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FORECLOSURE

The D'Oench, Duhme Doctrine

A Little Lesson On Loans Purchased From The FDIC And RTC

BY BRUCE J. BERGMAN

What kind of obscurity is this? Well, for lenders or servicers who have ever purchased loans from the FDIC or RTC, this seemingly arcane doctrine can take on genuine and startling meaning.

Bruce J. Bergman

In sum, it is worth knowing about and, while many readers may have encountered it, the impetus for this article is a new case underscoring the astonishing power of the law.

A little background

First, some background to make it all easier to absorb.

The D'Oench doctrine is a principle of federal common law arising from the decision of the U.S. Supreme Court in **D'Oench, Duhme & Co. v. FDIC, 315 U.S. 477 (1942)**. There, a borrower executed a series of notes pursuant to a secret agreement that the notes could never be collected upon. They were merely intended as a sham to increase the apparent assets of the bank.

After the bank failed, the FDIC was appointed receiver and sued the borrower to collect the amounts due on the notes. The holding of the court was that borrower's defense of failure of consideration on the notes. The policy was intended to protect the FDIC against misrepresentations of bank assets which it insures, the court ruled.

While D'Oench was clearly a case of fraud, the courts have greatly extended the circumstances under which borrowers are estopped from asserting defenses against the FDIC.

[See, among others, In re CTS Truss Inc., 859 F2d 357 (5th Cir.), vacated on other gds. 868 F.2d 146 (5th Cir. 1989).]

Thus, although the borrower in D'Oench knowingly participated in a scheme to defraud banking authorities, the doctrine has affirmatively found application even when the borrower did not intend to deceive banking authorities.

A case in point

The point was strongly presented in a case where the borrowers were themselves the victims of unscrupulous bank officers who defrauded them.

Nonetheless, the court ruled that the borrowers' defense of fraudulent inducement was indeed barred by the D'Oench doctrine. **[FSLIC v. HSI, 657 F.Supp. 1333 (E.D. La. 1986).]** Finding the principles of D'Oench to be clear, the court ruled that those who deal with banks must bear the risk of loss in transactions which defeat the rights of deposit insurers such as the FDIC and the FSLIC.

Without citing the enormous amount of case law on the subject, suffice it to say that this doctrine has been expanded to bar the defense (in a foreclosure or an action upon a debt) of side agreements, including:

- oral representations;
- fraudulent inducement;
- failure or want of consideration;
- oral agreements to fill in the blanks;
- breach of fiduciary duty;
- accord and satisfaction;
- deceptive trade practices;
- tortious interference with contractual relations;
- material alteration; and
- undue influence.

A codified doctrine

This vital doctrine has been codified in federal statute [12 U.S.S. 1823(e)] and finds application to the RTC **[FIRREA, Pub. L. No. 101-73, §217, 103 Stat. 183, 256 (1989)].**

The essence of this statute is that any agreement which tends to diminish or defeat the interest of the FDIC or the RTC (as the case may be) in any asset, shall be void unless:

- the agreement is in writing and executed by the depository institution and the person claiming the adverse interest, and

Bruce J. Bergman, a partner with Certilman Balin Adler & Hyman in East Meadow, N.Y., is outside counsel to a number of major lenders and servicers and author of the two-volume treatise, ***Bergman on New York Mortgage Foreclosures, Mathew Bender & Co. Inc. (Rev. 1995).*** *He is a member of the National Foreclosure Professionals, the American College of Real Estate Lawyers, an adjunct associate professor of real estate with New York University's Real Estate Institute, where he teaches the mortgage foreclosure course, and on the faculty of the MBA's School of Mortgage Banking.*

■ was approved by the board of directors of the depository institution or its loan committee, reflected in the minutes of the board or the committee and continuously maintained thereafter as an official record of the depository institution.

Of critical importance to lenders and servicers, the protection of D'Oench and the statute afforded to the FDIC and the RTC extends to successors and transferees. In other words, those who buy mortgage loans!

[See, among others, Federal Savings and Loan Ins. Corp v. Cribbs, 918 F.2d 557 (5th Cir. 1990); Vernon v. RTC, 907 F.2d 1101 (11th Cir. 1990); FDIC v. Newhart, 892 F.2d 47 (8th Cir. 1989).]

The latest example

And here is the latest example of just how protective the umbrella of D'Oench can be. **[FDIC v. De Guardioloa, N.Y.L.J., Jan. 5, 1995, at 27, col. 3 (Sup. Ct. N.Y. Co., Cahn, J.).]**

In the case, a borrower had a home equity loan on a co-op with a bank which also held a first position. When eventually the borrower defaulted on both loans, the bank agreed to a workout in a letter signed by a bank's officer. There was to be no foreclosure if the apartment would be sold, with the proceeds applied in full satisfaction of the senior loan and one-third satisfaction of the home equity portion.

The bank agreed also not to pursue a deficiency on the unsatisfied debt.

Sale of the apartment ensued. The bank attended the closing and was paid precisely in accord with the agreement. Not incidentally, the bank's officer who agreed to the settlement had submitted a sworn affidavit to that effect.

And here's the rub

After the bank was paid the FDIC became its receiver, accelerated the note and sued the borrower for the very amount the bank had agreed not to pursue!

What happens? The borrower loses!

Minutes of the board of directors meeting did not reflect satisfaction of the note, said the court. Moreover all four requirements of the statute [§ 1823(e)] must be met in order to defeat the FDIC's interest.

Most frightening to borrowers - although not so unexpected - the court ruled that execution of an agreement by a bank's employee, even with authority to bind the bank, does not satisfy the statute. So the vice president who made the deal, letter and affidavit notwithstanding, could not change the result.

The instruction of all this?

Whatever integrity loans purchased from the FDIC or RTC have, they won't likely be reduced by claims of deals, agreements or waivers.

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