Attachment B

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429
Division of Depositor and Asset Services

To: **Regional Directors**
Regional Counsel
Associate Director - COMB

From: **John F. Bovenzi**
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Subject: **Guidelines for Use of D'Oench and Section 1823(e)**

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1. **Purpose.** To set forth guidelines for the use of the D'Oench doctrine and 12 U.S.C. § 1823(e).

2. **Scope.** This directive applies to all Service Centers and Consolidated Offices, to all future Servicers and, to the extent feasible, to all current Servicers.

3. **Responsibility.** It is the responsibility of the Regional Directors, Associate Director - COMB, and Regional Counsel to ensure compliance with this Directive by all personnel in their respective service centers.

4. **Background.**

a. **D'Oench Doctrine**

In an effort to protect the federal deposit insurance funds and the innocent depositors and creditors of insured financial institutions, the Supreme Court in the case of D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942) adopted what is commonly known as the D'Oench doctrine. This legal doctrine provides that a party who lends himself or herself to a scheme or arrangement that would tend to mislead the banking authorities cannot assert defenses and/or claims based on that scheme or arrangement.

b. **Section 1823(e)**

In 1950, Congress supplemented the D'Oench doctrine with 12 U.S.C. § 1823(e) which bars any agreement which "tends to diminish or defeat the interest of the [FDIC] in any asset" unless the agreement satisfies all four of the following requirements: (1) it is in writing; (2) it was executed by the

depository institution and any person claiming an adverse interest under the agreement contemporaneously with the acquisition of the asset; (3) it was approved by the board of directors of the institution or its loan committee as reflected in the minutes of the board or committee; and (4) it has been continuously an official record of the institution.

In FIRREA Congress extended the coverage of section 1823(e) to claims against the receiver or the Corporation. 12 U.S.C. § 1821(d)(9)(A).

c. **Policy Considerations**

The D'Oench doctrine and section 1823(e) embody a public policy designed to protect diligent creditors and innocent depositors from bearing the losses that would result if claims and defenses based on undocumented agreements could be enforced against a failed bank. The requirement that any arrangement or agreement with a failed bank must be in writing allows banking regulators to conduct effective evaluations of open banks and the FDIC to accurately and quickly complete resolution transactions for failed banks. This requirement also places the burden of any losses from an undocumented or "secret" arrangement or agreement on the parties to the transaction, who are in the best position to prevent any loss.

Although the D'Oench doctrine and section 1823(e) generally promote essential public policy goals, overly aggressive application of the specific requirements of these legal doctrines could lead to inequitable and inconsistent results in particular cases. In order to ameliorate this possibility, the FDIC has undertaken development of these guidelines and procedures to promote the exercise of sound discretion in the application of D'Oench and section 1823(e).

5. **Guidelines.**

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. **The examples given are intended to give clear direction as to when D'Oench and section 1823(e) issues must be referred to Washington pursuant to the procedures discussed below in Section 6. In particular, if the use of D'Oench or 1823(e) is proposed in a DAS - Operations matter within the categories set forth below, the matter and recommendation must be referred to the Associate Director - Operations for approval through the procedures contained in Section 6.**

In the great majority of cases, however, it is anticipated that no resort to Washington should be necessary. It is only in the categories of cases highlighted in the guidelines that

Washington approval must be obtained.

a. **Pre-closing Vendors**

D'Oench and section 1823(e) **shall not** be used as a defense against claims by vendors who have supplied goods and/or services to the failed institution pre-closing when there is clear evidence that the goods/services were received. In such cases, D'Oench and section 1823(e) shall not be asserted whether or not there are written records in the bank's files confirming a contract for the goods and/or services.

This 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. When there is no evidence that goods or services were received by the failed bank or in other appropriate circumstances, **the defenses may be asserted after approval by Washington.**

Examples Requiring Washington Approval:

1. Landscaping service filed claim for planting trees around the institution's parking lot. There is no contract for planting trees in the books and records of the institution, but there are trees around the parking lot and no record of any payment. **In this example, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

2. A contingency fee attorney is unable to produce any contingency fee agreement, but there is evidence in the files that this attorney has been paid for his collection work for the past 20 years and his name appears on the court records for collection matters for which he has not been paid. **In this example also, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

3. Contractor had construction contract with bank to renovate an ORE property. At the time the bank failed, the contractor had completed 90% of the contract and was owed about 50% of the contract price. The Construction company filed a claim which was denied on the ground that the contract was not enforceable against the FDIC because it had not been approved by the bank's board of directors or loan committee. **Here too, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

b. Diligent Party

D'Oench and section 1823(e) may not be asserted without Washington approval where the borrower or claimant took all reasonable steps to document and record the agreement or understanding with the bank and there is no evidence that the borrower or claimant participated in some activity that could likely result in deception of banking regulators, examiners, or the FDIC regarding the assets or liabilities of the bank. In particular, Washington approval is required before D'Oench or section 1823(e) may be asserted where the agreement is not contained in the bank's records, but where the borrower or claimant can establish by clear and convincing evidence that the agreement was properly executed by the depository institution through an officer authorized by the board of directors to execute such agreements, as reflected in the minutes of the board. Cases involving "insiders" of the depository institution require particularly careful review because of the greater opportunities of such parties to manipulate the inclusion of "agreements" within the bank's records.

Further, where it is clear that a borrower or claimant has been diligent in insisting on a written document in an apparently arms-length transaction, and had no control over the section 1823(e) requirement that the transaction be reflected in the Board of Directors' or Loan Committee minutes, assertion of a section 1823(e) defense solely because the transaction is not reflected in those minutes may not be appropriate. In such cases, **Washington approval must be obtained before asserting D'Oench or section 1823(e).**

Examples Requiring Washington Approval:

1. Plaintiff sold a large parcel of land to the borrower of the failed bank and the property description in the failed bank's Deed of Trust mistakenly included both the parcel intended to be sold and a parcel of property not included in the sale. Prior to the appointment of the receiver, the bank agreed orally to amend the Deed of Trust, and indeed sent a letter to the title company asking for the amendment. However, there was nothing in the books and records of the institution to indicate the mistake. The bank failed and the Deed of Trust had never been amended. The borrower defaulted and the FDIC attempted to foreclose on both parcels. **In this example, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

2. A limited partnership applied for refinancing. A commitment letter was issued by the bank to fund a non-recourse permanent loan which required additional security of $ 1 million from a non-partner. The Board

of Directors minutes reflect that approval was for a nonrecourse loan, however, the final loan documents, including the note, did not contain the nonrecourse provisions. The bank failed, the partnership defaulted and it was determined that the collateral plus the additional collateral was approximately $ 3 million less than the balance of the loan. **In a suit by the FDIC for the deficiency, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

3. A borrower completes payment on a loan, and he has cancelled checks evidencing that his loan has been paid off. The bank's records, however, do not document that the final payment has been tendered. The bank fails and the FDIC seeks to enforce the note. **Washington approval must be obtained before asserting D'Oench or section 1823(e).**

However, if it is clear that the borrower or claimant participated in some fraudulent or other activity which could have resulted in deception of banking regulators or examiners, then D'Oench and/or section 1823(e) may be asserted without prior approval from Washington.

Examples Not Requiring Washington Approval:

1. Borrower signed a note with several blanks including the amount of the loan. Bank officer filled in the amount of the loan as $ 40,000. Bank failed, loan was in default, the FDIC sued to collect $ 40,000 and the borrower claimed that he only borrowed $ 20,000. There was nothing in the bank's books and records to indicate the $ 20,000 amount, and, in fact, the bank's books and records evidenced disbursement of $40,000. D'Oench and section 1823(e) may be asserted.

2. Guarantor, an officer of the borrower corporation, signed a guaranty for the entire amount of a loan to the corporation. At the time of the bank's failure, the loan was in default and the corporation was in Chapter 7 bankruptcy. FDIC filed suit against the guarantor for the entire amount of the loan. The guarantor claimed that he had an agreement with the bank that he was only liable for the first $ 25,000. There was no record in the bank's files of such an agreement. Again, D'Oench and section 1823(e) may be asserted.

Where the specific facts of a case raise any question as to whether D'Oench or section 1823(e) should be asserted, Washington approval must be obtained before asserting D'Oench or section 1823(e).

c. Integral Document

If there are documents in the books and records of the institution which indicate an agreement under the terms asserted by the claimant or borrower, the use of D'Oench and section 1823(e) must be carefully evaluated. Particular care must be taken before challenging a claim or defense solely because it fails to comply with the 1823(e) requirement that the agreement be reflected in the minutes of the Board of Directors or Loan Committee. While 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. **Where the records of the Bank provide satisfactory evidence of an agreement, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

Examples Requiring Washington Approval:

1. Note in failed bank's file was for one year term on its face. However, the loan application, which was in the loan file, was for five years renewable at one year intervals. The borrower also produced a letter from a bank officer confirming that the loan would be renewed on a sixty month basis with a series of one year notes. **In this example, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

2. Debtor executed two notes with the proviso that there would be no personal liability to the debtor beyond the collateral pledged. When the notes became due they were rolled over and consolidated into one note which recited that it was a renewal and extension of the original notes but did not contain the express disclaimer of personal liability. All three notes were contained together in one loan file. Here, all of the notes should be considered as part of the bank's records. **In this example also, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

d. No Asset/Transactions Not Recorded in Ordinary Course of Business

The use of D'Oench and section 1823(e) should be limited in most circumstances to loan transactions and other similar financial transactions, to matters involving specific current or former assets, or to transactions designed to acquire or create an asset. The application of D'Oench should be carefully

considered before it is asserted in opposition to a tort claim, such as negligence, misrepresentation or tortious interference with business relationships, where the claim is unrelated to a loan or similar transaction or to a transaction creating or designed to create an asset. **Washington approval must be obtained before asserting D'Oench or section 1823(e) in such cases.**

Examples Requiring Washington Approval:

1. Three years before failure the bank sold one of its subsidiaries. The bank warranted that the subsidiary had been in "continuous and uninterrupted status of good standing" through the date of sale. The buyer in turn attempted to sell the subsidiary and discovered that the subsidiary's charter had been briefly forfeited. The prospective buyer refused to go through with the sale and the original buyer sued the institution for breach of warranty. FDIC is appointed receiver. This transaction does not involve a lending or other banking financial relationship between the bank and the buyer. In addition, the subsidiary was not an asset or on the books of the institution at the time of the receivership. **In this example, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

2. In the case described above in the diligent party section, where the property description in the failed bank's Deed of Trust mistakenly included a parcel not included in the sale, the parcel at issue was not an actual asset of the failed bank and the assertion of D'Oench would not be appropriate. **Here too, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

However, if a claim arises out of an asset which was involved in a normal banking transaction, such as a loan, D'Oench and section 1823(e) would be properly asserted against such a claim despite the fact that the asset no longer exists. For example, collection on the asset does not preclude the use of D'Oench and section 1823(e) in response to claims by the former debtor related to the transaction creating the asset.

Example Not Requiring Washington Approval:

1. A borrower obtained a loan from a bank, secured by inventory and with an agreement that allowed the bank to audit the business. The business failed, the bank sold the remaining inventory, and applied the proceeds of the sale to the business's debt. Borrower sued the bank for breach of oral agreements, breach of fiduciary

duty, and negligence in performance of audits of the business. Borrower then paid off remaining amount of loan and continued the lawsuit. The bank subsequently failed. Despite borrower's argument that there was no asset involved since the debt had been paid, assertion of D'Oench would be appropriate.

To permit the borrower to proceed with the litigation after the loan is repaid, where that litigation would have been barred by D'Oench prior to the payoff, would be contrary to the public policy permitting regulators to ignore unknown and unrecorded agreements.

e. Bilateral Obligations

The facts must be examined closely in matters where the agreement which the FDIC is attempting to enforce contains obligations on both the borrower or claimant and the failed bank and the borrower or claimant is asserting that the bank breached the agreement. **If the failed bank's obligation is clear on the face of the agreement and there are documents supporting the claimed breach which are outside the books and records of the institution, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

f. Statutory Defenses

The appropriateness of using D'Oench and section 1823(e) to counter statutory defenses should be evaluated on a case by case basis. Although many such defenses may be based on an agreement that is not fully reflected in the books and records of the institution, a careful analysis should be made before asserting D'Oench or section 1823(e). In such cases, **Washington approval must be obtained before asserting D'Oench or section 1823(e).**

The clearest examples of situations where assertion of D'Oench or section 1823(e) may be appropriate occur where the opposing party is relying on a statutory defense based upon some misrepresentation or omission by the failed bank. Examples of this type of statute are unfair trade practice statutes.

On the other hand, application of D'Oench or section 1823(e) may not be appropriate to oppose claims based on mechanics lien statutes or statutes granting other recorded property rights. The fact that all elements of those liens may not be reflected in the books and records of the institution should not control the application of D'Oench or section 1823(e).

In analyzing the propriety of asserting the D'Oench doctrine or section 1823(e), at least the following two general factors

should be considered in preparation for seeking approval from Washington:

* To what extent is the purpose of the statute regulatory, rather than remedial? If the statute simply imposes regulatory or mandatory requirements for a transaction, such as a filing requirement or maximum fee for services, assertion of D'Oench and/or section 1823(e) is unlikely to be successful.

* To what extent is the application of the statute premised upon facts that are not reflected in the books and records of the bank? If the state statute requires the existence and/or maintenance of certain facts, but those facts are not recorded in the bank's records, then D'Oench and/or section 1823(e) may be applicable.

* To what extent do the facts involve circumstances where the opposing party failed to take reasonable steps to document some necessary requirement or participated in some scheme or arrangement that would tend to mislead the banking authorities.

Examples Requiring Washington Approval:

1. A priority dispute arose involving a mechanic's lien against property on which the FDIC was attempting to foreclose. An attempt to persuade a court that the mechanic's lien was a form of secret agreement under D'Oench, which, if given priority over the interests of the FDIC, would tend to diminish or defeat the value of the asset may not be appropriate. **In this example, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

2. State law required insurance companies doing business in the state to deposit funds with the Commissioner of Insurance. Further, the law provided that the deposit could not be levied upon by creditors or claimants of the insurance company. An insurance company purchased a certificate of deposit from a bank and assigned it to the Commissioner. At the same time a document was executed entitled "Requisition to the Bank" which stated that the bank would not release the CD funds without authorization of the Commissioner. Subsequently the insurance company borrowed money from the bank. When the loan went into default, the bank did not roll the CD over, but rather credited the proceeds to the loan account. The bank then failed and the Commissioner filed a proof of claim with the FDIC seeking payment on the CD. The FDIC may not defend the suit by claiming that the assignment

documents did not meet the requirements of section 1823(e). **In this example, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

3. The FDIC is attempting to collect on a note which the failed bank acquired from a mortgage broker. The note is at a 15% interest rate and the mortgage broker charged six and one half points. State law provides that interest shall be no more than 13% and that no more than one point may be charged. The FDIC may not defend the borrower's counterclaim of a usurious loan by asserting D'Oench or 1823(e). **Here too, Washington approval must be obtained before asserting D'Oench or section 1823(e).**

g. **Section 1823(e) Contemporaneous Requirement**

This requirement of section 1823(e) may not be asserted to invalidate a good faith workout or loan modification agreement where the sole issue is whether the contemporaneous requirement of section 1823(e) is met. Where there is an agreement which otherwise satisfies the remaining requirements of the statute, but was not executed contemporaneously with the acquisition of the asset, in most circumstances section 1823(e) should not be asserted. This applies only to workouts or loan modifications done by the failed bank prior to receivership. The assertion of the section 1823(e) contemporaneous requirement should be considered principally where the facts demonstrate that the workout or restructure was entered into in bad faith and in anticipation of bank failure.

Washington approval must be obtained before asserting D'Oench or section 1823(e) in these cases.

6. **Procedures To Obtain Washington Approval.**

DAS Operations: When facts involving the possible assertion of D'Oench and section 1823(e) arise, Legal should be consulted. When the assertion of D'Oench or section 1823(e) requires Washington approval, as outlined above, prior approval must be received from the Associate Director - Operations in Washington in all such cases. Such approval must be obtained by preparation of a memorandum identifying the facts of the case forwarded through Legal Division procedures to the Associate Director - Operations.

DAS Asset Disposition: When facts involving the possible assertion of D'Oench and section 1823(e) arise, Legal should be consulted. When the assertion of D'Oench or section

1823(e) requires Washington approval, as outlined above, Legal Division procedures should be followed for referral to Washington. Washington Legal will consult with Washington DAS where appropriate.

DAS COMB: When facts involving the possible assertion of D'Oench and section 1823(e) arise, Legal should be consulted. When the assertion of D'Oench or section 1823(e) requires Washington approval, as outlined above, Legal Division procedures should be followed for referral to Washington. Washington Legal will consult with the Managing Director - COMB.

Legal: Each attorney must carefully review the facts of each instance where the assertion of D'Oench or section 1823(e) is being considered under revised Litigation Procedure 3 ("LP 3"). All cases requiring consultation or approval within these Guidelines and/or LP3 must be referred to Washington pursuant to LP3 procedures.

These Guidelines are intended only to improve the FDIC's review and management of 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.