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Has the Federal Common-Law D'Oench Doctrine Been Preempted?

by Ralph C. Anzivino

Editor's Note: The Respondent's brief in this case was not available by PREVIEW's deadline.

ISSUE
Did the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 displace the federal common-law D'Oench Doctrine?

FACTS

On Aug. 18, 1989, petitioner Murphy invested more than $500,000 in Orchid Island Associates Limited Partnership ("Orchid") as part of a development project for a golf and beach club in Florida. Over a period of several years extending before and after this investment, Southeast Bank lent Orchid approximately $50 million for the project. Throughout this period, Southeast Bank exercised extensive control and direction over the project—making Southeast Bank a de facto joint venturer with Orchid. As a result of various wrongful activities by Southeast Bank and Orchid, Orchid eventually defaulted on its loans, and Southeast Bank foreclosed on the property. In 1991, Southeast Bank was declared insolvent and placed into FDIC receivership.

In 1992, Murphy filed suit in the U.S. District Court for the District of Columbia against the FDIC as receiver for Southeast Bank. The complaint alleged that Southeast Bank's wrongful actions in concert with Orchid caused the loss of Murphy's investment. The complaint set forth claims for breach of fiduciary duty, breach of contract, accounting deficiencies, fraud, negligent misrepresentation, and securities violations.

The FDIC-receiver moved to dismiss the complaint, arguing that Murphy's claims were barred by §1823(e) of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) and, independently, by the federal common-law D'Oench doctrine. In particular, the FDIC-receiver asserted that the
D'Oench doctrine barred Murphy's claims because liability depended upon the joint misdeeds of Southeast Bank and Orchid, but there was no written agreement memorializing their collusive wrongdoing as a formal "joint venture."

On Aug. 10, 1993, the district court, treating the FDIC's motion as one for summary judgment, granted summary judgment on all counts. The district court ruled that Murphy couldn't recover against Southeast on any theory of an alleged unwritten joint venture agreement pursuant to the D'Oench doctrine and 12 U.S.C. § 1823(e). Murphy appealed.

On Aug. 1, 1995, the D.C. Circuit reversed. The court held that § 1823(e) did not bar Murphy's claims because those claims did not relate to a specific "asset" acquired by the FDIC, and that the Supreme Court's decision in O'Melveny & Myers v. FDIC, 512 U.S. 79 (1994), removed the federal common-law D'Oench doctrine as a separate bar to such claims. In O'Melveny, the Supreme Court noted the extensive framework of FIRREA and commented that to create additional "federal common-law" exceptions would not supplement this scheme but alter it. The D.C. Circuit concluded that the need for a body of federal common law under the rubric of D'Oench has now disappeared and that the district court erred in holding that Murphy's claims are barred under D'Oench.

On May 7, 1998, the FDIC-receiver moved to substitute respondent Jeffrey H. Beck, as successor agent for Southeast Bank, as the party defendant in the Southern District of Florida. Beck had become the successor agent of Southeast Bank when, pursuant to 12 U.S.C. § 197, the FDIC-receiver had completed its receivership duties and called a meeting of the shareholders of Southeast Bank to elect an agent to wind up the bank's affairs. After a series of intervening appointments, Beck, who was also the Chapter 7 trustee for Southeast Banking Corporation and sole shareholder of the bank, elected himself as the successor agent. On May 11, 1998, respondent Beck, as successor agent for Southeast Bank, was substituted for the FDIC-receiver as the party defendant.

On July 27, 1998, the U.S. District Court for the Southern District of Florida granted the motion to dismiss pending from the District of Columbia court. The Florida district court held, inter alia, that Murphy's claims were barred by the common-law D'Oench doctrine, not withstanding the D.C. Circuit's contrary decision in the case. Murphy again appealed.

On April 7, 2000, the Eleventh Circuit, relying exclusively on the common-law D'Oench doctrine, affirmed the district court's decision. Murphy v. Beck, 208 F.3d. 959 (11th Cir. 2000). The Eleventh Circuit reasoned that the federal common-law D'Oench doctrine was still good law, notwithstanding FIRREA and the Supreme Court's decisions in O'Melveny and Atherton v. FDIC, 519 U.S. 213 (1994). The Eleventh Circuit explained that both O'Melveny and Atherton dealt with the question of whether to create new federal common law in particular areas rather than with the question whether Congress intended FIRREA to supplant the previously established and long-standing federal common-law D'Oench doctrine.

Murphy timely petitioned for a writ of certiorari, which the Supreme Court granted on Sept. 26, 2000. Murphy v. Beck, 121 S.Ct. 30 (2000). The Circuits are now evenly divided on this issue. The D.C. and Eighth Circuit have concluded that the enactment of FIRREA has displaced the common-law D'Oench doctrine, and the Fourth and Eleventh Circuits have concluded that Congress intended no displacement of the doctrine. Compare Murphy v. FDIC, 61 F.3d 34 (D.C. Cir. 1995), and Disavall Insured Income Fund Ltd. Partnership v. Boatmen's First National Bank, 69 F.3d 1398 (8th Cir. 1995) with Young v. FDIC, 103 F.3d 1180 (4th Cir. 1997) and Murphy v. Beck, 208 F.3d. 959 (11th Cir. 2000).

CASE ANALYSIS

The D'Oench doctrine originated more than half a century ago in the case of D'Oench, Duhme & Co. Inc. v. FDIC, 315 U.S. 447 (1942). In D'Oench, the FDIC sued to recover on a note it had acquired in connection with payments it made for the insurance fund to facilitate the transfer of deposit liabilities from a failed bank to a healthy bank. The FDIC was acting in its corporate capacity (FDIC-corporate) rather than in its capacity as a liquidating agent to liquidate a failed financial institution (FDIC-receiver). The maker of the note defended on the ground that the bank had agreed not to call the note, although no such agreement appeared in the bank's records.

Looking to a then-existing provision of the Federal Reserve Act criminalizing the false overvaluation of a (Continued on Page 204)
security to influence any action by FDIC-corporate, the Supreme Court discerned a federal policy to protect FDIC-corporate—and the public funds that it administers—against misrepresentations as to the securities or other assets in the portfolios of the banks that the FDIC insures or to which it makes loans. In light of that policy, the Supreme Court reasoned that one who gives 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. It is sufficient if the maker lends himself to a scheme or arrangement whereby the banking authority on which FDIC relied in insuring the bank was, or was likely to be, misled. Because the maker of the note in D'Oench was responsible for the creation of the false status of the note in the hands of the bank, the Court held that he was not allowed to plead the “secret agreement.” Otherwise, he would have been able to defeat the purpose of the statute by taking advantage of an undisclosed and fraudulent arrangement that the statute condemned and which the maker of the note made possible.

The original test stated by the Supreme Court for determining whether claims were barred under the D'Oench doctrine was whether the agreement, oral or written, was either designed to deceive the public authority or would tend to have that effect. Today, however, courts have expanded the doctrine, and it now applies in virtually all cases where the FDIC is confronted with an agreement not documented in the institution's records.

The common-law D'Oench doctrine serves two primary purposes. First, it allows federal and state examiners to rely on an institution's books and records in evaluating the institution's fiscal soundness. Second, it ensures a mature consideration of unusual loan transactions by senior bank officials and prevents the fraudulent insertion of new terms when a financial institution appears headed for failure.

In 1950, Congress substantially enacted the holding of D'Oench as part of a provision relating to purchase and assumption transactions by FDIC-corporate, but not when the FDIC was acting in its capacity as FDIC-receiver. See Federal Deposit Insurance Act of 1950, c. 967, 64 Stat. 873, 889 (Sept. 21, 1950) codified at 12 U.S.C. § 1823(e). That provision originally provided that “No agreement which tends to diminish or defeat the right, title or interest of the Corporation [the FDIC] in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement” satisfied four detailed conditions relating to writing, execution, approval, and recordation.

In 1989, as part of the comprehensive reforms adopted in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (Aug. 9, 1989), Congress amended 12 U.S.C. § 1823(e) both to expand and to make more precise the federal defense against certain unwritten agreements. FIRREA extended § 1823(e) to agreements tending to diminish or defeat the interest of the FDIC in any asset acquired by it “as receiver” (FDIC-receiver), and extended that section to the newly formed Resolution Trust Corporation (RTC), 12 U.S.C. § 1441a(b)(4). FIRREA also added a new provision at 12 U.S.C. § 1821(d)(9)(A), which made

§ 1823(e) applicable to affirmative claims against the banking authority.

From 1950 to the present, the Supreme Court has not considered whether the D'Oench case has continuing force as a common-law rule of decision separate from § 1823(e). The lower federal courts, however, have taken the holding of the D'Oench case and expanded its scope in a variety of directions. This case presents the question whether the expanded D'Oench “doctrine” has any federal common-law existence independent of the terms of § 1823(e).

Murphy initially asserts that the D'Oench doctrine cannot be applied to cases where the FDIC is acting in its capacity as receiver. Murphy contends that there is a well-defined dichotomy between the FDIC acting in its corporate capacity when pursuing its own rights as a bank insuror (FDIC-corporate), and the FDIC acting as a receiver of a failed bank asserting derivative rights on behalf of a bank's creditors and shareholders (FDIC-receiver). Murphy notes that the common-law D'Oench doctrine derived from a case in which the FDIC was acting as FDIC-corporate, not FDIC-receiver. Therefore, Murphy posits that the doctrine cannot be applied here, where the FDIC is acting in its capacity as FDIC-receiver.

Further, Murphy asserts that the Supreme Court's decisions in both O'Melveny and Atherton prohibit the FDIC-receiver from invoking federal common law, which would include the D'Oench doctrine. Although neither case involved the D'Oench doctrine, the Supreme Court in both cases held that the FDIC-receiver may not invoke federal common law to defeat claims involving the rights of a bank in receivership.
Murphy also argues that federal common law can only be invoked when a "federal interest" is involved. Federal common law is a disfavored creature limited to exceptional circumstances demanding a federal rule of decision in the absence of a federal statute to provide one. Federal common law exists only in such narrow areas as those concerned with the rights and obligations of the United States, interstate and international disputes that implicate the conflicting rights of states or our relations with foreign nations, and admiralty cases. Murphy asserts that there is nothing exceptional about claims against the estate of a bank in receivership that implicates a federal interest sufficient to draw the federal courts into the task of lawmaking. Even when the FDIC-receiver was still a party to this case, there was no question that it was acting only as a receiver of a failed institution and was not pursuing the interest of the federal government as a bank insurer. Further, as the case came to the Southern District of Florida and the Eleventh Circuit, even the FDIC-receiver, having completed its duties, left the scene, and pursuant to 12 U.S.C. § 197, returned the substantial remaining estate of Southeast Bank to respondent as its successor agent elected by and acting for the benefit of the shareholders. While even the direct involvement of the FDIC-receiver is insufficient to support a federal common-law rule, the current dispute affects only the shareholders of the bank and petitioner Murphy and does not even remotely implicate significant federal interests. Neither a need for uniformity, nor the deposit insurance fund, nor the proper operation of a federal program is in any way affected by the competing private claims in this case. Therefore, Murphy concludes, in the absence of any federal interest, the D'Oench doctrine cannot be applied.

Finally, Murphy asserts that the enactment of FIRREA displaced the D'Oench doctrine. Murphy argues that the detailed provisions of FIRREA both confirm the absence of federal common law, to begin with, and negate any existing federal common law. FIRREA is quite detailed regarding to whom and how far its D'Oench-like protections extend. For example, FIRREA extended the previous statutory protections to the FDIC-receiver, the RTC, and, at least for the FDIC, also to certain affirmative claims. See 12 U.S.C. §§ 1823(e), 1441a(b)(4), 1821(n)(4)(1) and 1821(d)(9). This detailed legislative treatment of the effectiveness of unwritten agreements suggests that Congress extended protection to such parties and such claims as it thought proper and declined to go further. In other words, allowing federal common law to proceed where Congress has chosen to stop does not supplement the scheme but rather alters it.

The preemptive inferences from FIRREA are further supported by the Supreme Court's pre-FIRREA decision in Langley v. FDIC, 484 U.S. 86 (1987). Interpreting the word agreement in the 1950 version of § 1823(e), the Supreme Court looked to the D'Oench case, but only as the leading case in the area prior to enactment of § 1823(e) in 1950. D'Oench was used exclusively as support for and confirmation of the otherwise permissible meaning of the word agreement, and there was no suggestion that either D'Oench or its progeny could extend any protection beyond the statutory terms. The Court viewed the statute as the final word in the area to the exclusion of federal common law.

Further corroboration that FIRREA shut the door on any putative federal common law comes from the behavior of the FDIC-receiver itself, which suggests that in the wake of FIRREA there is no need for the D'Oench doctrine. As the FDIC-receiver has argued in opposition to petitions for certiorari, it has adopted a policy under which it claims it will not invoke the common-law D'Oench doctrine as to any transactions arising after FIRREA's enactment. See Noel v. FDIC, 120 S.Ct. 935 (2000), where the FDIC states that it will assert D'Oench only as to transactions preceding the Aug. 9, 1989, enactment of FIRREA. Obviously, the FDIC has concluded that the enactment of FIRREA has displaced the common-law D'Oench doctrine.

The enactment of a federal statute, however, does not necessarily displace the federal common law. In United States v. Texas, 507 U.S. 529 (1993), the Supreme Court noted the long-standing principle that statutes that invade the common law are to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident. The Court held that in order to abrogate a common-law principle, the statute must "speak directly" to the question addressed by the common law. In this case, the Eleventh Circuit found that the most reasonable reading of congressional intent was that Congress did not intend FIRREA to displace the D'Oench doctrine but rather intended to continue the harmonious, 40-year coexistence of the statute and the D'Oench doctrine. In other words, the statute does not directly address all the questions addressed by the common-law D'Oench doctrine.

(Continued on Page 206)
Finally, it can be argued that the *O'Melveny and Atherton* cases do not support Murphy's assertion that the FDIC as receiver is unable to invoke federal common law, including the *D'Oench* doctrine. Rather it can be argued that *O'Melveny* and *Atherton* dealt with the question whether to create new federal common law, not whether Congress intended the enactment of FIRREA to supplant the federal common-law *D'Oench* doctrine.

**SIGNIFICANCE**

The *D'Oench* doctrine is a valuable tool in the FDIC's arsenal when dealing with insolvent financial institutions. The FDIC must swiftly evaluate the assets and liabilities of a failing financial institution in order to decide whether to liquidate or revive the failing entity. An essential part of that process is that the FDIC must be able to rely on the books and records of the failing entity without fear of extraneous or secret agreements, which may not appear in the records.

For almost 60 years, the common-law *D'Oench* doctrine has protected the FDIC by providing that no claims or defenses can be asserted against the FDIC, unless they are evident from the books and records of the failing institution. This permits the FDIC to be able to rely on the institution's books and records when deciding upon the most appropriate course of action for the failing entity.

In 1989, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act, which incorporated some of the protections afforded by the *D'Oench* doctrine. The question presented to the Supreme Court is whether Congress intended to displace the common-law *D'Oench* doctrine when it enacted FIRREA. Congress was silent on the point, and the Supreme Court must now decide.

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