No. _____

In The

Supreme Court of the United States

STEPHEN B. PENCE and THOMAS BEAN,

Petitioners,

v.

VNB NEW YORK, LLC, AS SUCCESSOR
BY MERGER TO VNB NEW YORK CORPORATION,
AS SUCCESSOR IN INTEREST TO
THE PARK AVENUE BANK,

Respondents.

On Petition For Writ Of Certiorari
To The Court Of Appeals Of Kentucky

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Does the *D'Oench* doctrine, *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942), or federal common law "holder in due course" doctrine, survive Congress' enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. 101-73, 103 Stat. 183?

Under 12 U.S.C. § 1823(e)(1), may an innocent victim of fraud assert state law fraud or illegality defenses where, as here, a successor bank sues on loans it knew at the time of purchase to be fraudulent?

PARTIES TO THE PROCEEDING

Petitioners Stephen B. Pence and Thomas Bean were the defendants in the Jefferson Circuit Court proceedings, appellants in the Court of Appeals of Kentucky proceedings, and movants in the Supreme Court of Kentucky proceedings. Respondent VNB New York, LLC, as Successor by Merger to VNB New York Corporation, as Successor in Interest to the Park Avenue Bank, was the plaintiff in the Jefferson Circuit Court proceedings, appellee in the Court of Appeals of Kentucky proceedings, and respondent in the Supreme Court of Kentucky proceedings.

In addition, Alexander & Alexander Risk Services, LLC, Aviation Solutions, LLC, River Falls Holdings, LLC, River Falls Investments, LLC, SDH Realty, Inc., Sheri D. Huff, W. Anthony Huff, Huff Grandchildren's Trust, Michele Brown, Ronald E. Heineman, Fifth Third Bank Kentucky, Inc., Bloomfield State Bank, James A. & Doris A. Roemer, Locust Creek Community Association, Oxmoor Woods Residents Association, Inc., Vesta Holdings I, LLC, American Tax Funding, LLC, Louisville Jefferson County Metro Government, and City of Middletown, Kentucky, were defendants in the Jefferson Circuit Court proceedings; they were nominal appellees in the Court of Appeals of Kentucky.

RELATED CASES

- *VNB New York Corp. v. Alexander & Alexander Risk Services, LLC, et al.*, No. 10-CI-405021, Jefferson Circuit Court. Judgment entered November 17, 2015 (and incorporating order entered January 12, 2015).
- *VNB New York, LLC v. Alexander & Alexander Risk Services, LLC, et al.*, No. 10-CI-405021, Jefferson Circuit Court. Judgment entered June 20, 2018.
- *Bean v. VNB New York, LLC, et al.*, No. 2015-CA-001821-MR, and *Pence v. VNB New York, LLC, et al.*, No. 2015-CA-001822-MR, Court of Appeals of Kentucky. Judgment entered June 2, 2017.
- *Pence and Bean v. VNB New York, LLC, et al.*, No. 2018-CA-001259-MR, Court of Appeals of Kentucky. Judgment entered September 13, 2019.
- *Pence, et al. v. VNB New York, LLC, et al.*, No. 2019-SC-000705-D, Supreme Court of Kentucky. Judgment entered May 20, 2020.

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Stephen B. Pence and Thomas Bean petition for a writ of certiorari to review the judgment of the Supreme Court of Kentucky in this case.

OPINIONS BELOW

The Supreme Court of Kentucky's order denying discretionary review of the Court of Appeals' decision is reproduced at App. 56. The Court of Appeals of Kentucky's opinions are reproduced at App. 1 and App. 26. The Jefferson Circuit Court's opinions are reproduced at App. 18, App. 49, and App. 52.

JURISDICTION

The Supreme Court of Kentucky denied discretionary review of the Court of Appeals' decision on May 20, 2020. App. 56. This Court has jurisdiction under 28 U.S.C. § 1257(a).

STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED

Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. 101-73, 103 Stat. 183 (codified in many places).

12 U.S.C. § 1823(e)(1):

> **(e) Agreements Against Interests of Corporation**
>
> **(1) In General.** No agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it under this section or section 1821 of this title, either as security for a loan or by purchase or as a receiver of any secured depository institution, shall be valid against the Corporation unless such agreement (A) is in writing, (B) was 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, (C) 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, and (D) has been, continuously, from the time of its execution, an official record of the depository institution.

INTRODUCTION

VNB New York, LLC (VNB) is the successor in interest to VNB New York Corporation and, in turn, Park Avenue Bank (PAB), having paid pennies on the dollar to take over that failed bank. PAB failed after its president and CEO, Charles Antonucci (Antonucci), and its executive vice-president, Matthew Morris (Morris), conspired to make fraudulent loans to various entities

controlled by Anthony Huff (Huff). Antonucci, Morris, and Huff have all pled guilty to federal crimes for their roles in the conspiracy.

VNB nevertheless sought to collect on those fraudulent loans. Here, it seeks to collect $1.5 million from Stephen B. Pence (Pence) and Thomas Bean (Bean), who – as nominal managers of two Huff-controlled entities – signed as guarantor on one fraudulent loan to the Huff-control entity each managed.[1] Pence and Bean have no quarrel with VNB's general right to collect on those loans.

But Pence and Bean played no part in the fraud; on the contrary, they were two of its victims. They therefore asserted a number of state law defenses, and attempted to assert claims against PAB for its officials' torts against them. (Because VNB bought PAB's liabilities, not just its assets, Pence and Bean sought to assert their counterclaims against VNB.)

Pence and Bean seek only the right to defend against VNB's collection suit by asserting and proving these defenses and/or counterclaims. The Kentucky courts held, as a matter of law, that this Court's *D'Oench* doctrine and a federal statute barred Pence and Bean from even asserting those fraud-based defenses and counterclaims. Their reliance on the *D'Oench* doctrine conflicts with federal circuit opinions deeming that common law doctrine to have been

[1] Pence and Bean each have full-time professional careers. Each devoted scant hours to serving as nominal manager of the Huff-controlled entities.

supplanted by FIRREA. Their reliance on the federal statute cannot be squared with the statutory text, but instead grafts *D'Oench*'s federal common law principles onto the text.

STATEMENT OF THE CASE

Charles Antonucci was PAB's president and CEO; Matthew Morris was its senior vice-president. In 2009, PAB made a series of "loans" to entities controlled by Anthony Huff. The loans were fraudulent, and masked multi-million dollar overdrafts by Huff-controlled entities.

Huff bribed Antonucci and Morris to facilitate these fraudulent loans. As Morris described it, PAB and its senior officials allowed Huff, and companies he controlled, to "direct millions of dollars of intra-bank transfers between . . . accounts . . . ," to "comingle funds," and "to obtain . . . loans in contravention of bank policy" through the use of "loan applications contain[ing] fraudulent representations, including misrepresentations as to what the use of the proceeds were for." In bribing PAB officials, Huff "agreed . . . to make [PAB] appear to be better capitalized," and participated in "a misstatement . . . in documents . . . about the source of funds that were being provided to [PAB]." By doing so, he gained "the ability to overdraft the accounts, obtain certain loans, [and] make intra-bank transfers."

On March 24, 2009, PAB transferred nearly $1.5 million in "loans" to River Falls Holding, LLC (RFH) and River Falls Investments, LLC (RFI), two of the Huff-controlled entities.[2] Pence was RFH's manager and Bean was RFI's manager. They were nominal roles; Pence and Bean did not control cash, write checks, make investment decisions, or take an active role in RFH's or RFI's operations. As managers, Pence and Bean signed all of the required loan documents; they were told that their signing was "a mere formality," and that they were guaranteeing payment on RFH and RFI's behalf, not individually. In fact, the loan documents included personal guarantees.[3] Neither Pence nor Bean received any portion of any "loan" proceeds.

PAB failed in 2010; the FDIC was appointed its receiver, and VNB became its successor by buying its assets and liabilities. The assets included the $1.5 million revolving line of credit secured by the promissory note that RFI and RFH had executed, and on which it had defaulted. These are the fraudulent "loans" that led to PAB's collapse, and to Huff, Antonucci, and Morris' federal criminal convictions. The loans' fraudulent nature, intended to mask multi-

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[2] PAB made similar transfers of nearly $1.5 million to two other sets of Huff-controlled entities. The three "loans" allowed Antonucci to transfer nearly $4.5 million to Huff-controlled entities, without requiring board approval. The scheme worked because Antonucci was authorized to approve loans up to $4.5 million on his own.

[3] These fraudulent representations to Pence and Bean are not part of their arguments for granting the writ. We cite them here to provide context.

million dollar overdrafts, was well-known, or patently obvious, by the time of PAB's collapse (and long before VNB bought PAB's assets and liabilities). Pence and Bean asserted that VNB knew at the time it bought PAB that the loans were fraudulent.

VNB sued many parties over the three sets of "loans" to Huff-controlled entities in December 2010, seeking to recover damages and to foreclose on real property. This petition involves only VNB's suit for damages against Pence and Bean as guarantors of one such "loan." The Jefferson Circuit Court granted summary judgment to VNB, holding that the *D'Oench* doctrine and 12 U.S.C. § 1823(e)(1) barred Pence and Bean from asserting their defenses and counterclaims, even if VNB knew at the time it bought PAB that the loans that Pence and Bean had guaranteed were fraudulent. App. 49 and App. 52. The Kentucky Court of Appeals affirmed as to Pence and Bean's fraud defenses, likewise relying on the *D'Oench* doctrine and 12 U.S.C. § 1823(e)(1), but vacated and remanded as to their illegality defenses. App. 26. On remand, the Jefferson Circuit Court granted summary judgment to VNB on Pence and Bean's illegality defense, App. 18, and the Kentucky Court of Appeals affirmed. App. 1. The Kentucky Supreme Court denied discretionary review on May 20, 2020. App. 56.

REASONS FOR GRANTING THE PETITION

Both the appeals court and trial court repeatedly cite, analyze, and apply the *D'Oench* doctrine. *See*, *e.g.*, App. 38-44 (appeals court); App. 49-50, 53-54 (trial court). Several federal circuits have held, in contrast, that FIRREA supersedes the doctrine, such that there no longer is any federal common law to apply, but rather the statutory provisions of FIRREA and 12 U.S.C. § 1823(e)(1). The Court should grant review to resolve this conflict.

In addition, the decision below largely conflates the federal common law principles in the *D'Oench* doctrine with the express statutory terms contained in 12 U.S.C. § 1823(e)(1), such that it is difficult to tell whether the appeals court deemed the statute, standing alone, to bar Pence and Bean's fraud and illegality defenses and counterclaims. If it did, that decision cannot be squared with the statutory text, which prohibits only side agreements that would diminish or defeat VNB's claim. The Court should grant review to guide lower courts on the statutory reach.

I. The Decision Below Conflicts With Federal Circuit Court Decisions Deeming FIRREA To Supersede The *D'Oench* Doctrine.

The *D'Oench* doctrine is a federal common law doctrine precluding borrowers from deceiving bank examiners, and successor banks, by relying on "secret side agreements." *See D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942). The trial and appellate courts

repeatedly cited, analyzed, and applied the doctrine in holding that Pence and Bean could not assert any state law defenses to VNB's lawsuit to collect on a fraudulent loan, even though VNB knew when it bought PAB that the loan was fraudulent. *See*, *e.g.*, App. 38-44 (appeals court); App. 49-50, 53-54 (trial court).

Whatever the proper scope of the federal common law "holder in due course" doctrine – that is, even if the courts below correctly read *D'Oench* and its progeny, – several federal circuits have deemed the doctrine to be superseded by federal statute. In 1989, in the wake of the Savings & Loan scandal, Congress amended Section 13(e) of the Federal Deposit Insurance Act (FDIA) by enacting the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. 101-73, 103 Stat. 183. Several years later, this Court construed FIRREA in two decisions about the standard of care that a bank's lawyers, officers and directors (bank fiduciaries) owe to their employer bank.

In *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994), the FDIC sued lawyers for professional negligence and breach of fiduciary duty. It argued that federal law should govern its rights because it was appointed receiver of the failed bank under FIRREA. *Id.*, 512 U.S. at 85-88. This Court "roundly rejected this reasoning," *FDIC v. Deglau*, 207 F.3d 153, 166 (3d Cir. 2000) (analyzing *O'Melveny*), instead holding that, "where Congress has promulgated a comprehensive and detailed statute, the court must presume that state law rather than federal common law governs matters

unaddressed in the federal statute." *Id.* (citing *O'Melveny*, 512 U.S. at 85-88).

Three years later, this Court expanded on *O'Melveny* in *Atherton v. FDIC*, 519 U.S. 213 (1997). There, the Court held that state law, not federal common law, applies in the face of federal statutory (FIRREA) silence, unless there is a "'significant conflict between some federal policy or interest and the use of state law.'" *Id.*, 519 U.S. at 218 (quoting *Wallis v. Pan American Petroleum Corp.*, 384 U.S. 63, 68 (1966)).

In essence, then, in *O'Melveny* and *Atherton*, the FDIC urged this Court to impose a uniform, *federal* standard of care that would apply to all banks, fiduciaries, and successors throughout the country. Their adversaries argued that state laws have traditionally set the standard of care and that this Court should not impose a federal common law standard. The Court agreed and refused to create federal common law. Its primary reason was that Congress had enacted FIRREA as a comprehensive statute affecting the rights and duties of failed banks, their fiduciaries, and their successors (including the FDIC). Had Congress wanted to impose a uniform federal standard, it would have done so in FIRREA. Because Congress chose not to do so, courts would usurp legislative authority if it created federal common law.

In light of *O'Melveny* and *Atherton*, several federal circuit courts have held that FIRREA's comprehensive regulation of the rights and duties of failed banks likewise supplants the *D'Oench* doctrine and the federal

holder in due course (FHDC) rule, because both are, after all, examples of federal common law.

Murphy v. FDIC, 61 F.3d 34 (D.C. Cir. 1995), involved a damages suit against the FDIC, on the theory that the failed bank that financed an unsuccessful real estate venture – and of which the FDIC was the receiver – was responsible for Murphy's loss. *Id.*, 61 F.3d at 35. The district court rejected Murphy's claim, deeming it barred by federal common law under the *D'Oench* doctrine. *Murphy*, 61 F.3d at 38. The D.C. Circuit reversed, holding that, under *O'Melveny*, FIRREA had supplanted the *D'Oench* doctrine. *Murphy*, 61 F.3d at 40. In doing so, the D.C. Circuit rejected the FDIC's argument that *O'Melveny* should be read narrowly, and limited to the issue directly before the Court. That view, the *Murphy* court said, "excludes from view all that the Supreme Court has said before about the impact of comprehensive new legislation upon existing federal common law." *Murphy*, 61 F.3d at 40. Although federal common law is sometimes a "necessary expedient," *Milwaukee v. Illinois*, 451 U.S. 304, 314 (1981),

> when Congress addresses a question previously governed by a decision rested on federal common law the need for such an unusual exercise of law-making by federal courts disappears. . . . [The Court's] commitment to the separation of powers is too fundamental to continue to rely on federal common law . . . when Congress has addressed the problem.

Id., 451 U.S. at 314-15, quoted in *Murphy*, 61 F.3d at 40 (ellipses and brackets added in *Murphy*). For this

reason, the *Murphy* court deemed federal common law, and the *D'Oench* doctrine, to have "disappeared" after Congress enacted FIRREA. *Murphy*, 61 F.3d at 40.

DiVall Insured Income Fund v. Boatmen's First Nat'l Bank of Kansas City, 69 F.3d 1398 (8th Cir. 1995), involved a declaratory judgment action in which DiVall argued that it was not liable on a promissory note because the note lacked consideration. *Id.*, 69 F.3d at 1399. The district court rejected the claim, deeming it barred by the FHDC Rule. *Id.* The Eighth Circuit first explored the development of the *D'Oench* doctrine and FHDC Rule, and Congress' enactment of FIRREA. *DiVall*, 69 F.3d at 1400-01. It then analyzed *O'Melveny*, highlighting this Court's statement that FIRREA "places the FDIC in the shoes of the insolvent S&L, to work out its claims under state law, except where some provision in the extensive framework of FIRREA provides otherwise. To create additional 'federal common-law' exceptions is not to 'supplement' this scheme, but to alter it." *DiVall*, 69 F.3d at 1401-02 (quoting *O'Melveny*, 512 U.S. at 88) (deleting emphasis added in *DiVall*). And, in light of *O'Melveny*, it held that the *D'Oench* doctrine and FHDC Rule were no longer good law; instead, if any defenses to liability on a note are "to be barred," they "must be barred either by a specific provision of FIRREA or by state law." *DiVall*, 69 F.3d at 1402-03. In other words, after *O'Melveny*, the FHDC Rule and the *D'Oench* doctrine – the very provisions that Kentucky's courts relied on here – are dead.

Ledo Financial Corp. v. Summers, 122 F.3d 825 (9th Cir. 1997), is analogous to this case. There, Ledo

sued the FDIC as receiver for Sun Savings & Loan, claiming that Sun had fraudulently misrepresented the value of stock that it transferred in purported repayment of a Ledo loan. *Id.*, 122 F.3d at 826. The district court granted summary judgment to the FDIC, holding that the *D'Oench* doctrine barred Ledo's claim. *Id.*, 122 F.3d at 826-27. The Ninth Circuit reversed, holding that Ledo's fraud claim could be heard on the merits, because the *D'Oench* doctrine could not survive *O'Melveny* and *Atherton*, and because no unique federal interest warranted applying federal common law. *Ledo*, 122 F.3d at 828-30.

And in *FDIC v. Deglau*, 207 F.3d 153 (3d Cir. 2000), the Third Circuit had to decide whether federal common law or state law governed the substantive issues in a bank's suit against a loan guarantor. Although a 1992 Third Circuit decision had held that federal common law applied, the *Deglau* court deemed *O'Melveny* and *Atherton* to undercut that decision, especially because *Atherton* "underscored the Supreme Court's antipathy to the inappropriate creation of federal common law." *Deglau*, 207 F.3d at 166-67. It therefore held that state substantive law governed the case. *Id.*, 207 F.3d at 167.

The Kentucky Court of Appeals' decision, which relies extensively on the *D'Oench* doctrine, conflicts with these federal circuit decisions holding that the doctrine does not survive FIRREA. This Court should grant review to resolve the conflict, and should squarely hold that, for reasons detailed in *Murphy*, *DiVall*, *Ledo*, and *Deglau*, the *D'Oench* doctrine, and

the FHDC Rule, do not survive FIRREA. As this Court held in *O'Melveny* and *Atherton*, Congress has comprehensively regulated the rights and duties of failed banks, bank fiduciaries, and successor banks (including the FDIC and VNB). There thus is no room for courts to craft other federal common law principles, for Congress' express statutory enactment trumps judicially-created common law rules.

II. The Decision Below Ignores the Statutory Text.

Because the appeals court conflated the *D'Oench* doctrine, FHDC principles, and 12 U.S.C. § 1823(e)(1), it is difficult to know the extent to which that Court deemed Pence and Bean's fraud and illegality defenses barred by the statute alone. That is reason for vacating and remanding for reconsideration.

But, if this Court grants review to address whether the *D'Oench* doctrine survives FIRREA, this case provides an opportunity to address the scope of 12 U.S.C. § 1823(e)(1). Statutory text matters. *See Bostock v. Clayton County*, ___ U.S. ___ (2020), slip op. at 4 ("This Court normally interprets a statute in accord with the ordinary public meaning of its terms at the time of its enactment. After all, only the words on the page constitute the law adopted by Congress and approved by the President. If judges could add to, remodel, update, or detract from old statutory terms inspired only by extratextual sources and our own imaginations, we would risk amending statutes outside

the legislative process reserved for the people's representatives. And we would deny the people the right to continue relying on the original meaning of the law they have counted on to settle their rights and obligations.").

The statute bars only side agreements: "No agreement which tends to diminish or defeat the interest of the [FDIC] in any asset acquired by it . . . shall be valid against the [FDIC] unless such agreement" meets specified conditions. 12 U.S.C. § 1823(e)(1). Despite that limited text, the appeals court deemed the statute to incorporate much of the *D'Oench* doctrine, and much of federal common law, so as to preclude Pence and Bean from asserting their state law fraud and illegality defenses. But that's not what the statute says. It bars agreements that fail to meet the statutory conditions. It says nothing about fraud, or fraud defenses, or illegality. It does not purport in its text to supplant state law defenses. This Court thus should grant review to clarify that statutory text means what it says, not what courts deem to be good policy, and not what supplanted federal common law would have provided.

CONCLUSION

For these reasons, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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