement that it is an official bank record; (4) a statement in the minutes that the agreement is an attachment to the minutes; and (5) initial and periodic certificates from an officer that the record has been a continuous bank record. *Id.*

that borrowers enlist the services of a good banking law attorney.[289] He argues that the responsibility for compliance should be placed solely on the borrower, because borrowers have had ample time to learn about *D'Oench* and the requirements of § 1823(e).[290]

These creative compliance methods may constitute good, practical legal advice for borrowers, but they merely offer a way to deal with the problem of *D'Oench* and § 1823(e) instead of solving it. For example, a borrower could create a substantial "paper trail" evidencing the existence of an agreement.[291] He might even finagle the bank into signing the side agreement, manage to have it affixed with an official seal, and, for that matter, convince every bank employee to record his thumbprint in the upper right hand corner. That agreement might not satisfy § 1823(e), however, because full compliance with § 1823(e) remains under the unilateral control of the bank, regardless of the legal measures the borrower takes to protect himself. The bank's promises to comply with § 1823(e), in writing or otherwise, both now and at periodic times in the future, are worthless once the bank fails and is taken over by the FDIC.[292]

289. *Id.* at 1435-36. Professor Sacks also proposes, quite correctly, that even if borrowers do not hire their own counsel, they definitely should not rely on the advice or services of the bank's attorney, as the bank's attorney has no legal interest or duty in making sure the borrower either is aware of *D'Oench* and § 1823(e) or has sufficiently complied with § 1823(e) because that issue would be relevant only between the borrower and the FDIC, and long after the bank has failed. *Id.*

290. *Id.* at 1436 ("Borrowers must beware that for over 40 years they have had 'a reasonable opportunity both to familiarize themselves with [the] general requirements [of § 1823(e) and] to comply with these requirements.'") (quoting Campbell Leasing v. FDIC, 901 F.2d 1244, 1248 (5th Cir. 1990)). Professor Sacks' assertions notwithstanding, most borrowers are not aware of *D'Oench* or § 1823(e), and currently a bank has no legal duty or financial incentive to inform borrowers about the rules. This Article, therefore, advocates a disclosure requirement. *See infra* Part III.E. (detailing a disclosure requirement).

291. *See also* Hudson, *supra* note 197, at 64 (arguing for the same sort of paper trail: banks should be as formal as possible in agreements, borrowers should obtain copies of board or loan committee minutes approving the loan and side agreements, and agreements should state that they are official bank records).

292. *See id.* (suggesting not only that there be a thorough one time paper trail, but that the borrower periodically obtain written confirmations that the side agreement is still in force and the bank has kept it in its official files continuously in compliance with the statute). However, even assuming a borrower is that diligent, if the bank is not completely up front about it, then fails and is taken over by the FDIC, the FDIC can use § 1823(e) against the

Kevin A. Palmer suggests reforming *D'Oench* by elevating the standard of proof regarding the existence of a side agreement to "clear, precise and convincing evidence."[293] With such persuasive evidence, Palmer argues, no valid reason would exist to prohibit a borrower's claims and defenses under *D'Oench*.[294] Because this heightened proof standard would be subject to judicial interpretation, however, it would not really assist the borrower because it would not provide him with any clear guidance for what he must do to prevail over the FDIC. Instead, courts would have even more discretion to interpret and possibly expand the *D'Oench* doctrine.[295]

Palmer's suggested change would give a small number of borrower-litigants the opportunity to rebut *D'Oench*'s application in their particular cases, instead of being barred by a pre-trial motion. Its application, however, would be limited to the relatively few borrowers with strong cases. Such reform also does not consider the policy justification for the *D'Oench* doctrine in the first place—the FDIC's legitimate concern in being aware of the existence of side agreements.[296] If a borrower proves by clear and convincing evidence that a legitimate side agreement exists, the FDIC still might not know which loan assets are affected by that side agreement. In an attempt to protect the FDIC, Palmer argues that borrowers should be required to demonstrate good faith and clean hands in their dealings with the bank. This suggestion, although reasonable, is ineffective because current *D'Oench* and § 1823(e) practice bars claims and defenses of borrowers without regard to good faith or clean hands, and Palmer does not address the changes necessary to

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borrower if the bank was not keeping the agreement as an official record, or did not do so "continuously."

293. Palmer, *supra* note 36, at 576.

294. *Id.*

295. One might imagine that the increased standard of proof would provide the courts with justification to allow the *D'Oench* doctrine and § 1823(e) to swallow up even more claims and defenses that so far have escaped the purview of the doctrine because the borrower would have failed to satisfy the elevated proof standard. *See supra* notes 263-75 and accompanying text (listing the remaining claims and defenses that neither the *D'Oench* doctrine nor § 1823(e) bar).

296. This underscores the need for the regulators to recognize existence of the side agreement without having to rely on the bank's unilateral actions. The disclosure and filing system proposed *infra*, directly addresses this issue.

achieve his goal.[297] The suggestion is also ineffective on a practical level because it does not necessarily guarantee a writing or notice to the FDIC.

Palmer finally suggests that courts should utilize a rebuttable presumption in favor of the FDIC. Again, this does nothing to alleviate the unfairness to the borrower, nor does it address the lack of notice to the FDIC, even when the borrower has a strong argument that the side agreement exists. Given such a presumption, secret side agreements may or may not be barred depending on the course of the impending litigation. Thus, unlike the current *D'Oench* practice, neither the FDIC nor private third-parties would be certain of the result.

Most other commentators, aside from criticizing the broad scope of the *D'Oench* doctrine and § 1823(e), simply argue that *D'Oench* and § 1823(e) should be interpreted more narrowly.[298] Perhaps most troubling is that they do not offer or consider any substantial statutory reforms to § 1823(e), nor do they address the FDIC's new internal agency guidelines regarding the use of *D'Oench* and § 1823(e). The FDIC guidelines and recently proposed statutory reforms are important considerations in understanding the possible reforms of the *D'Oench* doctrine and § 1823(e).

C. THE FDIC'S RECENT INTERNAL GUIDELINES

The FDIC itself has recognized the need to reform *D'Oench* and § 1823(e)[299] and has offered a proposed solution. In March of 1994, the FDIC responded to criticism from a host of sources[300] by establishing an inter-divisional work group to formulate "an appropriate response to concerns about the application

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297. Recall that the borrower's actions or lack of knowledge is irrelevant and no longer required by *D'Oench* case law or § 1823(e). *See supra* note 247 and accompanying text (noting that lack of knowledge is irrelevant).

298. *See, e.g.*, Lake, *supra* note 18, at 315; MacArthur, *supra* note 18, at 1271; Weiss & Kraus, *supra* note 18, at 256.

299. "Although the *D'Oench* doctrine and § 1823(e) promote critical public policy goals, the FDIC recognizes that the application of these legal principles requires a balancing of these goals with the public interest that individuals be treated fairly." *S. 648 Hearings*, *supra* note 1, at 3-4 (statement of Sharon Powers Sivertsen, Assistant General Counsel, FDIC).

300. Recall that criticism of *D'Oench* and § 1823(e) has come from: academics, *see supra* note 36 and accompanying text; practitioners, *see supra* note 39 and accompanying text; the judiciary, *see supra* notes 37, 276 and accompanying text; Congress, *see supra* note 40 and accompanying text; and private citizens, *see supra* note 38 and accompanying text.

of the *D'Oench* doctrine and section 1823(e) and to prepare recommendations."[301] Adopting that group's recommendations, the FDIC implemented formal written internal guidelines requiring FDIC attorneys to give special review and consideration in deciding whether to use *D'Oench* and § 1823(e) in seven specific circumstances.[302]

Although they attempt to promote equity, the guidelines offer little actual protection to borrowers and creditors. Neither Congress nor any outside agency can enforce FDIC guidelines. The FDIC can choose either to comply with, or ignore completely, its own guidelines.[303] In addition, although the guidelines set forth seven circumstances where *D'Oench* and § 1823(e) should not be applied, each category has many exceptions and plenty of room for creative interpretation.[304] Furthermore, an

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301. *S. 648 Hearings, supra* note 1, at 4 (statement of Sharon Powers Sivertsen, Assistant General Counsel, FDIC).

302. Those seven circumstances are as follows:

> (1) claims by pre-closing vendors (*e.g.*, a janitor who sells cleaning services to a bank before it fails);
> (2) claims or defenses by a "diligent party" who took all reasonable steps to document and record the agreement and there is no evidence that the borrower engaged in any activity likely to mislead the regulators;
> (3) claims or defenses based upon an agreement or documents not in the bank's official records but upon other documents in the bank's records reflecting the existence of the agreement;
> (4) claims or defenses based on transactions other than loan transactions ("no asset exception"), such as a negligence tort claim;
> (5) claims or defenses based on the bank's violation of some part of a written agreement—bilateral obligations;
> (6) statutory defenses, such as an unfair trade practice claim against the bank violative of statutory law; and
> (7) claims or defenses based solely on a loan workout or modification and the violation is limited to the contemporaneous requirement.

See id.

303. *See* Memorandum from John F. Bovenzi, Director, FDIC Division of Depositor and Asset Services, & Thomas A. Rose, FDIC Deputy General Counsel, to FDIC Regional Directors, Regional Counsel, and Associate Director, *Guidelines for use of* D'Oench *And Section 1823(e)* 1 ("It is the responsibility of the Regional Directors, Associate Director - COMB, and Regional Counsel [of the FDIC] to ensure compliance with this Directive by all personnel in their respective service centers.") (copy on file with the author).

304. *See id.* Take the first of these categories for example. The FDIC may still convincingly argue that *D'Oench* should apply. With respect to pre-closing vendors the guidelines state that "[t]his does not mean that *D'Oench* and section 1823(e) may never be asserted against a vendor, but only that each claim must be examined carefully on its facts." *Id.* at 3. With respect to the diligent party, the guidelines allow the application of *D'Oench* if "the borrower . . . participated in some fraudulent or other activity which *could have resulted* in deception of

FDIC attorney's determination that a particular case satisfies one of the seven categories does not preclude the application of *D'Oench*. In such circumstances, the attorney still might unsheathe *D'Oench* or § 1823(e) by obtaining approval from FDIC headquarters in Washington.[305] A loophole of this magnitude reduces the guidelines to a mere unenforceable vague promise to be fair. Thus, despite the FDIC's frequent use of the *D'Oench* doctrine and § 1823(e) over the last decade, the FDIC apparently now invites borrowers simply to trust them to do what is right.[306]

To underscore the fact that these guidelines offer no real protection for innocent borrowers, the FDIC included the following disclaimer in its guidelines:

> These guidelines are intended only to improve the FDIC's review and management of the utilization of *D'Oench* and section 1823(e). The Guidelines do not create any right or benefit, substantive or procedural, that is enforceable at law, in equity, or otherwise by any party against the FDIC, its officers, employees, or agents, or any other person. The Guidelines shall not be construed to create any right to judicial review, settlement, or any other right involving compliance with its terms.[307]

By including this disclaimer, the FDIC carefully shielded itself from all liability if it fails to comply with its own guidelines. Thus, the FDIC offers its internal guidelines as an olive branch, yet remains poised to wield the *D'Oench* sword at any time.

It is not surprising that the FDIC is attempting to keep its basic *D'Oench* powers intact by conducting its own reform

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banking regulators . . . ." *Id.* at 5 (emphasis added). Apparently no actual deception would be required and presumably even the most remote activity that conceivably "could have deceived" the regulators would qualify. With respect to the integral document the guidelines merely state that "[w]hile any number of cases have held that the terms of the agreement must be ascertainable on the face of the document, in some circumstances it may be appropriate to consider all of the failed bank's books and records in determining the agreement, not just an individual document." *Id.* at 6. Those circumstances are not defined and there is enough qualifying language to allow the FDIC to apply the doctrine.

305. *Id.* at 2. ("These guidelines are intended to aid in the review of matters where the assertion of *D'Oench* and/or section 1823(e) is being considered . . . to give clear direction as to when *D'Oench* and section 1823(e) issues must be referred to Washington . . . .").

306. *See supra* notes 21-34 and accompanying text (discussing the RTC's treatment of Rhetta B. Sweeney and the government's "Too bad, we win because *D'Oench* says we win" attitude); *supra* text accompanying note 98 (further demonstrating this "Too bad, we win because *D'Oench* says we win" attitude in disputes with former borrowers).

307. *Id.* at 11.

through internal guidelines that purportedly address the unfairness of *D'Oench* and § 1823(e). If Congress reforms *D'Oench* and § 1823(e), then the FDIC will lose an extremely powerful advantage in many failed bank litigation cases.[308] Any reform would reduce the savings the FDIC achieves by precluding borrower counterclaims and defenses in failed bank litigation—a savings the FDIC estimates at over $1 billion.[309] The high potential expenditures over the next few years increase the pressure on the FDIC to maximize collections and minimize expenses for failed institutions.[310] The FDIC thus has a strong incentive to preserve the litigation tool that has facilitated victory in over ninety-seven percent of the cases in which it was used.[311] Such resistance, however, should not prevail as a legitimate and *principled* reason for blocking efforts designed to

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308. The *D'Oench* doctrine and § 1823(e) bestow such a powerful litigation advantage to the FDIC in failed bank litigation against former borrowers that they have been renamed "Superpowers." Barry, *supra* note 106, at 1127; James J. Boteler, *Protecting the American Taxpayers: Assigning the FDIC's Six Year Statute of Limitations to Third Party Purchasers*, 24 TEX. TECH. L. REV. 1169, 1186-97 (1993); Echevarria, *supra* note 36, at 807; Galves, *supra* note 16, at 473; Zisman & Woung, *supra* note 282, at 516.

309. *See supra* note 20 (estimating these savings).

310. The cost of the S&L bailout is estimated as high as $500 billion over the next few years and more than one trillion dollars over the next several decades. *See* DAY, *supra* note 51, at 9. Others estimate "only" $2,500 per person. *See* Al Crass, *McConnell and S&L's Quickly Counter Sloane on Contribution Changes*, THE COURIER J., July 27, 1990, at 1B, *available in* LEXIS, Nexis Library. By comparison, U.S. taxpayers paid a total of $7.4 billion for the 1991 Gulf War, which is only about 7 to 14% of the total bank and S&L bailout cost. *Washington Roundup Lost Cause*, AVIATION WK. & SPACE TECH., May 11, 1992, at 17, 17. Even the laundering of illegal drug profits worldwide is estimated to be nearly $300 billion annually, less than half the cost of the bailout. *Drug Money Laundering, Banks and Foreign Policy, Report Submitted by the Subcomm. on Narcotics, Terrorism and International Operations to the Senate Foreign Relations Comm.*, 101st Cong., 2d Sess. 101-04 (Feb. 1990). The political and economic pressures on the FDIC are acute. A WESTLAW search conducted on March 18, 1996 produced 10,732 stories related to the cost of the S&L bailout which were published since January 1, 1990. Congress recently made the reduction of the total bailout cost a clear mandate in the FDICIA, *supra* note 49 (requiring the FDIC to execute its duties in a manner "least costly to the deposit insurance fund of all possible methods of meeting [its] obligations," § 1823(c)(4)(A)(ii), that "maximizes the net present value return from the sale or disposition of assets," and "minimizes the amount of any loss realized in the resolution of cases"). 12 U.S.C. § 1821(d)(3) (1994). Under current law, the easiest way to meet these requirements is to utilize *D'Oench* and § 1823(e).

311. *See supra* text accompanying note 1 (noting Senator Cohen's observation that 97% of claims that vendors and individuals filed were defeated by the government's invocation of the *D'Oench* doctrine).

revise the *D'Oench* doctrine and § 1823(e) so they are equitable to all concerned.[312]

The FDIC's record of using *D'Oench* and § 1823(e) to its advantage, despite the inequities of the situation, shows that Congress should not retreat from significant reform legislation merely because the FDIC, given its new internal guidelines, now claims that it is being fair to borrowers of failed institutions.[313] Moreover, although critics should welcome the FDIC's willingness to be flexible when applying *D'Oench* and § 1823(e), they should question the FDIC's motive in taking such action. Given the FDIC's strong economic interest in deflecting some of the cost of the banking and S&L bailout,[314] the FDIC's new self-regulation must reflect the FDIC's efforts to bend to today's prevailing political winds rather than a sudden desire to treat borrowers fairly.[315]

D. CONGRESS'S CURRENT REFORM PROPOSAL: S. 648, THE *D'OENCH, DUHME* REFORM ACT

On March 30, 1994, Senator Cohen introduced S. 648, The *D'Oench Duhme* Reform Act,[316] which "substantially curbs the power regulators have through the *D'Oench Duhme* doctrine to lay waste to claims of borrowers and vendors in financial institution insolvencies."[317] Although this proposed legislation

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312. Again, the FDIC and RTC both attempted to preempt the D'Oench Duhme Reform Act by unilaterally enacting internal guidelines designed to soften the harsh application of the *D'Oench* doctrine and § 1823(e) in certain circumstances. *See supra* notes 299-307 and accompanying text.

313. Indeed, Senator Cohen, co-sponsor of the current legislative reform proposal, *see supra* note 40; *infra* Part III.D., remains unimpressed by the FDIC's internal agency guidelines.

> I am aware that the FDIC has issued new guidelines governing when *D'Oench* may be asserted and, in some instances, requiring approval of the General Counsel's office before *D'Oench* may be used by attorneys in the field. I believe this is a step in the right direction.... These guidelines, however, do not obviate the need for legislation to restore the *D'Oench Duhme* doctrine to its original, narrow scope.

S. 648 Hearings, *supra* note 1, at 2 (statement of Senator William S. Cohen).

314. *See supra* note 51 (noting that the FDIC's bailout efforts cost only one billion dollars less than its insurance fund earned).

315. *See supra* text accompanying note 307 (quoting the disclaimer from the FDIC's own internal guidelines).

316. *See supra* note 40; *see also* text accompanying note 1 (quoting Senator Cohen's justification for this legislation).

317. *Big Change to Insolvency Doctrine Proposed*, THE THRIFT REGULATOR, April 10, 1995, at 8; *see also Sen. Cohen Offers Bill to Curb Abuses, Allow More Claims Under* D'Oench, Duhme, Banking Daily (BNA) at D2 (Apr. 4, 1995),

goes a long way toward remedying *D'Oench*'s problems, it contains a number of ambiguous phrases that will hamper its effectiveness. The following analysis and critique uses S. 648 as a starting point and highlights the content of ideal reform legislation.[318]

1. "Findings and Purposes"

To assist courts in construing the new provisions, the reform bill should contain sufficient legislative history to provide a clear understanding of the purposes and policy objectives supporting the reform and the new limited purview of § 1823(e). The goal is to ensure that judges and litigants understand the clear legislative intent to roll back the expansive interpretation and application of *D'Oench* and § 1823(e) to their original, limited scope. Accordingly, a "Findings and Purposes" section[319] of the

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available in WESTLAW, BNA-BBD. Two Senate hearings have been held addressing this issue. *See generally Oversight Hearings*, *supra* note 20; *S. 648 Hearings*, *supra* note 1.

318. References to the Act in the footnotes of this Part refer to portions of S. 648.

319. Section 2 of the Act sufficiently addresses these concerns, providing:

(a) FINDINGS—The Congress finds that—

(1) in D'Oench Duhme & Co. v. [FDIC], 315 U.S. 447 (1942), the Supreme Court determined that secret side agreements that were not recorded in the records of an insured depository institution should not be enforceable against Federal banking agencies when those agencies acquired assets following the failure of the institution;

(2) the Supreme Court based its holding (hereinafter in this section referred to as the "D'Oench doctrine") on its power to develop Federal common law;

(3) in 1950, the Congress supplemented the D'Oench doctrine by amending section 13(e) of the Federal Deposit Insurance Act [codified as 12 U.S.C. § 1823(e)] to invalidate agreements relating to assets acquired by the Federal banking agencies that were not recorded in official depository institution records;

(4) Federal and State courts have expanded the scope of the D'Oench doctrine and section 13(e) of the Federal Deposit Insurance Act by interpreting them to bar tort claims based on oral representations, claims that do not relate to assets acquired by Federal banking agencies, and numerous other claims and defenses beyond the original scope and intent of those two lines of authority;

(5) the Federal banking agencies' use of the D'Oench doctrine and section 13(e) of the Federal Deposit Insurance Act in the administrative claims process and litigation and the expansive interpretation of those authorities by Federal courts have led to fundamentally unfair results; and

(6) many individuals have been barred from asserting potentially valid claims and defenses once an insured depository institution has

reform act should reflect that Congress finds that federal and state courts have expanded the *D'Oench* doctrine and § 1823(e) beyond their original scope and intent, leading to unfair results and prohibiting countless valid claims and defenses. Congress should declare that the common law authority flowing from *D'Oench* and the interpretation of § 1823(e) is eliminated,[320] and that the reform legislation *revises* § 1823(e) significantly. The revised § 1823(e) would continue to bar unrecorded agreements that otherwise would allow certain borrowers to deceive the FDIC, while still allowing innocent borrowers to enforce their legitimate side agreements.

The "Findings and Purposes" section also should emphasize Congress's strong disapproval of the current overly broad interpretation of *D'Oench* by *explicitly* curtailing *Langley*'s broad interpretation of "agreement."[321] The interpretation of "agreement" should include neither non-promissory statements nor mere failures to make statements. Because *Langley* is the only case in which the Supreme Court specifically interprets § 1823(e), the case should be overruled legislatively[322] to remove any argument that *Langley*'s interpretation of "agreement" survives.

2. Clarification: Disregarding *D'Oench* and Old Section 1823(e); Adopting New and Improved Section 1823(e)

Any reform legislation should enunciate clearly that it

> been declared insolvent and taken over by a Federal banking agency.
> (b) PURPOSES—The purposes of this Act are—
>
> (1) to eliminate the Federal common law doctrine referred to in subsection (a)(2); and
>
> (2) to revise section 13(e) of the Federal Deposit Insurance Act so that it will continue to bar the enforcement of unrecorded agreements, but allow certain potentially valid intentional tort and other claims and defenses to be adjudicated on their merits.

S. 648, 104th Cong., 1st Sess. § 2 (1995).

320. *See supra* note 138 (setting forth the *Murphy* and *Boatman* cases, from the D.C. and Eighth Circuits, respectively, holding that common law *D'Oench* is no longer valid and has been superseded by § 1823(e), if not by FIRREA).

321. *See supra* note 151 and accompanying text (discussing the concept of "agreement" with regard to the *Langley* decision).

322. Congress possesses the authority to overrule a Supreme Court opinion when the opinion is an interpretation of a congressional statute. *See generally* Redwing Carriers Inc. v. Saraland Apartments, Ltd., 875 F. Supp. 1545, 1556 (S.D. Ala. 1995) ("A court should presume Congress means what it says when it drafts statutes. . . . Congress, not the courts, has the power to amend them.").

overrules the *D'Oench* common law doctrine and its progeny, repeals the current § 1823(e), and substitutes a new § 1823(e) in its place.[323] Many of the unfair interpretations of *D'Oench* or

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323. *See* "Findings and Purposes" section, *supra* note 319. In addition, the first provision of this portion of the Act states that § 1823(e) "is amended to read as follows." S. 648, 104th Cong., 1st Sess. § 3 (1995). This statement clarifies that proposed § 1823(e) completely repeals and replaces the current § 1823(e).

The recommendations that follow in the text for the new § 1823(e) will use S. 648 as a starting point for analysis. That bill provides, in relevant part:

(e) AGREEMENTS AGAINST INTERESTS OF THE CORPORATION—

(1) IN GENERAL—No agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by the Corporation under this section or under section 11, by purchase or assumption, or in its capacity as receiver of any insured depository institution, shall be enforceable against the Corporation unless that agreement—

(A) is in writing and

(B) was executed in the ordinary course of business

(C) by an insured depository institution through an officer or other employee or representative of the institution having the authority to execute such an agreement on behalf of the institution.

(2) CLAIMS AGAINST THE CORPORATION—No court may rely on paragraph (1) to bar or estop a claim or defense against the Corporation in its corporate capacity or as conservator or receiver of an insured depository institution if—

(A) the claim or defense does not relate to an agreement affecting an asset acquired from the insured depository institution by the Corporation;

(B) the claim or defense relates to a transaction that, in the normal course of business, would not be included in the official records of the insured depository institution;

(C) the claim or defense was filed in a judicial proceeding more than 90 days before the date of the appointment of the corporation as conservator or receiver for the insured depository institution;

(D) the claim or defense, filed at any time, is based on an alleged intentional tort or alleged violation of State or Federal statutory or regulatory law by the insured depository institution, its representatives, or its employees, if—

(I) the party asserting the claim or defense demonstrates that the party did not—

(II) participate in a scheme to defraud the insured depository institution; or

(III) knowingly lend itself to a scheme to mislead bank examiners by misrepresenting the value of the assets of the institution; and

(IV) any oral representations relied upon are not in conflict with a written agreement contained in the records of the institution.

(3) STATUS AS HOLDER IN DUE COURSE—When the corporation acquires an asset under this section, or by purchase or assumption, it shall succeed to the same status as a holder in due course, as defined by applicable State law, with respect to that asset and shall acquire no

§ 1823(e) then will not bind courts construing the new legislation.

a. *Preliminary Clarifications*

Legislative reform should scale back § 1823(e) to apply to the FDIC only in its receivership capacity, and not to transactions where the FDIC, in its corporate capacity as an insurer of deposits, loans capital to a troubled institution.[324] When the FDIC assists in its corporate capacity, it does so *before* the institution fails, and does not need *D'Oench* protection at that point. Section 1823(e) explicitly should preserve any right the FDIC otherwise may have against a former borrower or creditor where no side agreement affecting an asset is involved, to protect the FDIC from expansive judicial interpretation illegitimately favoring borrowers.[325] Reform legislation also should eliminate the Federal HIDC doctrine. Recall that the Federal HIDC doctrine operates as an overlapping extension of the *D'Oench* doctrine in certain situations.[326] Congress should explicitly eliminate this common law creation to make all *D'Oench* and § 1823(e) issues ones of statutory interpretation of the new § 1823(e). Finally, the statute should reaffirm Congress's continuing commitment to render unenforceable side

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more or no less rights as a holder in due course, as defined by applicable state law, with respect to that asset as the insured depository institution had prior to the appointment of the receiver of conservator.

(4) EXCEPTION FOR VENDOR AGREEMENTS—Subsection (e)(1) does not apply to an agreement for the sale or purchase of goods or services actually received by or delivered to an insured depository institution before the date of an appointment of a receiver for that institution.

(5) PRESERVATION OF OTHER RIGHTS—Nothing in this section shall impair or affect any rights the Corporation may have under any other applicable State or Federal statutory or regulatory law.

S. 648, 104th Cong., 1st Sess. § 3 (1995).

324. The first portion of the proposed § 1823(e)(1) does this by striking "security for a loan" from the current § 1823(e). Note that the language of the proposed § 1823(e)(1) governs agreements that "[tend] to diminish or defeat the interest of the Corporation in any asset acquired by the Corporation under this section or under section 11, by purchase or assumption, or in its capacity as receiver of any insured depository institution." *See supra* note 323 (quoting the Act). The reference to "section 11" in the proposed § 1823(e)(1) mirrors the reference to "section 1821" in the current § 1823(e)(1).

325. *See supra* note 323 (quoting the Act).

326. *See supra* notes 121-30 and accompanying text (discussing the expansion of the *D'Oench* doctrine and the creation of the federal HIDC doctrine).

agreements that diminish the value of an asset acquired by the FDIC unless they conform to certain requirements.[327] The remaining subsections of the new § 1823(e) should set forth only necessary prerequisites for enforcing side agreements or verbal representations against the FDIC.

b. *Section 1823(e) Requirements*

i. Writing and Execution

Section 1823(e) still should require a writing in most cases, as under current law,[328] but should require that writing to be executed only in the *ordinary course of business* rather than contemporaneously.[329] The new § 1823(e) should continue to require that the side agreement be properly executed,[330] but should make it easier to accomplish proper execution.

Congress should retain the flexibility of the execution process to prevent the FDIC from using a lack of proper execution or the failure to meet the strict contemporaneous requirement[331] to invalidate otherwise legitimate side agreements.[332] This revision will be especially helpful to borrowers because most loan modifications or loan workouts, by definition, occur over the course of the loan, sometimes years after the

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327. The proposed § 1823(e)(1) does this by making any agreements that do not conform to the statutory requirements unenforceable. *See supra* note 323 (quoting the Act).

328. Current § 1823(e) makes only one minor exception to its strict requirements, and in no event can unwritten side agreements comply. Although the proposed § 1823(e)(1) has the same writing requirement, in later subsections, it sets forth various exceptions to that requirement. Thus, under current § 1823(e), a writing is definitely required; however, under the proposed § 1823(e), a writing is necessary only if the side agreement does not fit within the later exceptions. *See supra* note 323 (quoting the Act).

329. The proposed § 1823(e)(1) eliminates the contemporaneous requirement in favor of an "ordinary course of business" requirement. *See supra* note 323 (quoting the Act).

330. *See supra* note 323 (noting that the proposed § 1823 requires that an agreement be executed). Under the current § 1823(e) this is a strict requirement, but under the proposed § 1823(e)(1) exceptions it would not be. *See supra* note 323 (quoting proposed Act); *infra* text accompanying notes 331-35 (discussing execution requirements).

331. *See supra* note 195 and accompanying text (noting that some courts interpret the contemporaneous requirement to require execution on the same day).

332. The proposed § 1823(e)(1) does not modify "execution" but leaves the term open to interpretation.

execution of the original promissory note.[333] As a result, most modification agreements that the current § 1823(e) bars[334] would be enforceable under the new § 1823(e) because they would be "executed in the ordinary course of business."

However, the use of the ambiguous phrase "executed in the ordinary course of business" could breed litigation over its proper interpretation, potentially eviscerating the goals of the Act. The FDIC might argue successfully that the particular side agreement was "unique" or posed "special circumstances" that placed the execution of the agreement outside the ordinary course of business. Suppose, for example, that a group of partners enters into a side agreement. Suppose further that because of the special nature of the loan, all partners must sign the promissory note to make it enforceable against the partnership. If only one partner's agent executed the agreement, and the institution were to fail, the FDIC could claim that the agreement was not executed in the ordinary course of business, and therefore is unenforceable. By allowing this kind of creative wordplay to continue, the new § 1823(e) would not remedy current § 1823(e)'s strict interpretation, unless "ordinary course of business" could be specifically defined. Using a term such as "ordinary course of business," however, is an attempt to infuse objectivity into an inherently subjective concept. Although it is easy to critique that inherent subjectivity, it is difficult, if not impossible, to define it more specifically. Therefore, using this admittedly ambiguous phrase may be the best available option.

In addition to proper execution, the new § 1823(e) should require both that execution only be accomplished by individuals with apparent authority to make such side agreements, rather than requiring approval by the board of directors or the loan committee, and that execution be reflected in the minutes of the

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333. *See supra* notes 196-97 and accompanying text (discussing loan modifications).

334. *See supra* notes 195-97 (examining the uncertain adjudication under current § 1823(e)); *see generally* FDIC v. Virginia Crossings, 909 F.2d 306, 309 (8th Cir. 1990) ("The plain language of § 1823(e) requires that an agreement, to be effective against the FDIC, must be executed by the bank and the obligor contemporaneously with the making of the note. The Janikula and Jensen memoranda clearly do not meet that requirement."); RTC v. Dubois, 771 F. Supp. 154, 156 (M.D. La. 1991) ("Although the commitment letter in this case does provide for a variable interest rate, adjusted quarterly, it was executed before, and not contemporaneously, with Note 1 or Note 2.").

appropriate group.[335] This revision removes some of the unilateral control over the agreement that a bank is given under the current § 1823(e). A borrower should not be punished simply because the bank approves the side agreement without properly recording or maintaining it in the official minutes of the appropriate committee. Once the written side agreement is executed in the ordinary course of business by a bank employee or other bank representative, that agreement instantly should become valid.

Allowing a borrower to rely on apparent authority protects her from a mistaken perception or active deception on the part of the institution.[336] For example, a typical borrower might believe in good faith that an assistant loan officer has the authority to execute a side agreement. Whether the assistant loan officer has actual authority, however, is not within the borrower's control. Under current law, the FDIC could argue successfully that the bank officer or employee, upon whom the innocent borrower relied in reaching the agreement, did not have actual authority to bind the financial institution within the meaning of the statute. Thus, under the new § 1823(e), the FDIC should not prevail with such an argument. Requiring apparent rather than actual authority to execute an agreement makes the *borrower's* innocence and good faith in executing the side agreement, rather than that of the FDIC or RTC, the touchstone by which to determine the side agreement's enforceability.[337]

ii. Continuous Recordation

The new § 1823(e) also should eliminate the continuous record requirement because borrowers have no way to ensure its

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335. The proposed § 1823(e)(1) requires execution "by an insured depository institution through an officer or other employee or representative of the institution having the authority to execute such an agreement on behalf of the institution." *See supra* note 323 (quoting the Act). It thus expands the pool of institutional employees who may approve an agreement over the current § 1823(e). It does not, however, contain the apparent authority provision advocated here.

336. The Act should be amended to require execution "by . . . a representative with *apparent* authority to execute such an agreement on behalf of the institution." (emphasis added).

337. However, a deceitful borrower who, for example, obtains the signature of a bank teller trainee or the bank's plumber would not be able to enforce the side agreement because no credible argument could be made in support of apparent authority in their situation.

compliance.[338] Although eliminating this requirement[339] is a sound policy decision to protect innocent borrowers, the reform act should continue to require that institutions keep valid side agreements as continuous records in their official files.[340] The legitimate purpose of § 1823(e), in terms of the FDIC's and the other regulators' responsibilities, would be defeated if valid side agreements were not discoverable during examinations or seizures.[341] But the bank's duty to keep official documents in the bank's official files to ensure that the examiners and regulators have access to them during an examination or seizure is a purely regulatory matter that should be handled exclusively between the bank and its regulators. The failure of an institution to comply with its regulatory duties should neither involve the borrower nor justify rendering unenforceable a borrower's otherwise valid side agreement.[342] Congress still should require banks to maintain the integrity of their official files, but § 1823(e) should not be used as the vehicle to ensure such maintenance by punishing innocent creditors for regulatory violations of the bank.

c. *Section 1823(e) Exceptions*

Current § 1823(e) dispenses with the contemporaneous requirement for governmental entities.[343] Dispensing with the contemporaneous requirement entirely eliminates the need for

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338. *See supra* notes 225-32 and accompanying text (discussing borrowers' inability to ensure compliance). Recall that this requirement renders many side agreements invalid, even though the borrower has complied with § 1823(e) in all other respects because a bank employee removes the side agreement from the official files.

339. The Reform Act eliminates the following requirement of the current § 1823(e): "has been, continuously, from the time of its execution, an official record of the depository institution." *See supra* note 323 (quoting the proposed § 1823(e)(1)).

340. *See generally* 12 C.F.R. § 9.9 (discussing the audit of a trust department); *id.* § 27.3 (outlining bank record keeping requirements for loan applications); *id.* § 563.17-1 (providing requirements for maintaining records).

341. *See supra* notes 225-229 (providing a hypothetical situation developed under the current § 1823(e)(1)).

342. Such injustice would not be tolerated in a slightly different context. For example, assume a bank's balance sheet demonstrates various liabilities to creditors. A dishonest bank officer could then delete liabilities to certain creditors to deceive examiners about the bank's financial position. If the bank fails, those creditors' claims remain valid because the bank's unilateral and illegal action in underreporting liabilities does not affect the contract between the bank and its creditor.

343. *See* 12 U.S.C. § 1823(e)(2).

this exception.[344] The new § 1823(e), however, should contain new exceptions to limit its application to those situations where equity requires its application.

i. Vendor Exception

The new legislation should provide that § 1823(e) does not apply to vendors of an institution. Recall that, although borrowers are affected by *D'Oench* in significantly larger numbers, creditors perhaps have been subject to the most highly publicized abuses of *D'Oench*.[345] Some courts have addressed this problem by adding a judicial "relatedness" requirement to current § 1823(e).[346] Those courts distinguish between typical claims like employment discrimination and automobile accidents, freestanding torts not barred by *D'Oench*, and those relating to "ordinary banking transactions."[347] The relatedness requirement directs the court to look beyond the form of the allegation by the individual to the substance of the claim.[348] The rationale behind such a requirement goes to the expectations of the bank examiners that those assets unrelated would not be expected to be in the records of regular banking transactions.[349] Not all courts, however, have accepted the freestanding tort exception. Therefore, § 1823(e) should be revised as follows.

First, the revised § 1823(e) should apply only to an asset acquired by the FDIC in its receivership capacity.[350] The

344. The proposed § 1823(e)(1) contains no contemporaneous requirement. *See supra* note 323 (describing the elimination of the contemporaneous requirement in favor of an "ordinary course of business" requirement).

345. *See supra* notes 119-120 and accompanying text (providing a discussion of cases involving creditors).

346. *See* OPS Shopping Ctr., Inc. v. FDIC, 992 F.2d 306, 310 (11th Cir. 1993) ("We simply do not think the *D'Oench* doctrine operates to bar free standing tort claims that are not related to a specific asset acquired by the FDIC.").

347. RTC v. Dunmar Corp., 43 F.3d 587, 595 (11th Cir. 1995) (quoting *OPS Shopping Ctr.*, 992 F.2d at 310)).

348. *See* Motorcity of Jacksonville Ltd. v. Southeast Bank, 39 F.3d 292, 300 (11th Cir. 1994) (deeming an agreement between car dealer and bank for preparation of audit reports unrelated to regular banking transactions in dealer's claim for negligence); *see also* Vernon v. FDIC, 981 F.2d 1230, 1233 (11th Cir. 1993) (deeming a purchase agreement of securities unrelated in claim for securities law violations).

349. *Motorcity of Jacksonville*, 39 F.3d at 300.

350. *See supra* notes 70-75 and accompanying text (discussing the role of the FDIC as a receiver).

assets usually acquired by the FDIC are loan obligations.[351] Although some case law limits the current § 1823(e) in the manner this Article suggests, some courts hold that current § 1823(e) can apply to a bank's debts which involve amounts it owes creditors for services provided to it. Limiting revised § 1823(e)'s application to assets the FDIC acquires in its receivership capacity will exempt claims brought by creditors of the failed financial institution from § 1823(e) and allow creditors to collect valid debts regardless of the existence of written agreements.[352]

Second, a revised § 1823(e) should contain an explicit relatedness requirement because not all courts have read the exception into the current § 1823(e).[353] For example, in *Hawke Associates v. City Federal Savings Bank*,[354] a landlord entered into an agreement with a thrift for the lease of additional space in the building on favorable terms, in return for the bank's commitment to continue to occupy its existing space.[355] Shortly after the lease was signed, the landlord sued the bank claiming that the bank had breached the lease by making misrepresentations during negotiations.[356] The court ignored the "asset" requirement of § 1823(e) and found that the lease agreement was not enforceable against the RTC which had taken over the failed thrift.[357] The proposed revision to § 1823(e)

351. Loan obligations are assets because they provide revenues to the bank as the borrower pays both the principal and interest.

352. In 1994, Representative Bill McCullom and Senator William Cohen introduced similar bills to reform the *D'Oench* doctrine so that it would not apply to claims brought by creditors. That bill never made it out of committee, but the provision requiring that the side agreement relate to an asset was included in S. 648. *See* H.R. 4146, 103d Cong., 2d Sess. (1994) (introduced by Representative McCullom); S. 1725, 103d Cong., 1st Sess. (1994) (introduced by Senator Cohen).

353. Proposed § 1823(e)(2)(A) does this by providing that § 1823(e)(1) does not apply if "the claim or defense does not relate to an agreement affecting an asset acquired from the insured depository institution by the Corporation." *See supra* note 323 (quoting the Act).

354. 787 F. Supp. 423, 424 (D. N.J. 1991).

355. *Id.*

356. *Id.*

357. *Id.*; *see also* Hall v. FDIC, 920 F.2d 334, 339 (6th Cir. 1990) ("There are . . . instances where FDIC no longer has an interest in an asset, but where the logic of *D'Oench* should still apply to protect FDIC."); Bowen v. FDIC, 915 F.2d 1013, 1015 (5th Cir. 1990) ("The agreement need not implicate a specific obligation, such as a note or other asset held by the FDIC."); Bell & Murphy and Assocs., Inc. v. Interfirst Bank Gateway, N.A., 894 F.2d 750, 753 (5th Cir. 1990) (noting that the "*D'Oench, Duhme* rule bars affirmative claims based upon

would reverse this case law.

Although this relatedness requirement to an asset makes an important "exception," it does present the problem of being open to a wide range of interpretations. Conceivably, a court might require only a loose nexus by applying § 1823(e) to claims and defenses only peripherally affecting some asset. For example, assume a bank orally agrees to make a $100,000 business loan to a customer, but actually loans only $10,000. The reduction in the loan amount hampers the customer's business. If the bank fails and the customer sues, *D'Oench* and § 1823(e) might bar the claim for the additional $90,000 loan and any consequential damages because the claim is arguably "related" to an asset—the $10,000 loan. In this case, however, the new § 1823(e) should not apply because the cause of action is not sufficiently related to the underlying loan. Legislative history should clarify and give examples of the required degree of relatedness to guide courts in interpreting this phrase.[358]

Creating an explicit vendor agreement[359] exception to § 1823(e), however, is perhaps a more effective way to protect vendors without assuming the interpretational problems of a relatedness exception.[360] Such an exception clearly would signal that no written agreement is required to enforce a bank's ordinary creditor's claims against the FDIC. Because the original *D'Oench* case never contemplated such agreements, Congress should restore their exemption from *D'Oench* and § 1823(e). Consistent with the *D'Oench* case, however, Congress should require that a vendor come to court with clean hands, and should prohibit vendors from enforcing an agreement made pursuant to a scheme to deceive or defraud the FDIC.

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unrecorded agreements to extend future loans."); McCaugherty v. Sifferman, 772 F. Supp. 1128, 1138 (N.D. Cal. 1991) (citing *Bowen* to support the proposition that the agreement does not need to involve a specific asset).

358. Perhaps including additional language so that the legislation reads: "an agreement *substantially* [emphasis added] affecting an asset . . ." will help courts to understand that only agreements that substantially affect the asset are related to it, and therefore, only those agreements must be written to satisfy § 1823(e).

359. A vendor agreement transpires between a seller of goods or services and a bank.

360. Proposed § 1823(e)(4) contains this explicit exception. *See supra* note 323 (quoting the Act).

ii. Transactions Not in the Normal Course of Business

The new § 1823(e) should not provide a new exception for transactions that would not be included in official records in the normal course of business, such as nominal subcontracting construction work.[361] The numerous interpretive problems such an exception would create perhaps outweigh the potential benefits.

The vague term "normal course of business" is open to varied interpretations. To create a workable standard, therefore, legislation would need to determine who decides what qualifies as "in the normal course of business"[362]—the judiciary, the FDIC, or borrowers. It also would need to clarify whether the standard is objective and uniform for all institutions throughout the nation, or whether it would allow subjective determinations.[363]

The interpretation of this vague phrase has significant implications. For example, a bank's promise to "be understanding" if payments are late might be in the "normal course of business" for some banks, but even those banks might differ regarding whether such a promise must be kept in the bank's files as a formal agreement. The prior course of conduct between a bank and a long-time customer raises similar problems. Their business relationship might be characterized by informal dealings, such that an agreement to allow late payments might not be included in the bank's official records. The FDIC could escape responsibility for the agreement if courts

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361. The Act proposes to revise § 1823(e) by providing that a court cannot use § 1823(e) to bar a claim or defense if "the claim or defense relates to a transaction that, *in the normal course of business*, would not be included in the official records of the insured depository institution." S. 648, 104th Cong., 1st Sess. (1995) (emphasis added). This Article advocates that this revision be eliminated, or at least revised. Any revision, however, appears to fall victim to this same critique.

362. It is not clear why the term "normal" course of business is used in this section, when in a previous section, the term "ordinary" course of business is used. It does not appear Congress intends anything different from a legal point of view by using the two terms, but a judge might draw a different interpretation. Ordinary is defined as "regular; usual; normal; common; often reoccurring." BLACK'S, *supra* note 152, at 1097. Normal is defined as "conform[ing] to a type, standard or regular form." *Id.* at 1059.

363. For example, "normal course of business" for a small bank in Pueblo, Colorado, might be very different than "normal course of business" for Citicorp Bank in New York City.

interpret "normal course of business" using an objective standard, rather than a subjective one.

Although the exception seems redundant, its inclusion will give judges the flexibility to address unforeseen manifestations of injustice. If reform legislation includes such an exception—using a more objective standard, such as the phrase "which conform to industry standards," in lieu of "normal course of business"— it might eliminate some of the subjectivity inherent in the latter phrase. Mandating the use of an objective industry standard would give courts more guidance in applying the statute because such standards are more ascertainable. This requirement would protect the FDIC from secret agreements that industry-wide standards require to be recorded in the bank's records.[364]

iii. Exception for Pending Claims and the 90-Day Window

The protections available to the FDIC under *D'Oench* and § 1823(e) give borrowers and creditors an incentive to sue to enforce side agreements with a failing institution before it fails. A rush of lawsuits, however, could hasten the failure of a bank already in financial trouble. Therefore, a revised § 1823(e) should require such claims to have been filed more than 90 days before the bank fails or is placed into conservatorship.[365] Claims filed more than 90 days before the bank fails or is placed into conservatorship are more likely to result from a valid side agreement rather than a borrower or vendor simply trying to record a claim against the institution while it is still solvent.[366] This exception thus protects claimants with pending suits from the FDIC's use of § 1823(e) late in litigation, as happened to Mrs. Sweeney. The 90-day window, however, protects the failing institution and the FDIC from an onslaught of suits filed simply

364. The disclosure and filing system proposed *infra* Part III.E. also would solve this dilemma. If institutions were required to disclose the possible application of § 1823(e), and if borrowers were allowed to immediately memorialize their side agreement and file it directly with the regulators, the need for this exception would be reduced.

365. *See supra* note 323 (quoting the Act).

366. Note that Senator Cohen's bill did not originally contain this provision to provide a 90-day period. On April 18, 1995, the author wrote a letter to the Senate Banking Committee suggesting this change. Letter from Professor Fred Galves, McGeorge School of Law, University of the Pacific, to the Senate Banking Committee (Apr. 18, 1995) (copy on file with the author). The markup of the bill contained this provision by the time of the hearings on June 14, 1995.

in anticipation of bank failure.

Congress should provide an exception to the 90-day period, however, for intentional torts,[367] or fraud or knowing misrepresentation by bank employees leading to violations of state or federal laws or regulations.[368] Suits based on these causes of action would remain viable regardless of their filing dates. This exception would reverse much of the case law that has given *D'Oench* and § 1823(e) a bad name in banking circles, because the FDIC no longer could use a bank's fraudulent, dishonest, or illegal behavior against the innocent borrower.[369] To base a claim or defense on the bank's statutory or regulatory violations, however, the borrower must come to court with "clean hands."[370] That is, the borrower cannot have engaged in deceitful activity, nor can an alleged oral side agreement or verbal representation conflict with a written agreement.[371] These exceptions to the exception merely reinstate the limited holding of the original *D'Oench* case based on equitable considerations.[372]

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367. The exceptions should apply to the intentional torts of the bank, not just negligence claims. It is important not to assume that this specific intentional tort exception means that claims and defenses based on negligence torts are prohibited by proposed § 1823(e). Under proposed § 1823(e)(2)(A), a negligence tort claim would not "relate to an agreement affecting an asset acquired from the insured depository institution." *See supra* note 323 (quoting the Act). Thus, an individual who, for example, slips and falls in the bank lobby, then attempts to claim against the FDIC as receiver when the bank fails, would be able to pursue a tort claim without having it barred by § 1823(e) for failure to obtain a writing. So both negligence *and* intentional torts, serving as the basis for claims and defenses against the FDIC, would not be barred by the application of proposed § 1823(e).

368. *See supra* note 323 (quoting the Act).

369. The *Sweeney* case, discussed *supra* notes 21-33 and accompanying text, for example, would be reversed (assuming the legislation could apply retroactively) because the bank and officers violated statutory and regulatory laws in dealing with Mrs. Sweeney. *See supra* note 27 and accompanying text (noting ComFed's legal violations).

370. Under the clean hands doctrine, "equity will not grant relief to a party, who, as actor, seeks to set judicial machinery in motion and obtain some remedy, if such party in prior conduct has violated conscience or good faith or other equitable principle." BLACK'S, *supra* note 152, at 250.

371. *See generally* FARNSWORTH, *supra* note 132, § 7.2 (discussing the parol evidence rule). The parol evidence rule bars later verbal statements used to reform a written agreement "to provide trustworthy evidence of the fact and terms of their agreement and to avoid reliance on uncertain memory." *Id.* at 447. The rule also "affirms the primacy of subsequent agreements over prior negotiations and even prior agreements." *Id.* at 451.

372. *See supra* note 102 and accompanying text (arguing for *D'Oench*'s limited applicability).

E. THE DISCLOSURE AND FILING REFORM PROPOSAL: MAKING SECTION 1823(e) A JUSTIFIABLE REQUIREMENT

Although the coping mechanisms and reform proposals discussed above would help alleviate certain aspects of the overall *D'Oench* problem, they either fail to provide a complete solution or create new interpretive problems. Most importantly, they fail to address adequately the difficult balance between fairness to innocent borrowers and protecting the FDIC's insurance fund. A simple disclosure and filing proposal, however, would provide a complete solution.

One of the hallmarks of American jurisprudence is the duty to warn.[373] The heavily regulated banking industry recognizes and practices this duty, as Congress has required financial institutions to disclose full information to bank customers about anti-discrimination laws,[374] allowable interest rates,[375] and various other consumer protection laws.[376] This disclosure

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373. *See generally* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 685 (5th ed. 1984) (explaining the two separate goals achieved by adequate warnings as "risk reduction and the protection of individual autonomy in decision-making").

374. *See* Community Reinvestment Act, 12 U.S.C. §§ 2901-2907 (encouraging credit extension to low- and moderate-income citizens); Equal Credit Opportunity Act, 15 U.S.C. § 1691 (1994) (requiring disclosure of reasons for denying credit).

375. Usury limits for national banks are contained in 12 U.S.C. § 85. Section 85 permits national banks to charge the greater of three rates:

> (1) the rate allowed by the laws of the state where the national bank is located, except that where a state sets a different rate for state-chartered banks, this rate is allowed for national banks; (2) 1 percent above the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the district where the bank is located; or (3) 7 percent if no interest rate is fixed by state law.

MACEY & MILLER, *supra* note 3, at 189-90.

376. *See* Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601-2617 (1994) (requiring residential mortgage lenders to disclose details about the terms of open end home equity loans); Home Mortgage Disclosure Act, 12 U.S.C. §§ 2801-2810 (1994) (requiring depository institutions to compile a variety of statistics about home mortgage lending); Truth in Savings Act, 12 U.S.C. §§ 4201-4313 (1994) (requiring disclosure for terms and conditions of interest paid and fees charged on deposit accounts); Truth in Lending Act, 15 U.S.C. §§ 1601-1665 (1994) (requiring disclosure for consumer credit and consumer lease transactions); Fair Credit and Charge Card Disclosure Act of 1988, Pub. L. No. 100-583, § 2, 102 Stat. 2960 (1988) (amending the Truth in Lending Act and requiring disclosures in connection with applications and solicitations for all credit and charge cards); Fair Credit Reporting Act, 15 U.S.C. §§ 1681-1681t (1994) (regulating the preparations and distribution of reports by consumer reporting agencies regarding a customer's credit worthiness or general

does not create new substantive legal rights for bank customers, but merely *informs* them of their *existing* legal rights and the legal consequences of failing to protect or preserve those rights.[377] Absent a warning, § 1823(e), either in its current or revised form, likely will continue to bar most otherwise legitimate claims and defenses of borrowers of failed institutions. Fairness dictates that those borrowers be warned about § 1823(e) and the ramifications of failing to comply with it.

To accomplish this delicate but important balance, the disclosure and filing system would operate somewhat like a simplified UCC filing system or a state law real property recording system.[378] It involves an easy two-step process. First, a lender must submit two standard forms to the borrower whenever it extends a loan or enters into a subsequent agreement regarding that loan.[379] At the time it makes a loan or signs any contract, the financial institution first must inform creditors and borrowers, through a short "§ 1823(e) Disclosure Form," of the possible application of the *D'Oench* doctrine and § 1823(e) in the event the financial institution fails.[380] This form simply alerts the borrower that any agreement he has with the bank that is not reflected in the promissory note or loan documents (hence, a "side agreement") is unenforceable if the

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reputation); Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§ 1701-1720 (1994) (imposing securities law-type disclosure obligations on the sale of large parcels of unimproved land in interstate commerce).

377. *See generally* Michael P. Malloy, *Public Disclosure as a Tool of Federal Banking Regulation,* 9 ANN. REV. BANKING L. 229 (1990) (arguing that disclosure in and of itself as a procedural requirement is a prevalent and very valuable tool in the efficient and legitimate regulation of the banking industry.) "[S]trides have been made by the regulators in the direction of utilizing disclosure in more creative ways as an enforcement instrument in the bank supervision context. The [FDIC] has been consistently ahead of the curve on this issue." *Id.* at 235-36.

378. *See, e.g.,* U.C.C. §§ 9-404 to 9-408 (1994) (providing procedures for noting the discharge of secured obligations and the termination of financing arrangements, permissive devices for a secured party to have their assignment or release of collateral noted of record, and assurances to the secured party that the mechanics of the filing system will be complied with). *See generally* ROGER A. CUNNINGHAM ET AL., THE LAW OF PROPERTY 824 (2d ed. 1993) (outlining the fundamental concepts behind property recording systems).

379. If S. 648 does not pass, institutions also should be required to submit these same forms to vendors or other individuals with whom the institution has a business or transactional relationship so that those individuals or businesses would be made aware of the possible application of § 1823(e) and the *D'Oench* doctrine should the institution fail.

380. *See infra* Appendix A (setting forth the form).

bank fails and the FDIC takes over.[381] Even if legislative reform of *D'Oench* and § 1823(e) opens the courthouse doors somewhat for borrowers and others in certain circumstances, innocent borrowers should be prepared for the potential consequences of a possible bank failure.

The second step becomes necessary only when the borrower or creditor has a side agreement with the bank that is *not* reflected in the primary loan or contract documents, and that borrower or creditor wants to preserve her rights in that side agreement in the event of bank failure. In such a situation, the individual and the institution would sign a second form, the "§ 1823(e) Filing Form."[382] The borrower would file the § 1823(e) Filing Form directly with the FDIC and the institution's primary federal regulator.[383] Filing will (1) ensure that the FDIC will recognize the side agreement or verbal understanding should the institution fail; (2) allow the borrower to comply with § 1823(e) without having to rely on the bank's unilateral action;[384] and (3) ensure that institutions cannot deceive regulators about the financial strength of their institutions. Such awareness would promote the FDIC's *legitimate* interests in failed financial institution litigation,[385] but not at the expense of *legitimate* claims and defenses of innocent borrowers.

The cost and responsibility of the filing would be placed upon the borrower seeking to memorialize his side agreement

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381. The form would simply inform the borrower or creditor of existing law. The disclosure form further informs the borrower that if they want to memorialize their side agreement so that it can be enforced later, such must be done in accordance with § 1823(e).

382. *See infra* Appendix B (setting forth the form). The "12 U.S.C. § 1823(e) Filing Form" would be used by borrowers and creditors wanting to properly memorialize, and ensure the enforceability of, their side agreements should their lending institutions ever fail.

383. *See supra* note 69 and accompanying text (discussing primary federal regulators). Regulators should be privy to this side agreement information along with the FDIC because it will keep them informed of the bank's activities and the strength or weakness of the bank's loan portfolio.

384. Filing the side agreement with regulators eliminates the borrower's vulnerability to a dishonest bank employee who might remove the side agreement from the bank's official files or who simply might fail to keep it there. *See infra* note 394 (noting the possibility of dishonest filing procedures).

385. *See supra* Part II.A.1. (explaining the original legitimate purposes and policy behind the *D'Oench* doctrine and § 1823(e)).

with the institution.[386] A borrower who waives his rights by failing to act, despite the institution's disclosure, later could not claim unfairness. The borrower's filing costs would include only postage, copying costs, and the time to complete the forms. The benefit to the borrower of not losing potential claims or defenses against the FDIC if the institution should fail clearly outweighs these negligible costs. The cost to the regulators also would be negligible because regulators *already* must collect, store, and manage detailed information about the institutions they regulate.[387] The cost to banks in providing the forms also would be minimal.

1. The Benefits of the Proposal for Borrowers

The filing system would provide borrowers "enforcement insurance" for any side agreement they may reach with their institutions. Filing ensures that an agreement will be enforceable both against the institution in the event the institution does not fail and against the FDIC in the event it does fail.[388] This benefit gives borrowers a great incentive to submit the Filing Form, unless they are trying to hide their agreements from the financial institution's federal regulatory examiners, in which case the *D'Oench* doctrine should apply as it was originally intended.[389]

The disclosure and filing system provides an important additional side benefit. This system encourages a writing to

386. The only cost to the financial institutions would be that of printing a two-page form and the time involved in distributing the two pages at every loan closing along with all of the existing disclosure requirements. As such, the additional cost would be negligible.

387. *See* MACEY & MILLER, *supra* note 3, at 577 (describing investigatory functions of regulators). Institutions must file and regulators must review quarterly balance sheets, and either quarterly (for larger banks) or semi-annual (for smaller banks) income statements. If this review reveals unusual conditions or potentially dangerous deterioration in performance, regulators schedule an on-site examination and perform a more detailed review. *Id.*

388. As with most disclosure requirements, the borrower may simply disregard them, fail to understand them, or be persuaded by the bank officer not to consider them seriously. Disclosure requirements nonetheless serve a vital function in making borrowers aware of important information. *See, e.g.*, Truth in Lending Act, *supra* note 376, §§ 1601-1665 (requiring disclosure for consumer credit and consumer lease transactions). Moreover, the disclosure would be an improvement over the status quo of no disclosure.

389. *See supra* notes 102-104 and accompanying text (explaining that the original purpose of the *D'Oench* doctrine was to estop a borrower, along with the bank, from deceiving the bank regulator).

evidence any agreement or verbal representation upon which a customer relies—a much more desirable approach to legal relationships. Borrowers thus will be less likely to fall victim to a bank's verbal misrepresentations because the disclosure form forces the bank either to acknowledge its verbal representations or oral side agreements in writing or to refuse to extend or modify the loan in conformity therewith. Although courts should allow borrowers to pursue legitimate lender liability actions, this proposal would protect innocent borrowers before filing an action became necessary, thereby reducing the number of such actions. Even if the close working relationship between the borrower and the bank breeds sufficient trust that the parties feel no need to memorialize oral side agreements or representations, disclosure would make borrowers aware that such trust will not automatically transfer to their relationship with the FDIC.

2. The Benefits of the Proposal for Financial Institutions

Although the proposal principally affects the legal relationship between the borrower and the FDIC, financial institutions also would benefit, despite the cost and burden of having to supply additional loan disclosure documents.[390] Currently, a borrower can use alleged oral side agreements and verbal misrepresentations[391] to defend against a bank's collection action or as a counterclaim in such an action. Even if that defense or counterclaim is unsuccessful and the borrower cannot escape liability on the loan, raising it may promote a favorable settlement by increasing the bank's cost of collection. The proposed filing system makes those defenses and counterclaims harder to maintain, because a bank can argue that the borrower failed to memorialize any oral side agreement or verbal representations with the FDIC when it was clearly in the borrower's

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390. Lenders typically balk at laws or regulations requiring them to supply borrowers with additional forms. *See* Bill Atkinson, *Small Banks, Big Compliance Load,* BANKING WK., Feb. 1, 1993, at 1 (noting that Truth in Savings compliance costs "are especially high for small banks"); Patrick Dalton, *Red Tape Maze Hinders Credit, ABA Tells House Subcommittee,* ABA BANKER'S WKLY., Aug. 11, 1992, at 6. Note, however, that any additional cost or training of bank officers would be negligible because the requirement would necessitate only that the borrower read the disclosure statement and that the officer explain to the borrower that should the bank fail, any side agreement or verbal representation made by the bank must comport with § 1823(e) to be enforceable against the FDIC.

391. *See, e.g.,* Platsis v. E.F. Hutton & Co., 642 F. Supp. 1277 (W.D. Mich. 1986); *In re* Roberti, 183 B.R. 991 (D. Conn. June 30, 1995).

self-interest to do so. Failing to file undercuts the strength and credibility of the borrower's reliance claim.

3. The Benefits of the Proposal for Regulators

The disclosure and filing system would provide the FDIC and financial institution regulators with immediate access to updated information regarding the status and strength of the loans at each particular financial institution. Although current law already gives regulators access to extensive financial information,[392] more information about the strengths and weaknesses of the institution's loans should lead to more effective monitoring and control. For example, an increase in § 1823(e) Filing Forms at a particular institution might alert the FDIC or other regulators that the institution is compromising too many of its loan assets with side agreements and thus needlessly exposing itself to poor loan collection and poor management.[393]

The filing system also would provide the FDIC and regulators full access to side agreement information as soon as it becomes available. This immediacy would be a considerable improvement over the current system, where regulators must wait sometimes up to a year to conduct annual examinations, only to have a *possibility* of discovering some of these side agreements.[394] This also would help the FDIC in its seizure and closure of an institution, when it must assess the value of the institution's loan files often overnight or in a weekend.[395]

The only drawback of the proposal for the FDIC is the elimination of potential collection recovery "windfalls" from the

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392. *See supra* note 387; *infra* note 394 (describing the ability of regulators to gain access to financial information).

393. Allowing the borrower payment schedule extensions, lowering the interest rate for the remainder of the loan, and promising additional financing if the borrower does not default are all examples of loan modifications or side agreements that might contribute to the bank's weak loan portfolio and thus overall weakness and perhaps eventual failure.

394. *See* 12 U.S.C. § 481 (1994) (requiring the OCC to examine banks "as often as . . . necessary"); *see also* 12 U.S.C. § 1440 (1994) (requiring the Federal Housing Finance Board to examine Federal Home Loan Banks at least on an annual basis); 12 U.S.C. § 1820(d) (1994) (requiring the FDIC, as the insurer, to examine banks at least annually to ensure compliance with FDIC insurance regulations). This assumes the institution's officers have not hidden records, or simply failed to keep them as part of the institution's "official" loan records.

395. *See supra* note 101 and accompanying text (noting the importance of quickness and efficiency in examining an insolvent institution's accounts).

automatic application of *D'Oench* to defeat most of the borrower's claims and defenses related to side agreements. The fact that current interpretation gives the FDIC an unjustified windfall in certain cases, however, cannot justify the operation of an equitable, legitimate *D'Oench* doctrine. Similarly, the FDIC's administrative convenience during a bank seizure of not having to address claims or defenses relating to side agreements or verbal representations should not justify a windfall to the FDIC.[396]

CONCLUSION

> A corporation cannot blush. It is a body, it is true; has certainly a head—a new one every year; arms it has and very long ones, for it can reach at anything; . . . a throat to swallow the rights of the community, and a stomach to digest them! But who ever yet discovered, in the anatomy of any corporation, either bowels or a heart?[397]

Congress created the FDIC during the Great Depression to protect banking customers and all U.S. citizens from disastrous bank runs.[398] Indeed, the New Deal represented hope in a new kind of federal government that would not bow to the power of corporations and their financiers, hope in a new government that would be responsible to common folk and not the powerful banking industry, and hope that, no matter what, our democratic government would not abuse its power against our people. That was then.

After the New Deal, and especially during the last decade, that hope has turned into disappointment and despair for many individuals who have faced the FDIC in failed bank litigation. The federal government, through the FDIC, has changed from a helpful guardian into a mighty enemy. Although *D'Oench* and § 1823(e) originally rested on legitimate equitable concerns, the courts and Congress have extended the doctrine's scope to the point that it now gives the FDIC a powerful and often unjust

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396. One of the arguments justifying the *D'Oench* doctrine is that the FDIC and other regulators should not be required to investigate all possible side agreements with former borrowers in order to determine the true value of the loan asset. *See supra* notes 99-100 and accompanying text (describing the difficulty of discovering unrecorded side agreements).

397. Howell Walsh, Speech, *Tralee assizes*, (1825), *quoted in* THE QUOTABLE LAWYER 27 (David S. Shrager & Elizabeth Frost eds., 1986).

398. *See supra* notes 65-66 and accompanying text (describing the rationale for the creation of the FDIC).

litigation weapon to bar most claims and defenses of borrowers and creditors of failed financial institutions. The FDIC's use of *D'Oench* has become an excess of the banking industry.[399]

Because of the doctrine's tremendous legislative and judicial growth, the only workable solution now appears to be significant *legislative* reform rewriting § 1823(e) and eliminating common law *D'Oench*. Even the FDIC's own voluntary policy guidelines cannot address the problem effectively. Although admirable, the Senate's recent legislative reform effort—S. 648, the *D'Oench Duhme* Reform Act—also fails to remedy the problem.

In setting forth the history and unsettling current status of the *D'Oench* doctrine, this Article has advocated a complete rewrite of § 1823(e), reining in the *D'Oench* doctrine, and instituting a disclosure and filing system that balances the many competing rights and responsibilities of all parties concerned after a bank failure. The filing system avoids many of the logistical problems and injustices suffered by unsuspecting individuals without sacrificing the FDIC's interests in protecting its insurance fund. This disclosure and filing arrangement will return the *D'Oench* doctrine to a legitimate equitable doctrine used to preserve justice.

When the government abuses its power, our core democratic ideals call for the kind of significant reform this Article advocates. We cannot trust the FDIC to police itself, and nothing but significant congressional action will restrict the FDIC's oppressive use of *D'Oench*. Justice demands that the powers of *D'Oench* and § 1823(e) be curtailed and that customers be warned of its existence. Only then will customers of financial institutions and the FDIC's insurance fund be protected fully and fairly. The *D'Oench* doctrine and § 1823(e) as they currently stand give the government great and even unfair powers to defeat individuals in failed bank litigation. But might does not make right.

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399. The FDIC should not be allowed to escape responsibility for legitimate side agreements or actual representations between the former solvent financial institution (in whose shoes the FDIC now stands) and a borrower or other individual if those agreements were later recorded pursuant to the disclosure and filing system. The financial institutions would have been responsible for the agreements or representations had they not failed. Accordingly, the FDIC should bear a similar responsibility. To decide otherwise would be to justify an unfair windfall unrelated to the original intent or purpose of the *D'Oench* doctrine or § 1823(e). Legislative reform and this Article's disclosure and filing proposal strike the proper balance between fairness to the borrower and meeting the legitimate needs and policy concerns of the FDIC.

APPENDIX A

12 U.S.C. § 1823(e) DISCLOSURE FORM

WARNING TO BORROWER IN THE EVENT OF A BANK FAILURE

This Disclosure Form is for the express purpose of making you, the BORROWER, aware that any side agreement or additional agreement made with the LENDING INSTITUTION, or any verbal representation made by the LENDING INSTITUTION upon which BORROWER relies, neither of which is specifically set forth in these loan documents, WILL NOT BE ACKNOWLEDGED BY THE FEDERAL GOVERNMENT IN THE EVENT THE LENDING INSTITUTION FAILS, UNLESS SUCH AGREEMENT IS IN WRITING AND COMPLIES WITH 12 U.S.C. § 1823(e).

THEREFORE YOU ARE ADVISED THAT YOU MUST COMPLETE AND FILE the attached 12 U.S.C. § 1823(e) FILING FORM with (1) THE FDIC (address below), (2) THE OCC or OTS or NCUA (addresses below), AND (3) YOUR LENDER IN ORDER FOR THE SIDE AGREEMENT OR VERBAL REPRESENTATION TO BE LEGALLY RECOGNIZED BY THE FEDERAL GOVERNMENT IN THE EVENT THE YOUR LENDING INSTITUTION FAILS.

If the BORROWER represents that there is no such side agreement with the LENDING INSTITUTION or there is no verbal representation made by the LENDING INSTITUTION upon which the BORROWER is relying in making this loan, or all such agreements and representations are ALREADY reflected in the loan agreement, the BORROWER should sign here

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However, if there is any side agreement or verbal representation upon which the BORROWER relies that is not specifically reflected in the loan agreement, the BORROWER must complete and file the attached 12 U.S.C. § 1823(e) FILING FORM SO THAT THE AGREEMENT OR REPRESENTATION WILL BE RECOGNIZED AND ACKNOWLEDGED BY THE U.S. GOVERNMENT IN THE EVENT YOUR LENDING INSTITUTION FAILS.

Moreover, in the future, if you ever modify, change, or add to this loan agreement, you must file this form again SO THAT THE AGREEMENT OR REPRESENTATION WILL BE RECOGNIZED AND ACKNOWLEDGED BY THE U.S. GOVERNMENT IN THE EVENT YOUR LENDING INSTITUTION FAILS.

APPENDIX B

12 U.S.C. § 1823(e) FILING FORM

SEND THIS COMPLETED FORM WITH THE SIDE AGREEMENT TO THE FEDERAL AGENCIES SET FORTH BELOW. FAILURE TO DO SO MAY PRECLUDE THE ENFORCEABILITY OF THE SIDE AGREEMENT AGAINST THE FDIC. THIS APPLIES TO ANY FUTURE AGREEMENTS MADE WITH YOUR LENDER.

The BORROWER, by filling out and filing this Form, is ensuring that the side agreement with the LENDING INSTITUTION and/or the verbal representations made by the LENDING INSTITUTION will be acknowledged by the federal government in the event that the LENDING INSTITUTION FAILS.

THE BORROWER states that the following constitutes an agreement made with the LENDING INSTITUTION and/or constitutes a verbal representation made by the LENDING INSTITUTION and relied upon by the BORROWER.

ATTACH WRITTEN AND SIGNED AGREEMENT

The BORROWER is required to send this form to the FDIC:

Federal Deposit Insurance Corporation
12 U.S.C. § 1823(e) Compliance Program
550 Seventeenth Street, N.W.
Washington, D.C. 20429

AND to the applicable agency (choose (1) one from below);

If the lending institution is a thrift, savings bank, or savings and loan:
Office of Thrift Supervision
12 U.S.C. § 1823(e) Compliance Program
1700 G Street, N.W.
Washington, D.C. 20552

OR

If the lending institution is a commercial bank:
Office of the Comptroller of the Currency
12 U.S.C. § 1823(e) Compliance Program
250 E Street, S.W.
Washington, D.C. 20219

OR

If the lending institution is a credit union:
National Credit Union Association
12 U.S.C. § 1823(e) Compliance Program
1775 Duke Street
Alexandria, VA 22314