

The S&L Payouts That Never Came

Eight years after high court said Uncle Sam was on the hook over thrift crisis, few plaintiffs have seen even a penny.

BY VANESSA BLUM

In 1996, when the Supreme Court issued its landmark ruling in *United States v. Winstar*, plaintiffs lawyers thought the decision would clear the path for thrifts and investors to recover tens of billions of dollars from the federal government.

In its decision, the high court found the government liable for breaking contracts with savings and loan associations as regulators tried to avert the 1980s S&L fiasco. But so far, actual damage awards have fallen far short of what everyone—even the government—anticipated.

In total, 55 of the original 122 *Winstar*-related suits have been resolved without the government paying any money whatsoever. And in those cases where judges have ordered monetary awards, plaintiffs have recovered just a small fraction of their claims.

“When the Supreme Court ruled, we thought it was just a matter of time,” says H.C. “Buster” Bailey Jr., former president and chief executive officer of Security Savings and Loan Association in Jackson, Miss., and lead plaintiff in one *Winstar*-related suit.

Bailey, 64, was among those in the courtroom for the arguments in *Winstar*. In August 2003, after nearly 15 years of litigation, the U.S. Court of Appeals for the Federal Circuit dismissed his claim.

The court found that while the government had breached contracts with Bailey, causing the family-owned business to go into federal receivership in 1992, no damages could be paid because the costs incurred by the federal government in the seizure exceeded the company’s value—an estimated \$44 million.

Now Bailey’s legal team—led by Harvard Law School professor Laurence Tribe and prominent D.C. attorney Charles Cooper—is seeking Supreme Court review of the decision, which Tribe and Cooper argue “makes a mockery” of the 1996 *Winstar* ruling.

“The Federal Circuit is engaged in a gradual piecemeal nullification of *Winstar*; and the Bailey case is the *coup de grâce*,” says Cooper, a partner at D.C.’s Cooper & Kirk who argued and won the *Winstar* case at the Supreme Court in 1996.

Justice Department officials declined to comment on the

Winstar litigation or on Bailey’s case. However, current and former DOJ lawyers say the outcome so far has been positive for the government, which faced potential liability of more than \$30 billion.

“People thought the government was going to be out billions of dollars to the point it would affect the treasury and balloon the federal deficit,” says a former DOJ official who worked on *Winstar* matters. “My impression is that DOJ has done a heroic job in restricting liability and probably saved U.S. taxpayers billions of dollars.”

To date, trial judges on the U.S. Court of Federal Claims have awarded plaintiffs about \$1 billion, according to Justice Department figures. Of that, only \$22.4 million has been paid out. The rest—\$988.8 million—continues to be litigated on appeal. Even if allowed to stand, the sum would represent just more than 5 percent of the amount claimed by plaintiffs in those cases.

The Justice Department has also settled eight cases—with a potential value of \$1.6 billion—for just more than \$100 million.

“The damage awards have been very disappointing, certainly in comparison with expectations,” says Jerry Stouck, a partner at D.C.’s Spriggs & Hollingsworth and a leader in the private *Winstar* bar. “Once the Supreme Court decided in favor of the test cases, plaintiffs assumed all these cases were winners.”

Roughly 40 *Winstar* cases still await trial. But other plaintiffs, facing mounting legal bills and dimming prospects for recovery, have found the cost-benefit analysis just doesn’t compute. According to the Justice Department, a dozen *Winstar* plaintiffs withdrew suits in 2003.

“The fact is, it costs money to litigate,” says Steven Rosenthal, a partner in the D.C. office of Kaye Scholer. Rosenthal, who practiced with Cooper from 1998 to 2001, has been litigating *Winstar* cases since 1991. “Even if you thought you were in the right, you might think about spending half a million in legal fees to collect a million,” he says.

There is no way to know how much private plaintiffs have poured into litigating *Winstar* claims. About 35 separate law firms currently represent *Winstar* clients, down from 60 in the late 1990s. Among the prominent law firms with a stake in the

litigation: Gibson, Dunn & Crutcher; Arnold & Porter; Kirkland & Ellis; and Jones Day.

In 1998, the Justice Department estimated that it would spend more than \$200 million litigating *Winstar* matters between 1999 and 2003. (The department could not provide actual costs.) At one point, the DOJ had more than 50 lawyers working on the cases. Currently, 36 Civil Division lawyers spend most of their time on *Winstar* litigation—nearly twice as many as work in the Office of the Solicitor General.

Cooper says he had two clients recently call it quits—one dropping its suit completely and the other settling for nominal damages.

“We’re now 15 years from the time the breach took place, and we’re still grinding it out in litigation on liability issues,” Cooper says wearily. “How long can individual investors sustain that type of commitment?”

Stuart Schiffer, head of the DOJ Commercial Litigation Branch, has disputed charges that the department has used scorched earth litigation tactics or sought to delay trials.

“In some cases, the government has conceded liability, and, in most, the courts have agreed with our defenses, holding that the government is not liable at all or is liable for only pennies on the dollar of the plaintiffs’ grossly inflated claims,” Schiffer wrote in a September 2003 letter to the *Los Angeles Times*.

Cooper concedes that not every case should have resulted in damages. “But I know there are cases that should have come out in favor of the plaintiff, which were resolved simply because the plaintiff was drained of the ability and desire to continue,” he says.

Bailey estimates he has personally spent more than \$1 million on legal fees and litigation expenses since 1989. In addition to Cooper and Tribe, Bailey is represented by lawyers at Atlanta’s Alston & Bird and Forman Perry Watkins Krutz & Tardy in Jackson.

“I will not be saying goodbye to this case as long as I have any chance of a claim,” Bailey vows, joking that his wife wishes he had said goodbye long ago. “It’s just not right what happened.”

FAMILY BANKERS

Bailey’s father got into the banking and mortgage loan business in 1930, and for the next six decades the family business—which came to be called Security Savings and Loan Association—thrived.

In the 1980s, as the federal government scrambled to stave off a looming savings and loan crisis, government regulators repeatedly urged Security Savings, which it considered healthy, to acquire failing thrifts, thereby taking them off the government’s hands. As incentive, the government allowed the institution to count certain intangible assets—such as good will—toward capital reserve requirements mandated by federal regulation.

By 1989, when Congress adopted the Financial Institutions Reform, Recovery, and Enforcement Act, or FIRREA, Security Savings had accumulated roughly \$20 million of intangible assets.

After the passage of FIRREA, the rules for calculating S&Ls’ required reserves grew more stringent, and the value of intangi-



ROBERTO WESTBROOK

FROM THE START: D.C.’s Charles Cooper argued and won the original *Winstar* case before the Supreme Court, in which the justices found that the federal government was liable for the failure of scores of thrifts.

ble assets like good will could no longer be counted toward required reserves.

Security Savings, along with dozens of other thrifts that had cut similar deals with the government, suddenly came up short.

“The news came to us in December [1989] that we were out of capital compliance and had to invest an additional \$20 million in the business,” Bailey recalls. “We thought it was just a matter of time until we could explain to someone high enough up the ladder that this had all happened because of them.”

On Oct. 16, 1992, after nearly three years of litigation in Mississippi’s federal courts, Bailey met with federal receivers to hand over his family’s business.

From there, Bailey’s case moved to the D.C.-based U.S. Court of Federal Claims—the only court empowered to award damages against the federal treasury in contract cases. The case was stayed pending a Supreme Court ruling in *Winstar*.

Following the high court’s decision, Bailey’s case passed to then-Chief Judge Loren Smith for a liability determination. Smith consolidated Bailey’s case with a related claim brought by the Federal Deposit Insurance Corp. involving Security Savings and found the government liable for breach of contract. The case was then assigned to Judge Edward Damich for a ruling on damages.

Damich—who became chief judge in 2002—rejected Bailey’s claims, which ranged from \$44 million to \$140 million. He held that Bailey could not recover damages at all, because the government’s own loss as the insurer of Security Savings deposits trumped any amount owed to Bailey by the government.

Put simply, the opinion stated that any damages awarded to the estate of Security Savings would, by law, have to flow, first, to the FDIC and, second, to private investors like Bailey. Since the FDIC’s claim of \$66 million exceeded Security Savings’ estimated 1989 value of \$44 million, any money awarded to Bailey would wind up passing from the government through the private investors and back to the government.

The court dismissed the case as non-justiciable.

In their cert petition, filed Jan. 26, 2004, Bailey’s lawyers call the decision “myopic” and a “stunning exercise of fuzzy math.”

“It is more than passing strange that the government must pay damages in cases where its breach of contract only maimed, but did not kill, its contracting partner, and yet avoids liability entirely in cases where its actions led to a total loss,” the brief states. “At bottom, the courts below permitted the government to avoid liability by seizing its contractual partner.”

The Justice Department has not yet filed a response to the petition.

According to Cooper, roughly 46 *Winstar* cases involve so-called dead thrifts like Security Savings, which were taken over by the government after FIRREA.

“I believe this case gravely prejudices the interests of all seized thrifts,” Cooper says. “It clearly deprives them of any prospect of being made whole or receiving significant damages.”

DISCOUNTED DAMAGE CLAIMS

The government’s post-*Winstar* success has come in bits and pieces rather than in any single dramatic courtroom victory.

In a series of incremental, fact-bound decisions, judges have discounted or rejected many of the damage theories presented by plaintiffs.

In 2002, the Federal Circuit overturned a \$15 million award in *Castle v. United States* on the grounds that S&L investors who had not signed any contract with the government did not have standing. Other plaintiffs who had signed the deal were also found ineligible to recover damages because they had not invested any personal money.

In 2003, the Federal Circuit rejected a \$132 million award in *Bluebonnet Savings Bank v. United States*, because the figure might include costs that plaintiffs would still have incurred absent a breach.

“I don’t think that there can be a question that there was enormous economic damage here,” says Stouck of Spriggs & Hollingsworth, who did not represent Bluebonnet. “What’s happened is that for one reason or another the courts have not accepted plaintiffs’ damage claims as legally valid.”

Other *Winstar* attorneys speculate that the cases were not quite as cookie-cutter as they were at first perceived.

“Although they’re all called *Winstar*-related cases, they differ very substantially among themselves,” says Kaye Scholer’s Rosenthal, who won a \$134 million award for client Home Savings of America in October 2003. “I’m not surprised cases have come out with a number of different results.”

Even the mere passage of time has been a hardship for plaintiffs.

“Many of these deals happened a long time ago,” says John Wendell Allen, a Kalamazoo, Mich., lawyer whose client, First of America Bank, dropped a *Winstar* suit in March 2003. “I think simply the age of the facts proved very difficult to a lot of parties.”

Despite the passage of so many years, it’s clear that, to Bailey, the seizure of his family’s 60-year-old business still feels very fresh. He says he never expected his legal battle would prove so difficult to win, adding, “I just can’t conceive that this is our justice system.” ■