

FEDERAL DEPOSIT INSURANCE CORPORATION v. MEYER

UNITED STATES DISTRICT COURT, DISTRICT OF COLUMBIA, 1991
755 F.SUPP. 10

FACTS Certain partners of the Finley Kumble law firm signed promissory notes that secured loans made to the law firm by the National Bank of Washington (NBW). When Finley Kumble subsequently declared bankruptcy and defaulted on the loans, NBW filed suit to collect on the notes. Then NBW itself became insolvent, and the Federal Deposit Insurance Corporation (FDIC) was appointed as receiver. The FDIC moved for summary judgment against each defendant on the grounds that Section 1823(e) the

Federal Deposit Insurance Act (FDIA) of 1950 places the FDIC in the position of a holder in due course and thus bars all personal defenses against FDIC claims as a matter of law. Twenty of the Finley partners opposed the motion, claiming that they signed the notes under the threat that their wages and standing in the firm would decrease if they refused to sign. Such a threat constituted economic duress, which, they contended, is not a personal defense but a real one. They argued that the FDIA does not bar real defenses.

DECISION Summary judgment granted in favor of FDIC.

OPINION Pratt, J. The Finley Partners argue that the FDIC's motion for summary judgment should be denied because their defense of economic duress survives the effects of § 1823(e). They concede that § 1823(e) operates to place the FDIC in the position of a holder in due course, making promissory notes free of personal defenses. They argue, however, that § 1823(e) does not extinguish real defenses set forth in the Uniform Commercial Code ("UCC") and that their economic duress defense constitutes such a real defense.

Defendants are correct that § 1823(e) bars personal defenses but not real defenses. *** As the Supreme Court explained in *Langley v. FDIC*, a real defense renders an instrument entirely void, leaving no interest that could be "diminish[ed] or defeat[ed]." [Citations.] In contrast, personal defenses render a note voidable but not void. ***

Thus, if the Finley Partners' economic duress constitutes a real defense, then their promissory notes were void from the beginning. *** On the other hand, if the Finley Partners' economic duress defense is a personal defense, then the FDIC received voidable title to the promissory notes from the NBW, which [defense would be cut off by the FDIC] ***.

The main legal question, then, is whether economic duress is a personal defense that rendered NBW's title to the promissory notes voidable, or a real defense that rendered its title entirely void. The Finley Partners suggest that duress of any nature constitutes a real defense, citing UCC § 3-305(2)(b) and several cases from outside of the District of Columbia. A careful reading of the UCC and its Official Commentary reveals that it does not make such a blanket classification.

First, § 3-305(2)(b) provides that holders in due course take free of all defenses except for "(b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity." The words "such" and "as" indicate that the section is not stating that any type of duress renders an obligation to be nullity. Rather, it

suggests that only those types of duress that are so severe as to render it a nullity stand as exceptions to the rule that holders in due course take free of defenses.

Of course, the question left open is what type of duress is severe enough to render it a nullity. Neither UCC § 3-305(2)(b) nor the Official Comment attempt to establish a rule governing which types of duress render a transaction void as opposed to merely voidable. Instead, Official Comment 6 declares that "[a]ll such matters are therefore left to the local law."

Duress takes two forms. In one, a person physically compels conduct that appears to be a manifestation of assent by a party who has no intention of engaging in that conduct. The result of this type of duress is that the conduct is not effective to create a contract ([Restatement] § 174). In the other, a person makes an improper threat that induces a party who has no reasonable alternative to manifesting his assent. The result of this type of duress is that the contract that is created is voidable by the victim (§ 175). [Citation.]

The Finley Partners do not allege that they were physically compelled to sign the promissory notes in question. They themselves labeled their defense as "economic" duress, and the substance of their allegations are that they signed the notes because of the threat that their wages and standing in the firm would decrease if they refused. Such economic duress does not reach the level of physical compulsion capable of rendering a transaction entirely void. Thus, NBW held at least voidable title to the promissory notes when the FDIC took over as Receiver. *** Thus, defendants' economic duress defense is not valid against the FDIC.

INTERPRETATION Where the obligation of an instrument is void, the Code authorizes the use of this real defense against a holder in due course.

CRITICAL THINKING QUESTION What other defenses, if any, should be real defenses? Explain.