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Savings and Loan Goodwill Cases on Remand

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Summary

This report discusses the Supreme Court's decision in *United States v. Winstar Corporation*, 518 U.S. 839, 116 S.C. 2432 (1996), in which the Court ruled that the United States had breached contracts made by the Federal Home Loan Bank Board with various savings and loan institutions. Before the federal courts are two separate lines of cases claiming damages for legislation affecting agreements by regulators in the 1980's with investors in failing thrifts as to treatment of goodwill and change in tax law. In the goodwill cases, in December 1997, the United States Court of Federal Claims ruled against the government on many common issues in the over 200 similar cases before that court. In May 1998, that court ruled, on the basis of the facts of one of those cases, that the Federal Deposit Insurance Corporation could maintain a claim against the United States as successor to a failed institution and that private investors in that institution would be limited to restitution damages and not expectancy damages. By July 2001, various other rulings at the trial court level, in the Court of Federal Claims, and at the appellate level in the Court of Appeals for the Federal Circuit, have added more complexity to these precise issues.

Good Will Cases. Whatever the causes of the thrift crisis in the 1980's—inflation, deregulation, poor investments, fraud—the results were that the number of troubled institutions and failures ultimately meant insufficiency in the deposit insurance fund that was designated to handle the thrift industry. That was the now-defunct Federal Savings and Loan Insurance Corporation (FSLIC) fund. Without adequate funding to close down troubled and failing institutions and pay off depositors, the fund's regulator, the Federal Home Loan Bank Board (FHLBB), embarked on a forbearance program to induce new investors to purchase or merge failed thrifts. It permitted them to take advantage, over 30 or 40 years, of favorable accounting treatment for intangibles, such as goodwill, in calculating regulatory capital. The net effect of including goodwill, which came to be called supervisory goodwill, appears to have been that of saving the regulator or the acquired institution from having to transfer tangible assets or cash to cover the deposit accounts transferred in the transaction.

What was happening, therefore, was an agreement by the government to allow the investors in failing thrifts to treat what was a deficit in the thrift's capital as an asset. The Financial Institutions Reform, Recovery, and Enforcement Act of 1987 (FIRREA), Pub. L. 101-73, 103 *Stat.* 183, set a twenty-year limit for phasing out supervisory goodwill. 12 U.S.C., sections 1464(t)(3)(A) and 4(t)(9)(B). It, therefore, nullified the agreements between the investors and the government.

In *Winstar*, the Court decided that these agreements could be found to be binding on the government. The government could be held liable for breach and could not assert four defenses that might have been available in other circumstances: (1) the need for an unmistakable waiver of sovereign authority; (2) need for an express delegation of authority to the Federal Home Loan Bank Board to bind the government; (3) the involvement of sovereign powers that may not be waived; and (4) the existence of a public and general law, FIRREA, that could serve to bar a damages claim. Essentially, these were all inapplicable because the Court did not interpret *Winstar* as involving a question of the United States' having waived its right to change conditions governing the savings and loan industry. It had not waived the authority to enact legislation. The Court viewed the case as involving an assertion that in making the agreements the government waived, not its power to modify the agreements, but its power to do so without having to pay contract damages. The Court treated these agreements as closer to ordinary, run-of-the-mill government contracts than to regulatory orders.

There are 120 cases involving similar situations before the federal courts with total damage claims in the $20 to $30 billion range. As of July 2001, of the 120 cases before the trial court, only 15 have been concluded–9 dismissed and 6 settled. Five cases are on appeal and 95 remain before the trial court, in various stages of litigation. The trial court, the United States Court of Federal Claims, scheduled 38 of these cases for accelerated treatment. In a December 22, 1997, opinion, *California Federal Bank v. United States*, 39 Fed. Cl. 753 (1997), the court ruled against the government on a series of legal issues common to many of the cases. It charged the government with raising weak arguments and suggested that settlement discussions should proceed. It noted the complexity of managing these cases, with distinct factual ingredients and varied issues, and that no single group of issues will resolve all the cases.

The Claims Court selected four cases to air representative contract defenses, presumably to stimulate the government to soften its litigation strategy. The December 1997 decision deals with these consolidated defenses. Many of the defenses involved alleged inconsistency reflected in the multitudinous documents and collateral agreements that constituted the deals by which the investors were induced to take over the failing institutions. Some of the issues were virtually identical to those raised in the Supreme Court; others involved different factual situations—such as whether or not the fact that the institution would have been adequately capitalized on the date of acquisition with or without the forbearance agreements was critical to finding the existence of a contract. After examining the issues, the court ruled for the plaintiffs and criticized the government and its arguments. Subsequently, the government, preserving its right to appeal, filed a motion to proceed with discovery and insisted that many of the cases involve factual circumstances that differ from *Winstar*. As these cases have proceeded, the government has argued that some of the deals were not arranged or induced by FHLBB or involve breaches by the thrifts before FIRREA and the government's breach.

In May 1998, in one of the *Winstar* cases, the Court of Federal Claims ruled that the Federal Deposit Insurance Corporation (FDIC) could pursue its goodwill claims as successor to a failed thrift and possibly recover damages for rights it received as assignee of the receiver but that it could not recover for payments it made, in its corporate capacity, to meet deficits in the receivership. Among the reasons was the avoidance of tying up the court's docket with an intra-governmental dispute, the Treasury being the creditor of 99% of the receivership's deficit. The court also ruled that the private plaintiffs damages claims would be limited to restitution damages representing return on their investments. Expectancy damages would not be allowed as they represent general damages recoverable by the institution and, presumably, by the FDIC as its successor. *Statesman Savings Holding Corporation v. United States*, 41 Fed Cl. 1 1998).

As cases are reviewed on appeal, issues as critical as whether or not to allow various types of damages are being reexamined. In *Glendale Federal Bank v. United States*, 293 F. 3d 1374 (Fed. Cir. 2001), the appellate court refused to allow restitution damages, vacated the trial court's $909 million judgment, and remanded for a calculation of the cost of actual reliance. It disallowed lost profits and restitution claims as being too speculative. In *California Federal Bank v. United States*, 245 F. 3d 1342 (Fed. Cir. 2001), the appeals court refused to allow restitution, as being too speculative, but found that the plaintiffs had presented sufficient evidence to raise a factual issue as to the existence of and quantity of lost profits. It, therefore, remanded the case for findings on the issue of lost profits.

Tax Benefits Cases. In addition to the 120 good will cases, there are at least eight cases (according to the *Wall Street Journal*, July 17, 2001, B76, col. 2) involving tax benefits available to investors who acquired failing thrifts in the late 1980's only to have the tax provisions repealed in 1993. Like the goodwill cases, the tax benefit cases involve agreements between investors and thrift regulators in the context of acquisition of failing thrifts. In the tax benefit cases, the plaintiffs entered into agreements with FSLIC and the FHLBB, providing that the regulators would reimburse them for the losses they sustained when disposing of certain assets that they acquired in the transaction. Under provisions of the tax law then in existence, specifically applicable to FSLIC, the acquirers could take advantage of the tax losses and were not required to include the FSLIC reimbursement in calculating their income. Subsequently, this tax benefit was repealed by enactment of section 13224 of the Omnibus Budget Reconciliation Act of 1993. Pub. L. 103-66. In *Centex v. United States*, 2001 U.S.Claims LEXIS 123 (July 6, 2001), a decision which encompasses five separate cases, the Court of Federal Claims ruled that the agreements with FSLIC were contracts and that they were breached by enactment of the 1993 legislation, thereby subjecting the United States to liability for contract damages. In reaching the decision, the court said that the "[p]aintiffs here legitimately expected that the covered asset loss deduction would not be eliminated through retroactive legislation targeted specifically at assistance agreements entered into by the FSLIC and the FHLBB. This expectation was protected by the implied covenant of good faith and fair dealing that was contained in the Assistance Agreement." 2001 U.S. Claims LEXIS 123. *73.

Unlike the goodwill cases, however, the tax benefit cases are at a preliminary stage in the litigation process. The *Centrex* case may be appealed by the Department of Justice. There has been no Supreme Court decision, comparable to *Winstar*, construing the repeal of the particular piece of legislation in question as a breach of contract. If and when the appellate process ends, the issue of damages awaits discovery and trial.

Funding. Costs of the litigation, damage awards, and settlement amounts, are to be disbursed from the FSLIC Resolution Fund, and when that is exhausted, from the Treasury, as authorized. Pub. L. 106-113, Div. B, § 1000 (a)(1), tit. I, §§ 110, 113 *Stat.* 1535, 1501A-20. That law further provided that litigation expenses are available under existing authority and are to be made available as set forth in a memorandum of understanding between the Department of Justice and the FDIC, dated October 2, 1998. See Pub. L. No. 105-61, §32, 111 *Stat.* 1272, 1315 (1997); Pub. L. No. 104-208, § 638, 110 *Stat.* 3009-364 (1996); and, 12 U.S.C. §§ 1821a(d), 1821a(c), and 1821a(f).