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Roger Williams University Law Review

Volume 3 | Issue 2 Article 5

Spring 1998

1997 Survey of Rhode Island Law: Cases: Agency Law

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Recommended Citation

Powers, William J. IV (1998) "1997 Survey of Rhode Island Law: Cases: Agency Law," *Roger Williams University Law Review*: Vol. 3: Iss. 2, Article 5.

Available at: http://docs.rwu.edu/rwu_LR/vol3/iss2/5

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Agency Law. *Rhode Island Depositors Economic Protection Corp. v. Ryan*, 697 A.2d 1087 (R.I. 1997). Where a defendant participated in a scheme designed to forward funds to an ineligible borrower, the defendant will be held personally liable for the note when bank records contained no written agreement memorializing the alleged agency relationship between the defendant and a third party.

FACTS AND TRAVEL

On August 5, 1988, P. Alan Ryan (Ryan) signed a promissory note in favor of Davisville Credit Union (Davisville).[1] The note was in the amount of $1.6 million dollars. Davisville subsequently failed because of unsound lending practices, and the Rhode Island Depositors Economic Protection Corporation (DEPCO) became the beneficiary to Davisville's rights under the note.[2] On May 23, 1994, DEPCO sought to collect on the note and filed a complaint in Rhode Island Superior Court. DEPCO alleged that the defendant defaulted on the note and that Ryan was obligated under the note's terms to pay the principal and interest plus costs.[3]

BACKGROUND

Ryan, the defendant, claimed that because he was an agent of the principal actor, David LaRoche (LaRoche), he was not obligated to the terms of the note.[4] Ryan conceded that "the note itself did not reveal any agency status, but he maintained that DEPCO was chargeable with notice of the agency relationship on the basis of other documents in Davisville's loan file."[5] Ryan contended that the documents created a genuine issue of material fact about whether he had signed the note as an agent. Ryan claimed this precluded the disposition of the case by summary judgment at the trial level.[6]

1. *See* Rhode Island Depositors Economic Protection Corp. v. Ryan, 697 A.2d 1087, 1089 (R.I. 1997).
2. *See id.*
3. *See id.*
4. *See id.*
5. *Id.*
6. *See id.*

Ryan admitted that he had participated in a plan to enable LaRoche to evade adhering to the maximum borrowing limit established by Davisville for individual debtors.[7] According to Ryan, the transaction was designed to allow "Davisville to loan money to Ryan for LaRoche's benefit."[8] In addition, Ryan claimed that Davisville was aware of the agency relationship that existed between Ryan and LaRoche.[9] In support of his allegations that the debtor on the note was in fact LaRoche, Ryan identified lending-procedure irregularities in several documents in the loan file that he claimed revealed the true nature of the loan.[10] At the trial level, the judge ruled that Ryan would survive summary judgment because he alleged sufficient facts to establish a basis for his defense.[11] However, the trial judge further determined that "none of the facts presented by the defendant, separately or cumulatively, is enough to put a subsequent holder of the note on notice of any agency relationship."[12] Ryan, however, had two defenses available against DEPCO. These defenses were based on (1) the federal holder-in-due-course doctrine[13] and (2) the D'Oench, Duhme doctrine.[14]

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7. *See id.* at 1090.

8. *Id.*

9. Ryan contended that Davisville officials told him that he "was not responsible for the loan and . . . would never be responsible for the loan since [he] was not the borrower." *Id.*

10. Ryan alleged that at the time he signed the note, his annual income was $36,000, he had never completed a loan application, he had never provided Davisville with any financial information and he had never signed a purchase-and-sale agreement for the property that was mortgaged as part of the transaction. *See id.* The property in question consisted of forty-three waterfront lots in Portsmouth, Rhode Island, which Ryan owned for fifteen minutes—just long enough to sign the note and mortgage before deeding the property by quitclaim deed back to LaRoche. Ryan also contended that the address on the note was the address of LaRoche. *See id.*

11. *See id.*

12. *Id.*

13. *See id.* at 1091. The court treated DEPCO and FDIC similarly as they both essentially perform the same function. *Cf.* O'Melveny & Myers v. FDIC, 512 U.S. 79 (1994) (leaving it up to individual states to supplement a federal statutory regulation that is comprehensive and detailed). *But see* Resolution Trust Corp. v. A.W. Assoc., Inc., 869 F. Supp. 1503, 1510 (D. Kan. 1994).

14. *See Ryan*, 697 A.2d at 1091 (citing D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942)).

Federal Holder-in-Due Course Doctrine

Traditionally a state law concept, the federal holder-in-due course doctrine[15] allows an entity such as DEPCO to hold a note in the regular course of business. DEPCO would not ordinarily be relegated to determining its status as a creditor under the Uniform Commercial Code Rhode Island General Laws title 6A.[16] However, in order to facilitate its function as a federal-depository agency,[17] DEPCO is afforded the protection of UCC regulation.[18] The federal holder-in-due-course doctrine extends to the regulatory agency the protection from personal defenses normally enjoyed by a holder-in-due-course under state law, but does not extend to the agency protection from real defenses.[19] Ryan asserted only personal defenses.[20]

Although Ryan argued that DEPCO knew or should have known of his agency relationship with LaRoche, the documentation in his loan file alone was insufficient to persuade the court to cre-

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15. *See* Gunter v. Hutcheson, 674 F.2d 862 (11th Cir. 1982), *cert. denied*, 459 U.S. 826 (1982).

16. R.I. Gen. Laws §§ 6A1-101 to -9-507 (1956) (1992 Reenactment) (adopting the Uniform Commercial Code).

17. The function of an agency such as the FDIC, or DEPCO in the present case, is to pay the depositors of the failed institution. This is accomplished through a purchase and assumption transaction whereby:

> the receiver of the failed bank transfers the assets and liabilities of the failed bank to another, solvent bank. In order to shield the acquiring bank from loss that may result from the acquisition of high-risk assets such as defaulted loans, the acquiring bank is permitted to return assets that are not of the highest quality. The FDIC as corporate insurer then purchases the returned assets from the receiver, who in turn forwards the money to the acquiring bank. In essence, the FDIC makes good on risky assets of the failed bank, thus allowing the assets and money transferred to the acquiring bank to equal or exceed the assumed liabilities. The FDIC then attempts to collect on the assets returned by the acquiring bank in order to minimize loss to the insurance fund.

Ryan, 697 A.2d at 1091-92.

18. *See* R.I. Gen. Laws §§ 6A-3-302 to -305 (1956) (1992 Reenactment) (setting forth qualifications and rights of a holder-in-due-course in Rhode Island).

19. *See Ryan*, 697 A.2d at 1092. Personal defenses consist of, but are not limited to: (1) failure of consideration, (2) nondelivery and (3) fraud in the inducement. *See* 11 Am. Jur. 2d *Bills and Notes* § 654 (1963). Real defenses consist of: (1) infancy, (2) incapacity, duress or illegality of the transaction that renders the party's obligation a nullity, (3) fraud in the factum and (4) discharge in bankruptcy. *See* R.I. Gen. Laws § 6A-3-305(2) (1956).

20. The defendant sought to avoid liability on the note, which he admitted signing, on the basis of an unrecorded agency agreement. *See Ryan*, 697 A.2d at 1093.

ate an agency relationship among the parties.[21] The defendant's position was essentially that, because his "straw-man" status in relation to LaRoche was arguably discernable on close inspection of the bank records, a factual question was created concerning whether DEPCO had notice of the alleged agency relationship.[22] The court found it reasonable that DEPCO would rely on the loan documents as they existed in Davisville's file obligating Ryan to assume responsibility for the note.[23]

The D'Oench, Duhme Doctrine

Second, the defendant argued that his agency relationship with LaRoche was memorialized in writing within the meaning of section 42-116-23 of the Rhode Island General Laws.[24] The D'Oench, Duhme doctrine is similar to the federal holder-in-due-course doctrine in that the FDIC[25] is presumably on notice of written agreements contained in the official records of a failed bank. The two doctrines diverge, however, in two separate situations.[26] First, section 42-116-23 does not require actual notice on the part

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21. The court noted that DEPCO could not be charged with knowledge of a defense merely because that information was contained in the files. *See id.* at 1094 (citing FDIC v. Wood, 758 F.2d 156, 162 (6th Cir. 1985)).

22. *See id.*

23. *See id.*

24. Certain Agreements. No agreement which tends to diminish or defeat the interest of the corporation in any asset acquired by it under this chapter shall be valid against the corporation unless such agreement:

(a) Is in writing;

(b) Was executed by the eligible institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the eligible institution;

(c) Was approved by the board of directors of the eligible institution or its loan committee; which approval shall be reflected in the minutes of the board or committee; and

(d) Has been, continuously, from the time of its execution, an official record of the eligible institution.

R.I. Gen. Laws § 42-116-23 (1956) (1993 Reenactment). This statute contains substantially the same language as that found in Rhode Island General Laws § 19-12-13 (1956) (1995 Reenactment) (Rhode Island's receivership statute). Both statutes essentially replicate 12 U.S.C. § 1823(e) of the Federal Deposit Insurance Corporation Act, which codifies the federal common-law doctrine that originated in *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942).

25. In this case, DEPCO is substituted for FDIC.

26. *See Ryan*, 697 A.2d at 1094-95.

of DEPCO.[27] If the agreement in contention satisfies the statute's four prongs, then DEPCO's lack of knowledge will not defeat a claim based on the agreement.[28] The defendant argued that his agency relationship was reflected in various documents executed at the closing and these documents, taken together, constituted a written agreement within the meaning of section 42-116-23.[29] Furthermore, the defendant contended that the trial judge erred in requiring a "specific written document evidencing the agreement" because the statute does not require a specific written document.[30] The court, however, relied on *Langley v. Federal Deposit Insurance Corp.*,[31] which required adherence to the specific writing requirement in 12 U.S.C. § 1823(e).[32] The court went on to equate the receivership statute,[33] which requires a specific writing,[34] to the DEPCO statute[35] because the two statutes are ostensibly a carbon copy of one another.[36] The court and the statute, therefore, required the defendant to point to a specific writing in order to evidence the relationship which he so fervently relied on, and Ryan was unable to do so.[37]

CONCLUSION

In dismissing both of Ryan's defenses, the court strictly adhered to the statutory requirements set forth by the federal holder-in-due-course doctrine and the D'Oench, Duhme doctrine. Para-

27. *See id.* at 1095.
28. *See id.*
29. *See id.*
30. *Id.*
31. 484 U.S. 86 (1987).
32. *See id.* (citing the Federal Deposit Insurance Act of 1950, 12 U.S.C. § 1823(e), which essentially provides that no agreement tending to diminish or defeat the FDIC's "right title or interest" in any asset acquired by the FDIC under the section shall be valid against the FDIC unless it shall have been (1) in writing, (2) executed contemporaneously with the bank's acquisition of the asset, (3) approved by the bank's board of directors or loan committee and reflected in the minutes of the board or committee and (4) continuously, from the time of its execution, an official record of the bank).
33. *See* R.I. Gen. Laws § 19-12-13 (1956) (1989 Reenactment).
34. *See* Paradis v. Greater Providence Deposit Corp., 677 A.2d 1340 (R.I. 1996).
35. *See* R.I. Gen. Laws § 42-116-23 (1956) (1993 Reenactment).
36. *See Ryan*, 697 A.2d at 1095.
37. Ryan admitted that, had such a writing been placed in the file, it would have frustrated the purpose of the transaction which was to "pull the wool over everyone's eyes." *Id.*

mount to the defendant's agency claim was the relationship that existed between himself, LaRoche and Davisville. In order to establish the necessary underpinnings of this unorthodox deal, Ryan portrayed himself as an innocent pawn in a high-stakes game of undercapitalized finance.[38] In attempting to create this portrait, Ryan himself became so intertwined in the incestuous fact pattern that his alleged naivete became highly suspect. Missing from the purported agreement, however, was written evidence of this relationship. The inability to point to a specific written document, as well as the protection DEPCO held under the federal holder-in-due course doctrine, was decisive in the court's conclusion that Ryan was liable on the note.

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38. *See id.* at 1090.