RENDERED: SEPTEMBER 13, 2019; 10:00 A.M.
NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2018-CA-00-1259-MR

STEPHEN B. PENCE AND THOMAS BEAN,

Appellants,

v.

APPEAL FROM JEFFERSON CIRCUIT COURT HONORABLE JUDITH E. MCDONALD-BURKMAN, JUDGE
ACTION NO. 10-CI-405021

VNB NEW YORK, LLC AS SUCCESSOR BY MERGER TO VNB NEW YORK CORPORATION, AS SUCCESSOR IN INTEREST TO THE PARK AVENUE BANK; 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 C/O W. ANTHONY HUFF AND SHERI D. HUFF, CO-TRUSTEES; 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; CITY OF HURSTBOURNE, KENTUCKY; AND CITY OF MIDDLETOWN, KENTUCKY,

Appellees.

App. 2

OPINION
AFFIRMING

** ** ** ** **

BEFORE: ACREE, COMBS, AND MAZE, JUDGES.

COMBS, Judge: Stephen Pence and Thomas Bean appeal from an order of the Jefferson Circuit Court granting summary judgment to VNB New York, LLC, successor by merger to VNB New York Corporation, successor in interest to Park Avenue Bank, a New York State chartered bank, ("VNB") now shuttered but formerly headquartered in New York, New York. After our review, we affirm.

This case has a lengthy procedural history which includes a prior appeal to this court. Litigation began in December 2010, when VNB filed a complaint in the Jefferson Circuit Court against numerous defendants, among whom were Pence and Bean. The complaint alleged that Pence and Bean breached a guarantee that they had executed *personally promising* the repayment of any sums loaned by Park Avenue Bank under a revolving line of credit extended to River Falls Holdings, LLC, and River Falls Investments, LLC. In March 2009, in his capacity as manager of River Falls Holdings, Pence executed the revolving-line-of-credit promissory note. Bean was manager of River Falls Investments and executed the revolving-line-of-credit note in his capacity as its manager.

On March 23, 2009, pursuant to Pence's direction, Park Avenue Bank disbursed $1,485,000 under the

revolving line of credit into a checking account of River Falls Holdings – an account opened by Pence on November 4, 2008, in his capacity as manager of the company. Thereafter, $1,480,000 was transferred from the River Falls Holdings' checking account to an account at Park Avenue Bank held by SDH Realty, Inc., a Kentucky corporation. Pence authorized the transfer of the loan proceeds. The president of SDH Realty was Sheri D. Huff; Wilbur Anthony Huff was the vice-president.

On March 12, 2010, the New York Banking Department seized Park Avenue Bank as a failed bank. The Federal Deposit Insurance Corporation (FDIC) was appointed as receiver for the bank. In its capacity as receiver, the FDIC eventually entered into a Purchase and Assumption Agreement and an Assignment and Purchase Agreement with Valley National Bank New York Corporation (VNB). Under the terms of the agreements, VNB purchased the assets and liabilities of Park Avenue Bank, which included the revolving line of credit and guarantee described above.

On April 1, 2010, River Falls Investment and River Falls Holdings defaulted under the terms of the revolving line of credit. Neither Bean nor Pence satisfied the outstanding indebtedness per the terms of their personal guarantee. As a result, VNB filed the foreclosure action referenced above and underlying this appeal. VNB alleged that Bean and Pence were jointly and severally liable per the terms of the guarantee upon default of the revolving line of credit for the outstanding balance of $1,500,000 in principal and $288,916.82 in interest as of December 9, 2010.

Eventually, VNB filed a motion for summary judgment on the issue of Bean's and Pence's liability under the terms of the guarantee. In its memorandum of law filed in support of the motion, VNB described a broad criminal conspiracy that allegedly led to the failure of Park Avenue Bank.

In 2010, Charles Antonucci, President of Park Avenue Bank, and Matthew Morris, a senior vice-president of the bank, were indicted in federal court. According to the indictment, Antonucci and Morris had devised a plan to circumvent the policies of Park Avenue Bank so that loans to borrowers – including the loans made to River Falls Investment and River Falls Holdings – would appear to be legitimate to the bank's board of directors and to bank regulators. Antonucci and Morris allegedly made false representations about the borrowers' need for working capital and overstated the net worth of the guarantors. By 2013, Antonucci and Morris agreed to plead guilty to charges ranging from bank fraud to securities fraud. They also agreed to cooperate with prosecutors in the federal insurance, tax, and bank fraud case against Anthony Huff. Ultimately, Antonucci and Morris were sentenced by a New York federal court and imprisoned for their roles in the fraud scheme.

In December 2014, Huff pleaded guilty to various tax crimes and to a massive bank and insurance fraud that involved the bribery of Antonucci and Morris. In 2015, Huff was sentenced to serve 12 years in prison and to pay $108,000,000 in restitution.

In their responses to the bank's motion for summary judgment in the foreclosure action, Bean and Pence asserted that they were unaware of the fraud scheme and explained that they were victims of Huff and Park Avenue Bank executives. They contended that the guarantee was unenforceable against them since it was an illegal agreement and was the product of fraud in the *factum.*

The Jefferson Circuit Court referred the motion for summary judgment to its master commissioner for consideration. On August 11, 2014, the master commissioner filed a report recommending that VNB's motion for summary judgment against Bean and Pence be granted. The master commissioner concluded as follows:

> Pence and Bean have not alleged any facts which fall into the category of fraud in the factum. They do not dispute that they knew they were signing a guarant[ee]. The terms of the guarant[ee] were spelled out in the instrument they each signed and the contents of the instrument were not changed after they signed it. The Sixth Circuit Court of Appeals has construed *D'Oench [Duhme & Co., v. FDIC*, 315 U.S. 447, 62 S.Ct. 676, 86 L.Ed.956 (1942)] to preclude a maker from asserting any personal defenses against the FDIC, regardless of the maker's intent, when it can be said he "lent himself to a transaction which is likely to mislead banking authorities." Therefore, at best, the defense of fraud which has been asserted by Bean and Pence is fraud in

> the inducement which is precluded by Section 1823(e).

Master Commissioner's Report at 11 (citations omitted).

On October 15, 2014, Pence filed a motion for leave to file an amended answer and counterclaim against VNB. In the amended answer, Pence sought to add the defense of fraud in the *factum* as a bar to prevent VNB from enforcing the guarantee. In the proposed counterclaim, Pence alleged that employees of Park Avenue Bank fraudulently misled and induced him to sign the guarantee. An earlier panel of this Court indicated that Bean had made an oral motion for leave to file a similar counterclaim.

By order entered on January 12, 2015, the circuit court adopted the Master Commissioner's recommendation. The circuit court concluded as follows:

> [Bean and Pence] raise [the] argument that the *D'Oench* Doctrine and § 1823 are inapplicable to void contracts. There is little dispute the promissory notes were obtained through fraud, however Pence and Bean acknowledge they knew at the time they were signing documents to obligate their respective companies. There are, however, questions as to the oral agreement to not hold them personally liable, despite the language of the notes, the date and location of their execution and purpose of the funds. Such considerations support a defense of fraud in the inducement, not

> fraud in the factum, and render the notes voidable not void *ab initio*.

January 12, 2015, Order at 3-4 (citations omitted).

Both Bean and Pence then filed motions seeking reconsideration of the January 12, 2015, order. Pence argued that the circuit court failed to rule on his motion to file an amended answer and counterclaim. By amended order entered on November 17, 2015, the circuit court denied the motions and also denied Pence's and Bean's motion to file an amended answer and counterclaim. The trial court concluded as follows:

> Pence and Bean are experienced businessmen, and do not dispute knowing what documents they signed. Their primary defense is that they had an oral agreement with Anthony Huff that they would not be liable and no funds were actually disbursed. However, this side agreement is the precise scenario *D'Oench* and § 1823 are designed to avoid. A failed bank's records, such as the promissory notes and mortgages, essentially are viewed in a vacuum; only errors in the written documents themselves and the institution's records can overcome *D'Oench* and § 1823. As the Court previously determined, Pence and Bean understood the terms of the documents they executed, did not raise any objections to the terms, and Park Avenue Bank's records do not reflect any amendments or alterations to those written terms. Illegal transactions may still fall within the parameters of *D'Oench*. For these same reasons, Pence's and Bean's

> motions to file counterclaims against VNB are also denied. They are based on the same arguments that are barred by *D'Oench*.

November 17, 2015, Amended Order at 1-2 (citations omitted). Pence and Bean filed their first appeal to this Court.

Pence and Bean presented identical arguments, and we addressed their appeals together. In our opinion, rendered June 2, 2017, *Bean v. VNB N.Y., LLC*, 2015-CA-001821-MR, 2017 WL 2399343 (Ky. App. 2017), we affirmed in part, vacated in part, and remanded the matter to the Jefferson Circuit Court for further proceedings.

Because the circuit court's conclusions were based upon application of the *D'Oench, Duhme* doctrine, we summarized it as follows:

> The *D'Oench Duhme* doctrine was initially recognized by the United States Supreme Court in *D'Oench, Duhme & Co., Inc. v. FDIC*, 315 U.S. 447, 62 S.Ct. 676, 86 L.Ed. 956 (1942), and subsequently codified by congressional act in 12 U.S.C. § 1823(e). The *D'Oench Duhme* doctrine is presently understood as shielding the FDIC or assignee bank from most claims or defenses raised to defeat its action to enforce or collect upon a debt of a failed banking institution. The modern *D'Oench Duhme* doctrine represents an amalgamation of the federal common law with 12 U.S.C. § 1823(e) to form a far reaching and consequential rule of law in the area of banking.

> The underlying purposes of the *D'Oench Duhme* doctrine are twofold:
>
> One purpose of § 1823(e) is to allow federal and state bank examiners to rely on a bank's records in evaluating the worth of the bank's assets. Such evaluations are necessary when a bank is examined for fiscal soundness by state or federal authorities. . . .
>
> A second purpose of § 1823(e) is implicit in its requirement that the "agreement" not merely be on file in the bank's records at the time of an examination, but also have been executed and become a bank record "contemporaneously" with the making of the note and have been approved by officially recorded action of the bank's board or loan committee. These latter requirements ensure mature consideration of unusual loan transactions by senior bank officials, and prevent fraudulent insertion of new terms, with the collusion of bank employees, when a bank appears headed for failure. . . .

Bean at 12-14 (citations omitted).

We observed that there are recognized exceptions to the *D'Oench, Duhme* doctrine, including the defenses/claims of fraud in the *factum* and illegality of the contract. "The defenses that 'survive are those . . . that void an interest *ab initio*' thus rendering the instrument 'void' and not transferable to the FDIC." *Bean* at 14 (citations omitted.)

Having carefully considered the arguments of Pence and Bean, we concluded that they had failed to raise material issues of fact as to fraud in the *factum.* We accepted that the revolving line of credit and guarantee were part of a criminal scheme, but we noted that it was not disputed that Park Avenue Bank disbursed loan proceeds in the amount of $1,485,000 under the terms of the revolving line of credit and transferred these sums to a River Falls Holdings' checking account. We rejected the argument that the fraud that Pence and Bean had alleged constituted fraud in the *factum.* Instead, we found the allegations more consistent with fraud in the inducement, "which of course is negated under the facts of this case by the *D'Oench, Duhme* doctrine." *Bean* at 17. We concluded that the circuit court properly rendered summary judgment upon the defense of fraud in the *factum* asserted by Bean and Pence and affirmed that judgment.

With respect to the defenses/claims of illegality of the contract, we reiterated that where the effect of the illegality merely renders the underlying note or instrument voidable, the defense or claim is barred under the *D'Oench, Duhme* doctrine. However, where the effect of the illegality is to render the underlying note or instrument void, the protections of the *D'Oench, Duhme* doctrine are inapplicable.

Referring to the briefs submitted by Pence and Bean, we observed that neither set forth specific legal authority that would support a legal argument to render void the revolving line of credit or guarantee. Nevertheless, we concluded that if Huff and Antonucci –

and perhaps others – "engaged in an elaborate shell game in the various bank loan transactions to shield a criminal enterprise unbeknownst to Pence and Bean, then their defense could possibly prevail." *Bean* at 18-19. Based upon the record before us, we noted that neither the circuit court nor the master commissioner had fully considered the issue of illegality of the underlying bank transactions as alleged by Pence and Bean. Consequently, we concluded that summary judgment was prematurely rendered upon the defense of illegality. Likewise, we concluded that their motion to file a counterclaim raising the claim of illegality was prematurely denied. We vacated the judgment and remanded for further proceedings with respect to these issues.

In an answer and counterclaim filed on September 8, 2017, Pence and Bean admitted that they had executed a "document purporting to be a Guaranty but which actually was, unbeknownst to [them], a phony document created by [Park Avenue Bank] and/or others pursuant to a criminal/illegal scheme." They reasserted as an affirmative defense the illegality of the "loan" upon which the bank's claims are based. With respect to their counterclaim, Pence and Bean alleged that Huff and/or agents of Park Avenue Bank told them that the loan was for the business purposes of River Falls Holdings, LLC, and River Falls Investments, LLC, and that their guarantee of the loan was for legitimate business purposes. They alleged that they had executed the purported guarantee based upon the representations of Huff, which they reasonably believed to be true. They asserted that the Park

Avenue Bank knew or should have known that the representations made to Pence and Bean were false and that the "fictitious loan was actually an illegal scheme." Finally, Pence and Bean alleged that the actions of Huff and the bank's representatives constituted a civil conspiracy to induce Pence and Bean to sign the guarantee at issue. They sought judgment against VNB as successor to Park Avenue Bank.

On October 18, 2017, VNB filed a motion to dismiss the counterclaim. It argued that the court lacked subject matter jurisdiction over the counterclaim because federal law required Pence and Bean to exhaust their administrative remedies at the FDIC before filing a claim against a failed bank in *federal* court. VNB also contended that it did not have successor liability to Park Avenue Bank because it had not expressly assumed any such liability. Written discovery among the parties proceeded.

On March 30, 2018, VNB filed a motion for summary judgment with respect to the defense of illegality asserted by Pence and Bean. VNB contended that Pence and Bean had failed to offer anything whatsoever in an effort to show that either the note or guarantee was void as illegal under state or federal law. With the discovery deadline long since expired, VNB observed that neither Pence nor Bean had produced a single document, deposed a single individual, or set forth any legal authority that would support their affirmative defense.

In an opinion and order entered on June 7, 2018, the Jefferson Circuit Court granted VNB's motion to dismiss all the counterclaims, including the claim of illegality, of Pence and Bean.

In an opinion and order entered on June 20, 2018, the circuit court granted VNB's motion for summary judgment with respect to the affirmative defense of illegality. The court concluded that Pence and Bean could not show that the loan and guarantee were void *ab initio* because the note contained nothing illegal. "[V]iewing the evidence in the light most favorable to Pence and Bean, they fall into the category of 'innocent defrauded borrowers.'" Order at 6. The court observed that this fact "does not protect them from the fact that legitimate loan documents bearing their signatures were purchased by [VNB]." *Id.* "It is the reliability of those documents that the *D'Oench* doctrine and § 1823(e) were designed to protect." *Id.*

In an opinion and order entered on July 19, 2018, the court's opinion and order granting summary judgment was made final and appealable pursuant to the provisions of Kentucky Rule(s) of Civil Procedure (CR) 54.02.

On August 15, 2018, Pence and Bean filed a motion to vacate the summary judgment pursuant to the provisions of CR 60.02(b) and (f). Alleging that they had discovered "more evidence," Pence and Bean filed the affidavit of Anthony Huff. In an affidavit executed from the federal penitentiary, Huff swore that Pence "was never intended to personally guarantee any note or

loan and that [Pence] had no knowledge of the [criminal conspiracy perpetrated] at [Park Avenue Bank]." With respect to Bean, Huff indicated, "I cannot state what Bean knew or didn't know but I have no reason to believe he was aware of the [criminal conspiracy perpetrated] at [Park Avenue Bank.]" Pence and Bean argued that "the guilty pleas by Antonucci, Morris, and Huff to bank fraud and deceiving [bank] regulators together with Huff's statements in allocution would, if considered in the light most favorable to them [Pence and Bean], be sufficient to raise a question regarding the 'illegality' of the underlying conduct associated with the guarantee[s]." They acknowledged that the question of whether the guarantee executed by Pence and Bean is void or voidable is a question of law for the court but argued that the "determination of the facts evidencing the 'illegality' of the transaction is a question for the jury." While this motion was pending before the circuit court, Pence and Bean filed a timely notice of appeal of the court's June 20, 2018 order.[1]

In this appeal, Pence and Bean present a single issue for our review: whether the circuit court erred by granting summary judgment in favor of VNB with respect to the affirmative defense of illegality. We are persuaded that it did not err in so doing.

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[1] A motion filed pursuant to the provisions of CR 60.02 does not affect the finality of a judgment or suspend its operation. Nor does it render a timely appeal interlocutory. Consequently, although that motion remains pending before the circuit court, our jurisdiction has been properly invoked.

Pence and Bean argue that the trial court improperly balanced two competing interests: an interest in enforcing the guarantee on its face *versus* a public policy interest opposing its enforcement because the underlying loan (as they contend) was part of a criminal conspiracy to defraud the bank. They argue that the guarantee was void *ab initio* because "both sides of the illegal loan transaction intended to engage in conduct in violation of federal criminal statutes." However, there is an inherent contradiction – if not misstatement – in this argument. Neither Pence nor Bean has conceded that either one of them participated in any criminal conspiracy. The record on appeal contains no proof that the execution of the note and guarantee by Pence and Bean had as its purpose any intention to commit bank fraud or, indeed, any crime.

As summarized above, the provisions of 12 U.S.C. § 1823(e) were enacted to ensure that federal and state bank examiners could rely on a bank's records in evaluating the worth of the bank's assets. Consequently, seemingly unqualified notes and guarantees that are executed as part of a typical loan transaction are not subject to a defense against their enforcement. Even where senior bank officials collude with bank customers to defraud the bank, the *D'Oench, Duhme* doctrine specifically prevents the assertion of a defense against the enforcement of the customers' obligation to repay the loan.

While Pence and Bean refer to the duly executed note and guarantee as a "phony document," there is nothing on the face of their provisions that appears to

be phony. The loan documents were executed prior to the bank's disbursement of funds on March 23, 2009, pursuant to Pence's direction, to a checking account opened by Pence in his capacity as manager of River Falls Holdings. Thereafter, Pence duly authorized the transfer of the loan proceeds to another account. Again, on their face, the note and guarantee reflect a perfectly ordinary loan transaction.

Nevertheless, citing the holding in *Zeitz v. Foley*, 264 S.W.2d 267 (Ky. 1954), Pence and Bean argue that we can declare their personal guarantees void on the basis that the underlying loan had as its "direct object and purpose" a violation of law. However, neither Pence nor Bean contends that they intended or were aware that the object and purpose of the loan that they sought and personally guaranteed was illegitimate or illegal in any way. The terms of the transaction were clear to the parties; Pence and Bean (managers of their companies) authorized the loan and personally guaranteed it. They have not declared that their intention in securing the loan or in authorizing the disbursement of funds was fraudulent. Thus, the ordinary loan transaction was not rendered void at its inception even where the loaned funds are said to have been used thereafter and by others for an illegal purpose.

Pence and Bean have acknowledged that the question of whether loan instrument is void *ab initio* is a question of law for the court to decide. Under these facts, the circuit court did not err by concluding as a matter of law that the parties' agreement was not void

ab initio. Therefore, VNB was entitled to summary judgment as a matter of law.

We AFFIRM the judgment of the Jefferson Circuit Court.

ALL CONCUR.

BRIEF FOR APPELLANTS:	BRIEF FOR APPELLEE:
Michael A. Valenti Lee S. Archer Louisville, Kentucky	Christie A. Moore April A. Wimberg Amanda L. Dohn Louisville, Kentucky

NO: 10-CI-405021 JEFFERSON CIRCUIT COURT

DIVISION NINE (9)

JUDGE JUDITH MCDONALD-BURKMAN

VNB NEW YORK, LLC. SUCCESSOR BY MERGER TO VNB NEW YORK CORP. SUCCESSOR IN INTEREST TO THE PARK AVENUE BANK PLAINTIFF

V.

ALEXANDER & ALEXANDER RISK SERVICES, ET. AL. DEFENDANTS

OPINION AND ORDER

(Filed Jun. 20, 2018)

This matter comes before the Court on Plaintiff's Motion for Summary Judgment. Defendants Stephen Pence and Thomas Bean have filed their Response and Plaintiff has filed its Reply. The issues now stand submitted.

The standard for summary judgment analysis is set forth in CR 56 and is interpreted by *Steelvest, Inc. v. Scansteel Ser. Ctr., Inc.*, 807 SW 2d 476 (Ky. 1991). Following that standard, the Court must view the evidence in the light most favorable to the non-moving party and award summary judgment only where there are no genuine issues of material fact that would make it possible for the non-moving party to prevail at trial. The non-moving party has the duty to produce at least some affirmative evidence that there are issues of fact. Further, in *Welch v. American Publ. Co.*, 3 SW 3d 724

(Ky. 1999), the Supreme Court re-examined the standard for summary judgment analysis in this Commonwealth. Chief Justice Lambert wrote that, "The inquiry should be whether, from the evidence of record, facts exist which would make it possible for the non-moving party to prevail. In the analysis, the focus should be on what is of record rather than what might be presented at trial."

On March 17, 2009, River Falls Holdings LLC and River Falls Investments LLC applied for a $1.5 million dollar Revolving Line of Credit Secured Promissory Note with Park Avenue Bank. Thomas Bean signed the loan documents on behalf of River Falls Investments LLC and Stephen Pence signed on behalf of River Falls Holdings LLC. Both men signed personal guarantees. Park Avenue Bank disbursed $1,485,000.00 to the River Falls Holdings LLC account, which had been opened by Pence. The funds were then transferred to SDH Realty, Inc. on Pence's authority.

Park Avenue Bank failed and the FDIC was appointed as Receiver. It executed a Purchase and Assumption Agreement and Assignment and Purchase Agreement with Plaintiff, allowing Plaintiff to purchase all assets, notes and guarantees of Park Avenue Bank. On April 1, 2010, River Falls Holdings LLC and River Falls Investments LLC defaulted.

The within foreclosure action was commenced alleging Pence and Bean breached their guarantees. On October 23, 2013, Plaintiff filed its initial Motion for Summary Judgment. Pence and Bean argued that they

were not aware of the documents they were signing, the loans in question were "phony," and the guarantees were procured by fraud. The issues were referred to the Master Commissioner and, on her recommendation, this Court granted Plaintiff's Motion for Summary Judgment. Pence and Bean appealed that Judgment. The Kentucky Court of Appeals held that the Judgment was premature as to the issue of illegality.

Pence and Bean argue that the transactions were "fictitious in nature and served no valid commercial purpose." They asserted that Park Avenue Bank, Huff and Antonucci utilized "fraudulent application documents to make the loans appear legitimate should the Board or bank regulators later review the transaction." The purpose of the transactions, according to Pence and Bean was "to hide massive overdrafts that Huff-controlled entities had with Park Avenue Bank/VNB pursuant to an illegal criminal scheme."

Discovery in this matter was to be completed by March 1, 2018. VNB asserts that, although it complied with Defendants' discovery requests, the responses of Pence and Bean were deficient. No documents were produced. No depositions have been noticed. Therefore, Plaintiff argues that Pence and Bean cannot meet their burden of proving illegality as they have failed to present any affirmative evidence that there are genuine issues of material fact as to the transactions. *Rock River Communs. Inc. v. Universal Music Group, Inc.* 745 F. 3d 343 (9th Cir. 2017).

12 USC § 1283 (e) codifies the doctrine enunciated in *D'Oench Duhme & Co. v. FDIC* 315 US 447, 62 S. Ct. 676, 86 L. Ed. 956 (1942) holding that a "secret agreement could not be a defense to suit by the FDIC because it would tend to deceive banking authorities." Further, the Court held that when the maker "lent himself to a scheme or arrangement whereby the banking authority . . . was likely to be misled, that scheme or arrangement could not be the basis for a defense against the FDIC." *Langley v. FDIC* 484 US 86 (1987). Further, "[T]he FDIC transfers its protected status to subsequent purchasers of notes it holds." FDIC v. Newhart, 892 F 2d 47 (8th Cir. 1989)

The statute states:

> No agreement which tends to diminish or defeat the right, title or interest of the Corporation (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 (FDIC) unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

One of its purposes is to support the reliability of bank records. As stated in *FDIC v. Hudson*, 800 F. Supp 867 (N.D. Cal. 1990), "Those purposes included 1) allowing federal and state bank examiners to rely on a bank's records in evaluating the worth of the bank's assets; 2) ensuring mature consideration of unusual loan transactions by senior bank officials; and 3) preventing fraudulent insertion of new terms with the collusion of bank employees, when a bank appears headed for failure." If a contract is void ab initio, the defense of illegality may be asserted. However, if a contract is merely voidable, the defense is barred. *In re Settlers Housing Serv. Inc. v. Schaumberg Bank & Tr. Co. N.A.* 514 BR 258 (N.D. Ill. 2014).

As a matter of Kentucky law, if an agreement is in violation of a statute and the statute does not declare it void, it will be enforced. *Zeitz v. Foley*, 264 SW 2d 267 (Ky, 1954). A contract is void under Kentucky law "if it is so connected with an illegal purpose as to be inseparable from it"; "If it appears that a contract has as its direct object and purpose a violation" of law." The Court further stated that:

> If it clearly appears that a contract has as its direct object and purpose a violation of the Federal or state constitution, Federal or state statutes, some ordinance of a city or town or some rule of the common law, courts will not lend their aid to its enforcement. However, contracts voluntarily made between competent persons are not to be set aside lightly. As the right of private contract is no small part of the liberty of the citizen, the usual and most

> important function of courts is to enforce and maintain contracts rather than to enable parties to escape their obligations on the pretext of public policy or illegality, If the legality of the contract can be sustained in whole or in part under any reasonable interpretation of its provisions, courts should not hesitate to decree enforcement. *Cumberland Valley Contractors, Inc. v. Bell Cty. Coal Corp.* 238 SW 3d 644 (Ky. 2007).

Plaintiff asserts that there are no facts which prove the loans are void or invalid.

Pence and Bean have stated that "What they were signing had nothing to do with an actual loan being made." They argue that the guilty pleas of Huff and Morris and the Indictments in the Southern District of New York constitute sufficient evidence that the transactions were evidence of the criminal conspiracy. They contend that the persona] guarantees are void ab initio because they violate public policy. *Kentucky Association of Highway Contractors v. Williams* 280 SW 937 (Ky. 1926).

In support of their position, Pence and Bean rely upon the case of *Signapori v. Jagaria*, 84 NE 3d 369, 416 Ill. Dec. (2017). The case deals with misrepresentations to lenders designed to hide the fact that the parties had terminated their formal business connection. To this end, they drafted an agreement which promised serious consequences should either or them disclose the arrangement. However, Signapori sought to enforce the agreement. The circuit court held that

because the agreement was to keep a criminal act secret it was void against public policy and would not be enforced. The appellate court held that, "Public policy favors the exposure of crime, and the cooperation of citizens possession knowledge thereof is essential to effective implementation of that policy [Citation omitted]." The Court concluded that, "contracts barring the reporting of crimes are held to be unenforceable." However, these facts bear no resemblance to the case at bar.

Both Plaintiff and Defendants have cited the *In re Settlers* case, *supra*, in support of their arguments. The Court therein held that, "D'Oench and § 1823 (e) were crafted precisely to protect the FDIC and its successors from the bad acts of the failed bank taken over by the FDIC." The Court stated that, "The scope of protection afforded to the FDIC and its successors in interest by D'Oench and § 1823 (e) is extremely broad. Not only does it cover the original subject of side-agreements between the bank and its customer, it also covers a possible fraud by a failed bank practiced upon a customer." The Court further held that, "When allocating losses between an innocent defrauded borrower and innocent depositors and regulators, the defrauded borrower should bear the loss as having been in the better position to avoid the loss."

The contract itself contained nothing illegal. In this case, viewing the evidence in the light most favorable to Pence and Bean, they fall into the category of "innocent defrauded borrowers." However, this does not protect them from the fact that legitimate loan documents bearing their signatures were purchased by

Plaintiff. It is the reliability of those documents that the D'Oench doctrine and §1283 (c) were designed to protect.

IT IS HEREBY ORDERED AND ADJUDGED that the Plaintiff's Motion for Summary Judgment is GRANTED.

/s/ Judith McDonald-Burkman
JUDITH MCDONALD-BURKMAN, JUDGE
JEFFERSON CIRCUIT COURT

DATE: 6-20-18

Cc: Christie A. Moore/April A. Wimberg
Michael A. Valenti/Lee S. Archer

RENDERED: JUNE 2, 2017; 10:00 A.M.
NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2015-CA-001821-MR

THOMAS BEAN

APPELLANTS

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VNB NEW YORK, LLC; AS SUCCESSOR BY MERGER TO VNB NEW YORK CORPORATION, AS SUCCESSOR IN INTEREST TO THE PARK AVENUE BANK; 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, C/O W. ANTHONY HUFF AND SHERI D. HUFF, CO-TRUSTEES; MICHELE BROWN; RONALD E. HEINEMAN; STEPHEN B. PENCE; FIFTH THIRD BANK, KENTUCKY, INC.; BLOOMFIELD STATE BANK; JAMES A. AND 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; CITY OF

HURSTBOURNE, KENTUCKY; AND CITY OF MIDDLETOWN, KENTUCKY,

APPELLEES

AND

NO. 2015-CA-001822-MR

STEPHEN B. PENCE,

APPELLANT

v.

APPEAL FROM JEFFERSON CIRCUIT COURT HONORABLE JUDITH E. MCDONALD-BURKMAN, JUDGE
ACTION NO. 10-CI-405021

VNB NEW YORK, LLC, AS SUCCESSOR BY MERGER TO VNB NEW YORK CORPORATION, AS SUCCESSOR IN INTEREST TO THE PARK AVENUE BANK; 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, C/O W. ANTHONY HUFF AND SHERI D. HUFF, CO-TRUSTEES; MICHELE BROWN; RONALD E. HEINEMAN; THOMAS BEAN; FIFTH THIRD BANK, KENTUCKY, INC.; BLOOMFIELD STATE BANK; JAMES A. AND DORIS A. ROEMER; LOCUST COMMUNITY ASSOCIATION; OXMOOR WOODS RESIDENTS ASSOCIATION, INC.; VESTA HOLDINGS I, LLC; AMERICAN TAX FUNDING, LLC; LOUISVILLE JEFFERSON COUNTY METRO GOVERNMENT; CITY OF

HURSTBOURNE, KENTUCKY; AND CITY OF MIDDLETOWN, KENTUCKY

APPELLEES

OPINION
AFFIRMING IN PART,
VACATING IN PART, AND REMANDING

** ** ** ** **

BEFORE: J. LAMBERT, NICKELL, AND TAYLOR, JUDGES.

TAYLOR, JUDGE: Thomas Bean brings Appeal No. 2015-CA-001821-MR and Stephen B. Pence brings Appeal No. 2015-CA-001822-MR from January 12, 2015, and November 17, 2015, Orders of the Jefferson Circuit Court rendering summary judgment upon their defenses and counterclaims of fraud in the factum and illegality. We affirm in part, vacate in part, and remand Appeal No. 2015-CA-001821-MR and Appeal No. 2015-CA-001822-MR.

The underlying substantive and procedural facts are complex. To aid in the disposition of these appeals, only those facts necessary to our resolution will be recited.

The genesis of these appeals emanate from 2009 loan agreements between River Falls Holdings, LLC, River Falls Investments, LLC, and the Park Avenue Bank. Particularly, in March 2009, River Falls Holdings, and River Falls Investments executed a Revolving Line of Credit Secured Promissory Note (Revolving Line of Credit) with Park Avenue Bank for a loan in

the principal amount not to exceed 1.5 million dollars.[1] Thomas Bean was manager of River Falls Investments and signed the Revolving Line of Credit in such capacity. Stephen B. Pence was manager of River Falls Holdings and also signed the Revolving Line of Credit in such capacity. Both Bean and Pence also executed a Guarantee, personally promising to guarantee payment of any sums loaned under the Revolving Line of Credit.[2] Pursuant to Pence's direction, Park Avenue Bank disbursed $1,485,000 under the Revolving Line of Credit into a checking account of River Falls Holdings on March 23, 2009; thereafter, $1,480,000 was transferred from the River Falls Holdings' checking account to an account at Park Avenue Bank held by SDH Realty, Inc. The president of SDH Realty was Sheri D. Huff, and W. Anthony Huff was the vice-president.[3]

Approximately one year later, on March 12, 2010, the New York Banking Department seized Park Avenue Bank as a failed bank, and the Federal Deposit Insurance Corporation (FDIC) was appointed as receiver for the Park Avenue Bank. In its capacity as receiver, effective the same date, the FDIC entered into a Purchase and Assumption Agreement and an Assignment and Purchase Agreement with Valley National Bank

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[1] The Revolving Line of Credit Secured Promissory Note (Revolving Promissory Note) was also secured by a mortgage upon real property located in Louisville, Kentucky, and owned by SDH Realty, Inc.

[2] Although not at issue, the Guarantee was also signed by Sheri D. Huff.

[3] SDH Realty, Inc., was a Kentucky Corporation.

New York Corporation (VNB). Under the agreements, VNB purchased the assets and liabilities of Park Avenue Bank, which included the Revolving Line of Credit and Guarantee, at issue in this case.

Thereafter, on April 1, 2010, River Falls Investment and River Falls Holdings defaulted under the terms of the Revolving Line of Credit. Despite notice of the default, neither Bean nor Pence satisfied the outstanding indebtedness per the terms of their Guarantee.

In December 2010, VNB, as successor to Park Avenue Bank, filed a complaint in the Jefferson Circuit Court against, *inter alios*, River Falls Holdings, River Falls Investments, Bean, Pence, the Huffs, and SDH Realty. Relevant to this appeal, VNB claimed that River Falls Holdings and River Falls Investments defaulted under the terms of the Revolving Line of Credit and owed a total of $1,500,000 in principal and $288,916.82 in outstanding interest, as of December 9, 2010. VNB also claimed that Bean and Pence were jointly and severally liable upon default of the Revolving Line of Credit for the outstanding balance of principal and interest in the amount of $1,788,916.82 per the terms of their Guarantee.

Subsequently, VNB filed a motion for summary judgment upon the issue of Bean and Pence's liability under the Guarantee.[4] In its memorandum of law filed

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[4] Actually, Valley National Bank New York, Corporation (VNB) filed two Motions for Summary Judgment in this case, one in 2011 and one in 2013. The order on appeal emanates from the

in support of the motion for summary judgment filed on October 23, 2013, VNB outlined the alleged criminal conspiracy that led to Park Avenue Bank's ultimate failure and eventual receivership by the FDIC:

> On September 27, 2012, the sealed indictment of Anthony Huff and two other men was unsealed in the United States District Court in the Southern District of New York. . . . As alleged in the Huff Indictment, Anthony Huff controlled 22 affiliated entities, referred to in the indictment as the "Huff-Controlled Entities." These entities include some of the Defendants herein including [River Falls Holdings, River Falls Investments and SDH Realty].
>
> One of the other men indicted in the Huff Indictment was Matthew Morris ("Morris"), a Senior Vice President at Park [Avenue] Bank. Morris managed Park [Avenue] Bank's

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motion filed on October 23, 2013. At first blush, we question whether a final and appealable judgment has actually been entered on the respective individual guarantor liability pursuant to Kentucky Rules of Civil Procedure (CR) 54. No specific amount of liability has been awarded by judgment, including accrued interest and attorney's fees. Additionally, the findings of the Master Commissioner were not incorporated into the orders on appeal regarding the guarantor liability. However, the circuit court also granted judgment to VNB on Stephen B. Pence (Pence) and Thomas Bean's (Bean) counter claims, which directly relates to the affirmative defenses of fraud in the factum and illegality, as asserted by Pence and Bean to the allegations in the complaint. Further, the orders on appeal included the requisite language set forth in CR 52.04. We thus have addressed those claims as final per *Watson v. Best Financial Services., Inc.*, 245 S.W.3d 722 (Ky. 2008).

relationships with Huff and the Huff-Controlled Entities. Another man mentioned in the Huff Indictment is Charles Antonucci ("Antonucci"). He served as President of Park [Avenue] Bank. Prior to the release of the Huff Indictment, on October 8, 2010, Antonucci had been separately indicted and pled guilty. Antonucci pled guilty to criminal charges of fraud against the U.S. Treasury's Troubled Asset Relief Program ("TARP"), securities fraud, self-dealing, bank bribery, and embezzlement of Park [Avenue] Bank funds.

According to the Huff Indictment, in violation of Park [Avenue] Bank policies, while working with Huff, Antonucci and Morris allowed the Huff-Controlled Entities to overdraw their accounts at Park [Avenue] Bank in amounts exceeding $9 million, funds which were taken out of and lost by Park [Avenue] Bank. In exchange for cash payments and other benefits, the Huff Indictment alleges that Antonucci abused his powers at Park [Avenue] Bank to allow the three (3) Borrowers to obtain three (3) separate line of credit approvals of up to $1.5 million for a total of up to $4.5 million. . . . (alleging that Anthony Huff "paid hundreds of thousands of dollars to Morris and Antonucci in exchange for Morris and Antonucci providing Huff favorable treatment at Park Avenue Bank"). The Huff Indictment notes that the $1.5 million was the limit of Antonucci's individual authority for real estate secured loans. Those loans violated the provisions of the Park [Avenue] Bank Credit Policy, including, but not limited to, the

> treatment of cross-collateralized loans as a single loan, which caused the loan to exceed Antonucci's approval threshold. . . . The Huff Indictment alleges that the lines of credit for up to $4.5 million were taken to mask the excessive overdrafts of the Huff-Controlled Entities. These overdrafts and other regulatory concerns would have prevented Park [Avenue] Bank Board of Directors from approving additional debt to the Huff-Controlled Entities if bank procedures had been followed and the loans had been sent to the Board for review.
>
> According to the Indictment, Huff and Antonucci devised a plan to deceive Park [Avenue] Bank and to "circumvent" Park [Avenue] Bank's policies so that the loans would appear legitimate to the Park [Avenue] Bank Board of Directors and to bank regulators who may review the bank's transactions.
>
> They did this by, unbeknownst to Park [Avenue] Bank, making false representations about the need for working capital for the Borrowers and by overstating the net worth of the Guarantors. Ultimately, the three (3) loans were approved by Antonucci without the required approval of the Park [Avenue] Bank Board of Directors. The funds were used to pay down the overdraft of the Huff-Controlled Entities, funds which has already left the bank.

VNB's Memorandum of Law in Support of its Motion for Summary Judgment at 10-12 (citations omitted). VNB maintained that as an assignee of the FDIC it

was entitled to the protections of the *D'Oench Duhme* doctrine, which barred most claims or defenses asserted by borrowers/guarantors to prevent enforcement of notes or guarantee instruments.[5] VNB argued that Bean and Pence breached the terms of the Guarantee by failing to pay the outstanding balance owed under the Revolving Line of Credit, and summary judgment was proper against them.

Bean and Pence filed responses to the motion for summary judgment. Therein, Bean and Pence claimed to have possessed no knowledge of the criminal scheme relating to loans from Park Avenue Bank and claimed to also have been victims thereof. Bean and Pence argued that the Guarantee was unenforceable due to fraud in the factum and illegality of the agreement. Both Bean and Pence pointed out that these defenses are exceptions to the *D'Oench Duhme* doctrine.

The circuit court referred the motion for summary judgment to the master commissioner for consideration. On August 11, 2014, the master commissioner filed a report recommending that VNB's motion for summary judgment against Bean and Pence be granted. In so recommending, the master commissioner concluded that the *D'Oench Duhme* doctrine barred Bean and Pence's defenses and that no exceptions thereto existed:

> Pence and Bean have not alleged any facts which fall into the category of fraud in

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[5] *See D'Oench, Duhme & Co., Inc., v. FDIC*, 315 U.S. 447, 62 S. Ct. 676, 86 L. Ed. 956 (1942).

> the factum. They do not dispute that they knew they were signing a guarant[ee]. The terms of the guarant[ee] were spelled out in the instrument they each signed and the contents of the instrument were not changed after they signed it. The Sixth Circuit Court of Appeals has construed *D'Oench* [*Duhme & Co., v. FDIC*, 315 U.S. 447, 62 S. Ct. 676, 86 L. Ed. 956 (1942)] to preclude a maker from asserting any personal defenses against the FDIC, regardless of the maker's intent, when it can be said he "lent himself to a transaction which is likely to mislead banking authorities." Therefore, at best, the defense of fraud which has been asserted by Bean and Pence is fraud in the inducement which is precluded by Section 1823(e).

Master Commissioner's Report at 11 (citations omitted).

On October 15, 2014, Pence filed a motion for leave to file an amended answer and counterclaim against VNB. In the amended answer, Pence sought to add the defense of fraud in the factum as a bar to prevent VNB from enforcing the Guarantee. And, in the proposed counterclaim, Pence alleged that employees of the Park Avenue Bank fraudulently misled and induced him to sign the Guarantee. It appears that Bean also made an oral motion for leave to file a similar counterclaim.

By Order entered January 12, 2015, the circuit court followed the Master Commissioner's recommendation and overruled the "objections" filed by Bean and Pence. Relevant herein, the circuit court concluded:

> [Bean and Pence] raise [the] argument that the *D'Oench* Doctrine and § 1823 are inapplicable to void contracts. There is little dispute the promissory notes were obtained through fraud, however Pence and Bean acknowledge they knew at the time they were signing documents to obligate their respective companies. There are, however, questions as to the oral agreement to not hold them personally liable, despite the language of the notes, the date and location of their execution, and purpose of the funds. Such considerations support a defense of fraud in the inducement, not fraud in the factum, and render the notes voidable not void *ab initio*.

January 12, 2015, Order at 3 – 4 (citations omitted).

Both Bean and Pence then filed motions seeking reconsideration of the January 12, 2015, Order. Pence argued the circuit court failed to rule on his motion to file an amended answer and counterclaim. By Amended Order entered November 17, 2015, the circuit court denied the motions and also denied Pence and Bean's motion to file an amended answer and counterclaim:

> Pence and Bean are experienced businessmen, and do not dispute knowing what documents they signed. Their primary defense is that they had an oral agreement with Anthony Huff that they would not be liable and no funds were actually disbursed. However, this side agreement is the precise scenario *D'Oench* and § 1823 are designed to

> avoid. A failed bank's records, such as the promissory notes and mortgages, essentially are viewed in a vacuum; only errors in the written documents themselves and the institution's records can overcome *D'Oench* and § 1823. As the Court previously determined, Pence and Bean understood the terms of the documents they executed, did not raise any objections to the terms, and Park Avenue Bank's records do not reflect any amendments or alterations to those written terms. Illegal transactions may still fall within the parameters of *D'Oench*. For these same reasons, Pence's and Bean's motions to file counterclaims against VNB are also denied. They are based on the same arguments that are barred by *D'Oench*.

November 17, 2015, Amended Order at 1 – 2 (citations omitted). These appeals follow.

APPEAL NOS. 2015-CA-001821-MR
AND 2015-CA-001822-MR

To begin, we will address both appeals simultaneously as Pence and Bean raise identical arguments in their respective briefs as to the propriety of the circuit court's summary judgment.

Summary judgment is proper where there exists no material issue of fact and movant is entitled to judgment as a matter of law. Kentucky Rules of Civil Procedure 56; *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky. 1991). When ruling upon a

motion for summary judgment, all facts and inferences therefrom are to be viewed in a light most favorable to the nonmoving party. *Steelvest, Inc.*, 807 S.W.2d 476. Our review proceeds accordingly.

Bean and Pence initially contend that the circuit court erred by rendering summary judgment upon their defenses of fraud in the factum and illegality. Bean and Pence maintain that these defenses are not barred by the *D'Oench Duhme* doctrine. Bean and Pence allege that material issues of fact existed upon these defenses and that the circuit court erred by concluding otherwise.

D'Oench Duhme Doctrine

The *D'Oench Duhme* doctrine was initially recognized by the United States Supreme Court in *D'Oench, Duhme & Co., Inc., v. FDIC*, 315 U.S. 447, 62 S. Ct. 676, 86 L. Ed. 956 (1942), and subsequently codified by congressional act in 12 U.S.C. § 1823(e).[6] The *D'Oench*

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[6] 12 U.S.C. § 1823(e) provides:

(E) Deposit Insurance Fund available for intended purpose only

(i) In general

After December 31, 1994, or at such earlier time as the Corporation determines to be appropriate, the Corporation may not take any action, directly or indirectly, with respect to any insured depository institution that would have the effect of increasing losses to the Deposit Insurance Fund by protecting –

Duhme doctrine is presently understood as shielding the FDIC or assignee bank from most claims or defenses raised to defeat its action to enforce or collect upon a debt of a failed banking institution. *See Langley*, 484 U.S. 86. *Bell & Murphy and Assocs. v. Interfirst Bank Gateway, N.A.*, 894 F.2d 750 (5th Cir. 1990); *UMLIC-Nine Corp. v. Lipan Springs Dev. Corp.*, 168 F.3d 1173 (10th Cir. 1999); *Fleet Bank of Maine v. Steeves*, 785 F. Supp. 209 (D. Maine 1992). The modern *D'Oench Duhme* doctrine represents an amalgamation of the federal common law with 12 U.S.C. § 1823(e) to form a far reaching and consequential rule of law in the area

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(I) depositors for more than the insured portion of deposits (determined without regard to whether such institution is liquidated); or

(II) creditors other than depositors.

(ii) Deadline for regulations

The Corporation shall prescribe regulations to implement clause (i) not later than January 1, 1994, and the regulations shall take effect not later than January 1, 1995.

(iii) Purchase and assumption transactions

No provision of this subparagraph shall be construed as prohibiting the Corporation from allowing any person who acquires any assets or assumes any liabilities of any insured depository institution for which the Corporation has been appointed conservator or receiver to acquire uninsured deposit liabilities of such institution so long as the insurance fund does not incur any loss with respect to such deposit liabilities in an amount greater than the loss which would have been incurred with respect to such liabilities if the institution had been liquidated.

of banking. The underlying purposes of the *D'Oench Duhme* doctrine are twofold:

> One purpose of § 1823(e) is to allow federal and state bank examiners to rely on a bank's records in evaluating the worth of the bank's assets. Such evaluations are necessary when a bank is examined for fiscal soundness by state or federal authorities. . . .
>
> A second purpose of § 1823(e) is implicit in its requirement that the "agreement" not merely be on file in the bank's records at the time of an examination, but also have been executed and become a bank record "contemporaneously" with the making of the note and have been approved by officially recorded action of the bank's board or loan committee. These latter requirements ensure mature consideration of unusual loan transactions by senior bank officials, and prevent fraudulent insertion of new terms, with the collusion of bank employees, when a bank appears headed for failure. . . .

Langley, 448 U.S. at 91-92. There are, however, recognized exceptions to the *D'Oench Duhme* doctrine, including the defenses/claims of fraud in the factum and illegality of the contract. The defenses that "survive are those . . . that void an interest *ab initio*" thus rendering the instrument "void" and not transferable to

the FDIC. 4 Law of Distressed Real Estate, *Real Defenses* § 45:18 (2016); *see Langley*, 448 U.S. 86.[7]

FRAUD IN THE FACTUM

Fraud in the factum occurs "when a party signs a document without full knowledge of the character of essential terms of the instrument." *McLemore v. Landry*, 898 F.2d 996, 1002 (5th Cir. 1990) (citations omitted); *see also* 4 Law of Distressed Real Estate, *Real Defenses – Fraud in Factum* § 45:19 (2016). The Restatement (Second) of Contracts § 163 (1981) sets forth fraud in the factum as follows:

> If a misrepresentation as to the character or essential terms of a proposed contract induces conduct that appears to be a manifestation of assent by one who neither knows nor has reasonable opportunity to know of the character or essential terms of the proposed contract, his conduct is not effective as a manifestation of assent.

And, as to the *D'Oench Duhme* doctrine, the United States Supreme Court has recognized that fraud in the factum constitutes "the sort of fraud that procures a party's signature to an instrument without knowledge of its true nature or contents." *Langley*, 484 U.S. at 93 (citations omitted). A commonly cited example of fraud

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[7] Both Pence and Bean asserted fraud and illegality as affirmative defenses to the allegations set forth in the complaint. They reasserted these defenses in their objections to the Master Commissioner's Report.

in the factum occurred where a party "erased the original bank's name [on a guarantee] and inserted the name of another bank" after execution of the guarantee. *FDIC v. Turner*, 869 F. 2d 270, 274 (6th Cir. 1989).

In this case, Bean and Pence specifically argue that the Revolving Line of Credit and Guarantee are void due to fraud in the factum:

> Bean [and Pence] never knew that Huff and PAB's [Park Avenue Bank's] officials had masterminded this devious scheme to funnel money between several Huff controlled bank accounts at PAB to mask massive bank overdrafts and that bogus documents purporting to be loan documents, including the "guarantee" signed by Bean [and Pence], were a complete sham. Bean [and Pence] had no opportunity, much less a reasonable opportunity, to obtain knowledge that the documents purporting to be loan documents were contrived to conceal an **intra-bank**, money funneling scheme. . . .
>
> It is abundantly clear that the bogus PAB documents purporting to be loan documents were void *ab initio*. . . .
>
> . . . .
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> All of the "loan documents" at issue in the case at bar are completely fictitious. They were concocted to cover up a criminal scheme to funnel money between several Huff controlled bank accounts at PAB to mask massive bank overdrafts. In other words, the fictitious

> guarantee at issue here was void *ab initio* and the fraud at issue here is "fraud in the factum." . . .
>
> . . . .
>
> Bean [and Pence] signed a document that was not only used for an "unforeseen and unrelated design," but a document that was not genuine! The guarantee and the loan documents in this case are undisputedly phony, contrived, and otherwise fake. They were concocted by PAB officials and Huff, and there is no evidence that Bean [and Pence] knew anything about the fact that they were bogus papers intended to cover up a criminal banking scheme to funnel money between several Huff controlled bank accounts at PAB to mask massive bank overdrafts. . . .

Bean's Brief at 9, 12, and 15 (citations omitted).

Viewing the facts most favorable to Bean and Pence, they have failed to raise material issues of fact as to fraud in the factum. Although the Revolving Line of Credit and Guarantee were part of a criminal scheme, it is undisputed that Park Avenue Bank disbursed loan proceeds in the amount of $1,485,000 under the terms of the Revolving Line of Credit and transferred said sums to a River Falls Holdings' checking account. Additionally, Bean and Pence knew they were signing a Revolving Line of Credit and knew the repayment terms of the Revolving Line of Credit. As observed by the circuit court, both Bean and Pence were "experienced businessmen." The fraud alleged by

Bean and Pence simply does not constitute fraud in the factum but may raise facts more consistent with fraud in the inducement, which of course is negated under the facts of this case by the *D'Oench Duhme* doctrine. Accordingly, we are of the opinion that the circuit court properly rendered summary judgment upon Bean and Pence's defense of fraud in the factum.

ILLEGALITY

The illegality of an agreement or contract with a banking institution is also a recognized exception to the *D'Oench Duhme* doctrine when the effect of the illegality is to render the underlying note or instrument void. 4 Law of Distressed Real Estate, *Real Defenses – Illegality* § 45:20 (2016). However, where the effect of the illegality merely renders the underlying note or instrument voidable, there is no exception to the *D'Oench Duhme* doctrine, and the defense or claim is barred thereunder. *FDIC v. Hudson*, 800 F. Supp. 867 (N.D. Cal. 1990); *In re Settlers' Housing Serv. Inc. v. Schaumburg Bank & Trust Co., N.A.*, 514 B.R. 258 (N.D. Ill. 2014). To determine whether an agreement is void or voidable, the court may look to both state and federal law; however, if state law is in contravention of federal law, the federal law will control. *FDIC v. Turner*, 869 F.2d 270 (6 Cir. 1989). And, federal case law holds that not every agreement violative of law or public policy will render the underlying note or instrument void. *CMF Virginia Land, L.P. v. Brinson*, 806 F. Supp. 90 (E.D. Va. 1992); *Settlers Housing Serv.*, 514 B.R. 258.

Based on the record in this case, neither the circuit court nor the master commissioner fully considered the issue of illegality of the underlying bank transactions, as alleged by Pence and Bean. The circuit court made merely one cursory reference to illegality in its orders, and the master commissioner failed to even acknowledge the issue entirely in his report. Moreover, in their respective briefs, Bean and Pence have not set forth the specific legal authority that would support a legal argument to render the Revolving Line of Credit or Guarantee void. Notwithstanding, if Huff and Antonucci, and perhaps others, engaged in an elaborate shell game in the various bank loan transactions to shield a criminal enterprise unbeknownst to Pence and Bean, then their defense could possibly prevail. Of course, when the lid is lifted off of Pandora's Box, any alleged complicity, knowledge or participation by Pence and Bean in the criminal enterprise shall be open to scrutiny and discovery, which could negate the illegality defense under various legal doctrines, which is not properly before this Court at this time.

Therefore, in view of the complexity of this case and current posture thereof, we conclude that summary judgment was prematurely rendered upon the defense of illegality and vacate the summary judgment upon said defense.

COUNTERCLAIMS

Bean and Pence also argue that the circuit court erred by denying their motion to file a counterclaim

against VNB. Bean and Pence maintain that their claims of fraud in the factum and illegality were not barred by the *D'Oench Duhme* doctrine. In the circuit court's November 17, 2015, Order, it concluded that Bean and Pence's "motions to file counterclaims against VNB are also denied. They are based on the same arguments that are barred by *D'Oench*."

It is clear that the *D'Oench Duhme* doctrine bars both defenses and claims raised against the FDIC or assignee bank. *Bowen v. FDIC*, 915 F.2d 1013 (5th Cir. 1990); *FSLIC v. Gemini Mgmt.*, 921 F.2d 241 (9th Cir. 1990). As previously discussed in this Opinion, we held that the circuit court properly rendered summary judgment upon Bean and Pence's fraud in the factum defense. As their counterclaim is based upon identical law and facts, we conclude that their fraud in the factum counterclaim was, likewise, barred. *See Bowen*, 915 F.2d 1013; *Gemini Mgmt.*, 921 F.2d 241. However, in this Opinion, we have also held that summary judgment was premature upon Bean and Pence's illegality defense; likewise, we view Bean and Pence's motion to file a counterclaim raising the claim of illegality as prematurely denied.

SUMMARY

In summation, we hold that the circuit court properly rendered summary judgment upon Bean and Pence's defense of fraud in the factum and properly denied Bean and Pence's counterclaim also based upon fraud in the factum. We, however, conclude that the

circuit court prematurely rendered summary judgment upon Bean and Pence's defense of illegality and also prematurely denied their motion to file a counterclaim based upon illegality.[8] Therefore, we vacate the circuit court's orders as to the defense and counterclaim of illegality and remand for additional proceedings.

For the foregoing reasons, the orders of the Jefferson Circuit Court are affirmed in part, vacated in part, and remanded for proceedings consistent with this Opinion.

ALL CONCUR.

BRIEF FOR APPELLANT THOMAS BEAN:

Michael A. Valenti
Lee S. Archer
Louisville, Kentucky

BRIEFS FOR APPELLEE VNB NEW YORK, LLC AS SUCCESSOR BY MERGER TO VNB NEW YORK CORPORATION:

Christie A. Moore
April A. Wimberg
Louisville, Kentucky

[8] Our Opinion should not be misconstrued as holding that Thomas Bean or Stephen B. Pence has set forth a valid claim or defense upon illegality. We merely conclude that the circuit court's ruling upon illegality was premature. Upon additional consideration by the circuit court, including additional discovery if the circuit court deems necessary, summary judgment for VNB may, indeed, be properly granted against such defense and counterclaim.

ORAL ARGUMENT FOR APPELLANT, THOMAS BEAN:

Michael A. Valenti
Louisville, Kentucky

ORAL ARGUMENT FOR APPELLEE VNB NEW YORK, LLC AS SUCCESSOR BY MERGER TO VNB NEW YORK CORPORATION:

Christie A. Moore
Louisville, Kentucky

BRIEF FOR APPELLANT, STEPHEN B. PENCE:

Michael A. Valenti
Lee S. Archer
Louisville, Kentucky

ORAL ARGUMENT FOR APPELLANT, STEPHEN B. PENCE:

Michael A. Valenti
Louisville, Kentucky

JEFFERSON CIRCUIT COURT
DIVISION NINE
JUDGE JUDITH E. McDONALD-BURKMAN
CASE NO. 10-CI-405021

VBN NEW YORK, LLC AS SUCCESSOR IN INTEREST TO THE PARK AVENUE BANK — **PLAINTIFF**

v. — **AMENDED ORDER**

ALEXANDER & ALEXANDER RISK SERVICES, LLC, et al. — **DEFENDANTS**

*** *** ***

(Filed Nov. 14, 2015)

This matter comes before the Court on Motion to Alter, Amend or Vacate filed by Defendant Stephen B. Pence ("Pence"). Defendant Thomas Bean ("Bean") has also filed a Motion for Reconsideration. Plaintiff VNB New York, LLC, as Successor in Interest to the Park Avenue Bank ("VNB") has responded and the matter is now submitted.

Pence and Bean seek reconsideration of the Court's January 12, 2015 Order overruling their objections to the Master Commissioner's Report based on the *D'Oench* Doctrine and 12 U.S.C. § 1823(e), The facts and circumstances surrounding the promissory notes and mortgages at issue are discussed in the January 12, 2015 Order and are incorporated herein by reference.

Pence and Bean are experienced businessmen, and do not dispute knowing what documents they

signed. Their primary defense is that they had an oral agreement with Anthony Huff that they would not be liable and no funds were actually disbursed. However, this side agreement is the precise scenario *D'Oench* and § 1823 are designed to avoid. A failed bank's records, such as the promissory notes and mortgages, essentially are viewed in a vacuum; only errors in the written documents themselves and the institution's records can overcome *D'Oench* and §1823. As the Court previously determined, Pence and Bean understood the terms of the documents they executed, did not raise any objections to the terms, and Park Avenue Bank's records do not reflect any amendments or alterations of those written terms. Illegal transactions may still fall within the parameters of *D'Oench*. *FDIC v. Investors Assocs. X Ltd.*, 775 F.2d 152, 156 (6th Cir. 1985). For these same reasons, Pence's and Beans motions to file counterclaims against VNB are also denied. They are based on the same arguments that are barred by *D'Oench*.

Therefore, after a careful review of the record, applicable law and the Court being otherwise sufficiently advised, **IT IS HEREBY ORDERED AND ADJUDGED** that Defendant Stephen B. Pence's Motion to Alter, Amend or Vacate and Defendant Thomas Bean's Motion for Reconsideration are **DENIED**.

This is a final and appealable order there being no just cause for delay.

/s/ Judith McDonald-Burkman
JUDITH E. MCDONALD-BURKMAN, JUDGE
JEFFERSON CIRCUIT COURT

DATE: 11-17-15

[Distribution List Omitted]

JEFFERSON CIRCUIT COURT
DIVISION NINE
JUDGE JUDITH E. McDONALD-BURKMAN
CASE NO. 10-CI-405021

VBN NEW YORK, CORPORATION AS SUCCESSOR IN INTEREST TO THE PARK AVENUE BANK — **PLAINTIFF**

v. **ORDER**

ALEXANDER & ALEXANDER RISK SERVICES, LLC, et al. — **DEFENDANTS**

*** *** ***

(Filed Jan. 12, 2015)

This matter comes before the Court on Objections to Master Commissioner's Report filed by Defendants Stephen B. Pence ("Pence") and Thomas Bean ("Bean"). Plaintiff VNB New York Corporation as Successor in Interest to Park Avenue Bank ("VNB") has responded. A hearing was held October 22, 2014 and the matter is now submitted.

In March 2009, VNB's predecessor Park Avenue Bank ("PAB") entered into a $1,500,000 Revolving Line of Credit Secured Promissory Note, signed by Pence as Manager of River Falls Holdings, LLC and Bean as Manager of River Falls Investments, LLC. It was also secured by a mortgage granted by SDH Realty, Inc. and Sheri D. Huff, as well as personal guaranties of Pence, Bean and Sheri D. Huff. Pence acknowledges signing the various documents involved in the transaction, but disputes the dates on the documents. He claims he signed all the documents at one

time on March 25, 2009, not on different days as indicated on the notary pages. At Pence's written direction to PAB Vice President Matthew Morris on March 23, 2009, the funds were disbursed to River Falls on March 24, 2009, and then were transferred to a PAB account belonging to SDH Realty, Inc. Bean alleges he signed the documents in Florida, despite the notary pages indicating they were signed in Kentucky on March 18, 2009. Pence and Bean claim they were both told by PAB officers they would not be held personally liable for the guaranties despite the language contained therein to the contrary.

PAB failed in 2010, and the FDIC was appointed its receiver. VNB became its successor by buying its assets and liabilities, including the promissory note at issue. Ultimately, PAB's President Charles Antonucci and Vice President Matthew Morris were indicted, and eventually pled guilty, for an extensive fraud scheme involving another PAB client, Anthony Huff. PAB allowed Huff to overdraw his accounts by millions of dollars, and hide them through the use of loan applications obtained through fraudulent mispresentations as to the purpose of the proceeds. There is no allegation that Pence and Bean were anything other than victims of this banking scheme.

The Master Commissioner determined that Pence's and Bean's defenses were precluded by the *D'Oench* Doctrine and/or 12 U.S.C. § 1823(e). Both aim to prevent oral side agreements that are not documented in the official records of failed institutions. Pence and Bean claim *D'Oench* is no longer good law

since FIRREA supersedes it, relying on *FDIC v. Deglau*, 207 F.3d 153 (3rd Cir. 2000). In *Deglau*, the Court determined that in light of *Atherton v. FDIC*, 519 US 213 (1997) and *O'Melveny & Myers v. FDIC*, 512 US 79 (1994), § 1823(e) was sufficiently comprehensive and detailed and the common-law *D'Oench* doctrine was not needed to supplement it. *Deglau* at 171.

Under § 1823(e), to diminish the interest of the depository institution that takes over a failed institution in an agreement, the agreement must (1) be in writing; (2) be executed by the depository institution and the person claiming an adverse interest under it contemporaneously with the acquisition of the asset by the depository institution; (3) be approved by the board of directors of the depository institution; and (4) have been an official record of the depository institution since its execution. Pence's allegation that he was not to be held personally liable on the note is the type of oral side agreement the *D'Oench* Doctrine and § 1823 were designed to prevent. It was unwritten, never approved by PAB's board of directors, or made part of PAB's official records.

Defendants raise argument that the *D'Oench* Doctrine and § 1823 are inapplicable to void contracts. *Langley v. FDIC*, 484 U.S. 86 (1987). There is little dispute the promissory notes were obtained through fraud, however Pence and Bean acknowledge they knew at the time they were signing documents to obligate their respective companies. There are, however, questions as to the oral agreement to not hold them personally liable, despite the language of the notes, the

date and location of their execution, and purpose of the funds. Such considerations support a defense of fraud in the inducement, not fraud in the factum, and render the notes voidable not void *ab initio*.

Therefore, after a careful review of the record, applicable law and the Court being otherwise sufficiently advised, **IT IS HEREBY ORDERED AND ADJUDGED THAT** Objections to Master Commissioner's Report filed by Defendants Stephen B. Pence and Thomas Bean are **OVERRULED**.

/s/ Judith McDonald-Burkman
JUDITH E. MCDONALD-BURKMAN, JUDGE
JEFFERSON CIRCUIT COURT

DATE: 1-12-15

[Distribution List Omitted]

Supreme Court of Kentucky

2019-SC-000705-D
(2015-CA-001821 & 2018-CA-001259)

STEPHEN B. PENCE, ET AL. MOVANTS

V. JEFFERSON CIRCUIT COURT
2010-CI-405021

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

ORDER DENYING DISCRETIONARY REVIEW

The motion for review of the decision of the Court of Appeals is denied.

Nickell, J., not sitting.

ENTERED: May 20, 2020.

/s/ John D. Minton, Jr.
CHIEF JUSTICE