

1996

The Thrift Crisis and the Constitution

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Stanley Langbein, *The Thrift Crisis and the Constitution*, 53 *Wash. & Lee L. Rev.* 159 (1996).

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Stanley I. Langbein*

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In August 1995, the United States Court of Appeals for the Federal Circuit decided *Winstar Corp. v. United States*.¹ That case held that the federal government breached contracts with a number of thrift institutions when Congress, in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA),² abrogated the right of the institutions to take "supervisory goodwill" into account when computing their capital

1. 64 F.3d 1531 (Fed. Cir. 1995).

2. Pub. L. No. 101-73, 103 Stat. 183. The abrogation of supervisory goodwill was affected by § 301 of FIRREA, which amended § 5(t) of the Home Owners' Loan Act to impose special capital standards on thrift institutions. See 12 U.S.C. § 1464(t) (1994) (requiring uniformly applicable capital standards).

position for purposes of federal rules that require depository institutions to maintain their capital at certain specified minimum levels.³ *Winstar*, together with other cases pending in the United States Claims Court that raise the same issue, has substantial financial implications for the federal government and the affected institutions; estimates of the total amount at stake range from \$12 to \$15 billion.⁴

The *Winstar* decision centered on contract issues posed by the case. The court held that the government had entered into contracts with the thrifts, that those contracts had conferred on the thrifts a continuing right to include supervisory goodwill in capital, and that the statutory enactment of FIRREA constituted a breach of the contracts.⁵ Earlier decisions of the federal courts of appeals had held that the thrifts had no right to injunctive relief because the statute and legislative history suggested that Congress had intended to abrogate the agreements.⁶ In those cases, the thrifts contended that the congressional action amounted to a taking of property without due process of law. For the most part, the early courts of appeals decisions refused to decide this question on the jurisdictional ground that the question belonged before the United States Claims Court.⁷ The Claims Court, when faced with the issue, also refused to decide the constitutional question, finding the nonconstitutional breach-of-contract ground an adequate basis for decision.⁸ In affirming the Claims Court decisions, the Federal Circuit largely followed the lower court opinions.

3. *Winstar Corp. v. United States*, 64 F.3d 1531, 1540-44 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996). The current minimum capital standards for thrifts are set forth at 12 C.F.R. §§ 567.1-.2 (1995). Capital standards are described in greater detail at *infra* notes 248-52 and accompanying text.

4. See Justin Fox, *Thrifts Ready to Sue; U.S. Seen Unlikely to Settle Up Fast*, AM. BANKER, Sept. 6, 1995, at 4; Jaret Seiberg, *Goodwill Claims Look Solid, Lawyers Agree*, AM. BANKER, Sept. 13, 1995, at 4.

5. *Winstar*, 64 F.3d at 1540-44.

6. See *infra* notes 312-25 and accompanying text (discussing earlier court decisions).

7. The single exception was *Transohio Sav. Bank v. Director*, 967 F.2d 598 (D.C. Cir. 1992), in which the court reached the constitutional question because of a circuit precedent that the court believed required it to determine the adequacy of the money damage remedy. The court held that the government action did not constitute a taking. See *infra* notes 312-20 and accompanying text.

8. See *Statesman Sav. Holding Corp. v. United States*, 26 Cl. Ct. 904 (1992), *aff'd sub nom. Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996); *Winstar Corp. v. United States (Winstar II)*, 25 Cl. Ct. 541 (1992), *aff'd*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996); *Winstar Corp. v. United States*, 21 Cl. Ct. 112 (1992), *aff'd*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996).

In the immediate aftermath of the *Winstar* decision, lawyers familiar with the issue and the industry agreed that the result reached was sound and expressed the expectation that the thrifts ultimately would prevail.⁹ A number of uncertainties, however, remain. The Supreme Court has granted certiorari in the case.¹⁰ There are reports that Congress may respond in ways that will defeat or limit the rights of the thrifts to recover on the judgments.¹¹ There is considerable question concerning the source of funds to satisfy the judgments. In theory, the amounts should come from the Judgment Fund, but legislation has been introduced to pay damages from the funds of the Resolution Trust Corporation, in part in an effort to ensure an accurate historical record of the true cost of the thrift industry bailout of the late 1980s and early 1990s.¹² Should the thrifts ultimately prevail, complex questions lurk in the future concerning the entitlement of bondholders or other claimants to amounts received by the thrifts or by their shareholders pursuant to the court rulings.

Furthermore, although industry lawyers publicly express the view that the decision is a sound one, there remain substantial questions, not necessarily about the result reached in the case, but about its rationale and, in particular, its abstention from resolving the constitutional "takings" question. For in the cases, the action of the government to which the thrifts pointed as the source of their rights was not a specific contractual arrangement with any government body, but rather the regulators' action in approving a transaction involving the thrift, ordinarily a "conversion" of a mutual thrift into a stock thrift or an acquisition of one institution by another.¹³ The "undertaking" by the government was thus an undertaking in a regulatory role and not an undertaking in a proprietary role or any other role as a contracting body. The congressional action at issue in the cases, therefore, was only a change in regulations, overriding a prior change in the position of the regulators. As this change caused serious losses to the affected institutions, the issue involved really is a takings question — whether the action of Congress constituted an impermissible "regulatory taking" of property without the just compensation required by the Fifth Amendment.

9. See Fox, *supra* note 4, at 4; Seiberg, *supra* note 4, at 4.

10. *United States v. Winstar Corp.*, 116 S. Ct. 806 (1996).

11. See Seiberg, *supra* note 4, at 4.

12. See Fox, *supra* note 4, at 4.

13. On conversions of mutual thrifts to stock thrifts, see *infra* notes 154-57 and accompanying text. On assisted acquisition, see *infra* notes 143-53 and accompanying text. On the role of these kinds of assisted transactions in the process of resolving the thrift industry and its problems during the 1980s, see *infra* notes 165-73 and accompanying text.

This Article examines the supervisory goodwill cases from the standpoint of whether the congressional action involved constituted a taking under the Supreme Court's contemporary and evolving decisional law concerning the Takings Clause. There are several reasons for this undertaking. First, and most plainly, the resolution of the cases themselves is not yet settled. The *Winstar* decision has been appealed to the Supreme Court, and that Court may have to decide the matter. Furthermore, given the magnitude of the amounts involved, some congressional action regarding the issue is quite possible. To the extent any such action would have the effect of curtailing the rights of the thrifts, that action might in turn be subject to a challenge under the Takings Clause. A close examination of the takings issue with respect to Congress's original action can lend some guidance to Congress in taking further steps on the matter.

Second, there are other issues growing out of FIRREA and subsequent banking legislation that raise takings problems. Indeed, the Claims Court has held one provision of FIRREA, the so-called "cross guarantee" provision, unconstitutional, but that decision was reversed by the Federal Circuit.¹⁴ In addressing these issues, it is useful to look at the thrift legislation as a whole and to examine the context in which the crisis underlying it emerged and the legislation developed. The supervisory goodwill issue is the most far-reaching and controversial aspect of the FIRREA legislation; it therefore provides the best framework for analyzing general questions posed by the legislation under the Takings Clause.

Third, and along similar lines, there are a significant range of issues in pending litigation growing out of FIRREA (and subsequent legislation) that do not involve Takings Clause analysis, but that also are informed by an analysis of the legislation's background. These include issues concerning the standard of care imposed on officers and directors of financial institutions,¹⁵

14. *Branch ex rel. Maine Nat'l Bank v. United States*, 31 Fed. Cl. 626, 637 (Cl. Ct. 1994), *rev'd*, 69 F.3d 1571 (Fed. Cir. 1995). The cross guarantee provision requires that if one of two commonly controlled institutions requires assistance from the FDIC, the other solvent institution is required to reimburse the FDIC for the amount of assistance it provides. The provision is codified as § 5(e) of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. § 1815(e) (1994).

15. See *Resolution Trust Corp. v. Frates*, 52 F.3d 295 (10th Cir. 1995); *FDIC v. Bates*, 42 F.3d 369 (6th Cir. 1994); *Resolution Trust Corp. v. Chapman*, 29 F.3d 1120 (7th Cir. 1994); *Resolution Trust Corp. v. Miramon*, 22 F.3d 1357 (5th Cir. 1994); *Resolution Trust Corp. v. Gallagher*, 10 F.3d 416 (7th Cir. 1993); *FDIC v. McSweeney*, 976 F.2d 532 (9th Cir. 1992). The *Chapman* decision is in some conflict with the decisions in *Bates*, *Frates*, *Miramon*, and *Gallagher* (a decision of the same circuit). In any event, all five of these cases are inconsistent with *Resolution Trust Corp. v. Cityfed Fin. Corp.*, 57 F.3d 1231 (3d Cir. 1995). All involve the survival of either a state law or federal common-law, simple negli-

the requirement of exhaustion of remedies under the claims process for failed institutions,¹⁶ the substantive rights of the deposit insurance bodies as receivers of the institutions,¹⁷ the right to a jury trial in connection with administrative enforcement proceedings,¹⁸ and a number of others. Most of the litigation involved also has followed a pattern that the supervisory goodwill cases typify. In the early phases of the post-FIRREA litigation, which took place when public attitudes about insider abuse and fraud were intense, the challenges to the statute met with little success in the federal courts. As time has passed, however, the trend of litigation has begun to shift against the government and the regulatory agencies and in favor of the private parties.

All of these issues involve, at a fundamental level, an interpretation of the interface between the powers of the administrative state and the property rights of private parties who are involved, in an economic way, in a complex regulatory environment. The Takings Clause issue, as it has emerged from the Supreme Court's decisions in recent regulatory takings cases, presents perhaps the most fundamental basis under existing doctrine for examining these problems. And again, an examination of the background and development of the FIRREA legislation, as it pertains to the doctrinal issues as well as the fundamental problems, is useful in developing a framework for looking at these problems generally.

Finally, the entire area of regulatory takings has implications throughout the federal law governing banking institutions, as well as other areas of administrative law. It is part of the thesis of this Article that, difficult as the problems presented may be, the role of the takings law should and can be broadened, rather than narrowed, as it applies to complex regulatory environments. An examination of the background and development of the thrift crisis and the FIRREA legislation reveals a justification for invoking constitutional restrictions with respect, at least, to the most stringent provisions of that legislation. The story thus told may have wider implications in other areas of regulatory law.

gence basis for proceeding against officers and directors of failed insured depository institutions in the wake of § 11(k) of the Federal Deposit Insurance Act, 12 U.S.C. § 1821(k) (1994), which provides a statutory gross negligence standard.

16. See *Whatley v. Resolution Trust Corp.*, 32 F.3d 905 (5th Cir. 1994); *Brady Dev. Co. v. Resolution Trust Corp.*, 14 F.3d 998 (4th Cir. 1993); *Marquis v. FDIC*, 965 F.2d 1148 (1st Cir. 1992); *Resolution Trust Corp. v. Mustang Partners*, 946 F.2d 103 (10th Cir. 1991); *Rosa v. Resolution Trust Corp.*, 938 F.2d 383 (3d Cir.), *cert. denied*, 112 S. Ct. 582 (1991).

17. *E.g.*, *Murphy v. FDIC*, 61 F.3d 34 (D.C. Cir. 1995).

18. See *Cavallari v. Comptroller of the Currency*, 57 F.3d 137, 145-46 (2d Cir. 1995).

This Article proceeds in three parts. Part I discusses two concepts that may be unfamiliar to counsel working in the field, but that inform the interpretation of the thrift crisis and the legislation to which it led — set forth in Part II. The interpretation of the crisis and the legislation in turn informs Part III, which analyzes the capital forbearance cases themselves, with emphasis upon the manner in which takings analysis bears upon the question those cases pose.

I. Two Concepts

A. Premium Value of Entities

Institutions, especially those characteristically recognized as business entities, possess premium or enterprise value. This means that the enterprise valued as an entity exceeds the value of its assets summed together. The existence of this value is linked to "profit" or the "profitability" of the enterprise (as an economic, not an accounting, concept). The existence or presence of the value, however, is not dependent upon the enterprise's being "profitable." Insolvent enterprises have premium value, as the history of the thrift crisis plainly shows. In insolvent enterprises, the liabilities of the enterprise exceed the aggregate (gross) value of its assets (including its premium value). Ordinarily, however, there is still positive premium value, in that the net "cost" to an acquirer in taking over the whole institution (the amount the acquirer will have to be paid in exchange for the assumption) is typically less than the excess of the liabilities over the value of the assets summed individually. The difference is the premium value of the insolvent institution, which will often (if not always) be positive.

This observation probably strikes the average practitioner engaged in transfers of control of financial institutions in particular, and business entities generally, as obvious. Yet from the standpoint of theoretical economics — the principles synthesized by Leon Walras on the Continent and Alfred Marshall in Great Britain in the late nineteenth century, still the bedrock of most conventional economics¹⁹ — the propositions expressed are radical. Conventional economics posits that entities exist in equilibrium, and at equilibrium, economic actors enjoy "zero profits."²⁰ The zero profit hypothesis derives from the conception that economic decisionmaking essentially

19. See generally ALFRED MARSHALL, *PRINCIPLES OF ECONOMICS* (9th ed. 1961); LEON WALRAS, *ELEMENTS OF PURE ECONOMICS: OR, THE THEORY OF SOCIAL WEALTH* (William Jaffe trans., 1954).

20. For a modern, straightforward mathematical presentation of the hypothesis, see JAMES M. HENDERSON & RICHARD E. QUANDT, *MICROECONOMIC THEORY* 107-10 (3d ed. 1980).

involves substitution at the margin — consumers substitute goods in reaction to price changes so that they buy specified bundles among which they are indifferent; producers substitute inputs to achieve outputs determined by their resources. Increases in the price of a factor provoke substitution and drive down demand, counteracting the price increase; decreases provoke substitution enhancing demand, countering the decrease. The process of substitution drives out profit.

Positing the existence of permanent profit positions is "Schumpeterian," a faith in a "disequilibrium" economics. For Schumpeter, capital and enterprise are distinct; enterprise gains are different from capital gains.²¹ There is thus both explanation of and justification for the premium value of enterprises. Similarly, if much less clearly, for Coase, there is a process of substitution at the margin of organization forms²² — organization replaces the market, and regulation may replace both,²³ which generates a "product." Again, the conception suggests both explanation and justification. With classical assumptions, profit, explainable solely by reference to imperfections, has net social cost. With Schumpeterian or Coasean assumptions, the opposite is the case. The actual circumstance may be ambiguous: Multinational enterprise theory proceeds from attacks on the phenomenon of multinationalism as a product of (costly) structural, firm-specific advantages,²⁴ proceeds through an explanation based on transaction costs (under which the phenomenon is unambiguously net positive),²⁵ and proceeds to the "Dunning eclectic" model, which explains the phenomenon as both, i.e., agnostic as to social product.²⁶ Some of the legal literature on takeovers is similarly

21. See JOSEPH A. SCHUMPETER, *HISTORY OF ECONOMIC ANALYSIS* 953-58, 1067-75 (1954).

22. See Ronald H. Coase, *The Nature of the Firm*, *ECONOMICA* 386, 393, 405 (Nov. 1937) (stating that "[a] firm . . . consists of the system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur. . . . A firm becomes larger as additional transactions (which could be exchange transactions co-ordinated through the price mechanism) are organised by the entrepreneur. . . . [T]his analysis enables us to state more exactly what is meant by the 'marginal product of the entrepreneur'").

23. See Ronald H. Coase, *The Problem of Social Cost*, 3 *J.L. & ECON.* 1 (1944).

24. See generally STEPHEN HYMER, *THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT* (1976). This study was an MIT doctoral dissertation written in 1960. After it began to attract scholarly attention as an unpublished work, the tract was published by MIT Press in 1976.

25. See generally PETER J. BUCKLEY & MARK CASSON, *THE FUTURE OF THE MULTINATIONAL ENTERPRISE* (1976); JOHN McManus, *The Theory of the International Firm*, in *THE MULTINATIONAL FIRM AND THE NATION STATE* 66 (Gilles Paquet ed., 1972).

26. See generally John H. Dunning, *Trade, Location of Economic Activity and the MNE: A Search for an Eclectic Approach*, in *THE INTERNATIONAL ALLOCATION OF ECO-*

agnostic, both as to the net cost question and as to the question of explanation, though without denying the existence of the value.²⁷

Regulatory systems unquestionably, and in obvious ways, may enhance (but probably cannot create) enterprise value. Restrictions on entry render permitted entry more valuable. Regulatory systems are correspondingly appropriative by nature. Modulated, they may employ privately created value in pursuit of regulatory objectives.

Premium value is a crucial concept in understanding the evolution of banking law and policy of which the thrift crisis was a dramatic part. It is also important to understand, at least generally, that premium value is both an ambiguous and a controversial concept in economics. For the pattern of the thrift crisis, and the problem of the capital forbearance cases, involves an early phase in which the regulators delayed closing thrifts by arranging acquisitions and by allowing the thrifts to count supervisory goodwill as capital, which was essentially an accounting device that allowed premium value to be counted as an asset. FIRREA sharply reversed this policy. Although it is commonplace now in, for instance, the trade press to state that "nobody really wants to defend supervisory goodwill, an intangible asset that is to a balance sheet what a hole is to a doughnut,"²⁸ the matter is a subject of some controversy because the value does exist — a fact confirmed by the market for the institutions themselves. The concept is ambiguous and controversial, but it is a concept, and the policy abrogated in FIRREA was a policy well within the ambit of reason. An understanding of the concept's ambiguities and its importance informs the constitutional question of the fairness of the sharp policy shift that greatly damaged unprepared private parties.

B. Regulatory Space

In the early 1980s, British interest group theorists began to identify historical "parenthetic" periods, which were defined by identifiable shifts in the roles played by and relationships among dominant interest groups in capitalist economies. Charles S. Maier expressed the point most succinctly, finding that "between an earlier age of statist interests that waned during the course of the late eighteenth century and an era of 'collective' or interest group rivalry that arose toward the end of the nineteenth century lay an

NOMIC ACTIVITY (Bertil Ohlin et al. eds., 1977).

27. See Lynn A. Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 YALE L.J. 1235 (1990).

28. Robert M. Garsson, *Capitol Account: Annunzio Got It Right on Goodwill Cases*, AM. BANKER, Sept. 15, 1995, at 3.

interval of relative parliamentary insulation from the needs and pleas of the marketplace"; "[t]his era was the zenith of Bagehot's parliament and of his informed public opinion; to borrow a suggestive, if overdrawn image: the liberal parenthesis."²⁹ This notion proved to have substantial explanatory power for the study of the relationship between organized interest groups and the state. Colin Crouch, convinced of the role and importance of national identity in defining and conditioning such relationships, saw deeper implications in the idea: "Without doing too much violence to individual cases it is possible to speak of a 'parliamentary parenthesis' as a universal phase in Western European societies, starting some time in the eighteenth or nineteenth centuries and lasting until the final quarter of the nineteenth."³⁰ For Crouch, however, the idea conditions another, that of "public space" or "political space" — the "range of issues over which general, universal decisions are made within a given political unit, particularly decisions which are seen by political actors to affect overall social order."³¹ For the liberal state, it is "a crucial feature . . . that political space is monopolized by specialized political institutions: legislature, executive, and judiciary."³² Prior to the parliamentary parenthesis, political space was shared; the state "typically . . . left several aspects of social regulation to guilds, *Stände* and similar corporate bodies."³³ Similarly afterwards, "organized economic interests became increasingly important."³⁴ Different societies, however, were different in the degree to which the parliamentary idea took hold, and this gives rise to Crouch's central thesis:

[T]he longer the interval, or the sharper the breach, between the destruction of ancient guild and *Ständestaat* institutions and the construction of typically 'modern' interest organizations, the more committed did the state become to liberal modes of interest representation, and the less likely to tolerate sharing political space; the less likely were modern organizations to target their ambitions on participation of that kind; and the less likely were neo-corporatist institutions to become established.³⁵

29. See Charles S. Maier, 'Fictitious bonds . . . of wealth and law': *On the Theory and Practice of Interest Representation*, in *ORGANIZING INTERESTS IN WESTERN EUROPE: PLURALISM, CORPORATISM, AND THE TRANSFORMATION OF POLITICS* 27 (Suzanne Berger ed., 1981).

30. Colin S. Crouch, *Sharing Public Space: States and Organized Interests in Western Europe*, in *STATES IN HISTORY* 177, 177 (John A. Hall ed., 1986).

31. *Id.* at 179-80.

32. *Id.* at 180.

33. *Id.* at 181.

34. *Id.*

35. *Id.* at 182.

For Leigh Hancher and Michael Moran, Crouch's concept of public space lends itself to a concept descriptive of the role played by nonpublic parties in contemporary economic regulation as an alternative to the long-running debate about "capture" in regulation — an idea that "betrays an assumption that there is a sphere of public regulatory authority which ought to be inviolate from private influence."³⁶ From Crouch, they "likewise speak of a 'regulatory space' whose dimensions and occupants can be understood by examining regulation in any particular national setting, and by analysing that setting in terms of its specific political, legal, and cultural attributes."³⁷

This concept of regulatory space is imagistic ("an image being used to convey a concept"³⁸) and to an extent "diffuse,"³⁹ but it has core meaning. It is spatial in that it refers to a range of issues that the public has chosen to subject to public decisionmaking, as the term "public space" is used by Crouch.⁴⁰ The spatial image conveys the central idea concerning the role of the private parties in the regulatory process: The regulated do not capture the process, but compete, within the space that is the metaphor for the process, to occupy the space. Thus, "the play of power is at the centre of this process," and "[d]iscovering who has power in regulation involves paying close attention to the relations between the organizations which at any one time occupy regulatory space."⁴¹ But the "idea of space . . . encourages us not only to examine relations between those who enjoy inclusion, but also to examine the characteristics of the excluded" because "economic regulation . . . [is] . . . a set of power relationships dominated by large organizations . . . organized in administrative hierarchies whose method of doing business is shaped by standard operating procedures," which "rather than individual choice, is the dominant influence in deciding who is taken into, or kept out of, regulatory space."⁴² Fundamentally, however, the idea is driven by the reality of economic organizations, their internal structure and culture, and the external relations among them: "[T]he most important relationships in economic regulation are relationships between organizations"; "the key

36. Leigh Hancher & Michael Moran, *Organizing Regulatory Space*, in *CAPITALISM, CULTURE AND ECONOMIC REGULATION* 271, 274 (Leigh Hancher & Michael Moran eds., 1989).

37. *Id.* at 277.

38. *Id.*

39. Ross Cranston, Book Review, 1992 *PUB. LAW* 173.

40. Hancher & Moran, *supra* note 36, at 277.

41. *Id.*

42. *Id.* at 277-78.

matters requiring explanation — inclusion and exclusion, the relative power of the included, the scope of regulatory issues — will be illuminated in terms of the characteristics of the operating organizations."⁴³

In synthetic aspiration and value judgment ambiguity, the concept of regulatory space in relation to interest group analysis mimes Dunning's eclectic model in relation to premium value in multinational institutions. The eclectic model synthesizes a value-negative model (Hymer structuralism predicated on classical price theory) with its value-positive rejoinder (Buckley-Casson transaction cost savings) when both predecessors show empirical weaknesses. By combining value-negative and -positive predecessors, the eclectic theory is value-ambiguous. The notion of regulatory space synthesizes a dominant received conception, which in this case is the value-positive predecessor (the liberal ideal of a domain of decisionmaking monopolized by "public" and "representative" offices) and its value-negative antithesis (regulatory capture), when both predecessors fail to explain the factual milieu. The resulting pictorial concept is necessarily vague and is necessarily value-ambiguous.

Nevertheless, the concept of regulatory space is both manageable and useful. Joni Young has applied it to the accounting aspects of the thrift crisis.⁴⁴ Under Young's analysis, the "story" of the role of accounting in the crisis is "a prologue and three acts."⁴⁵ The prologue concerns the early days of the crisis when "accounting 'facts' were deployed to suggest the need for action to assist the ailing savings and loan industry"; "a 'right' accounting was one that was held to *reveal* the financial condition of both individual organizations and the industry in order to provide 'facts' useful in regulatory decision making."⁴⁶

The first act is the period of the thrift crisis (about 1981 to 1984 or 1985) when regulators sought "to buy time for troubled savings and loan organizations."⁴⁷ Within that time, "the [Federal Home Loan Bank Board] altered [regulatory accounting practices] in an effort to '*conceal*' the financial condition of the . . . industry . . . to avoid closing those thrifts that would have required regulatory action under the old rules"; "a 'right' accounting shifted from an accounting used in decisions about whether to intervene into the operations of specific organizations to an accounting that

43. *Id.* at 278-79.

44. See Joni J. Young, *Getting the Accounting "Right": Accounting and the Savings and Loan Crisis*, 20 ACCT., ORGANIZATIONS & SOC'Y 55 (1995).

45. *Id.* at 58.

46. *Id.*

47. *Id.*; see *infra* notes 56-74 and accompanying text.

provided a *justification* for regulatory inaction."⁴⁸ The second act (roughly 1985 through 1991) involved recognition of the necessity for closing many institutions: "[T]he definition of a 'right' accounting was changed A 'right' accounting was redefined as one intended once again to *reveal* the organization and to help justify assessments of organizational insolvency."⁴⁹ The final act (since about 1991) involves questions about generally accepted accounting principles: "[A] 'right' accounting continued to be defined as one intended to reveal the organization and to justify assessments of organizational insolvency," but "additional demands were also placed upon accounting practices," involving a "more expansive disciplinary role for accounting" that would "discipline the regulator as well as the regulated entity."⁵⁰

The exegesis of the crisis in Part II of this Article bears out this identification of phases in the thrift crisis as it unfolded over fifteen years. This discussion substantiates the utility of the regulatory space idea even though the actual tactics, strategic moves, motivations, and actions of the various parties involved are vastly more ramified, complex, interesting (and perhaps also value-positive) than Young's picture presents. Both Hancher and Moran and Young depart, however, from Crouch's programme in describing nationally specific and identifiable divergent patterns of "shared public space." Appreciating the implications of the thrift crisis and the wave of regulatory development of which it is part, however, is enriched by a return to the Crouch hypothesis because it elucidates aspects of the question of the fairness of congressional policy shifts at the height of the thrift crisis.

Reference to the comparative aspects of the concept of regulatory space provides a framework for explanation of the thrift crisis and the larger developments in banking law and regulation of which it is a part. A principal consequence of that series of developments, and to a considerable extent a principal motivation, has been to render the American financial system more like the system of other industrialized nations, notably Japan and Germany. In recent years, Crouch and other Anglo-American theorists, particularly at the wake of the end of the Cold War, have recognized that "the obvious competitive power of the capitalisms of Germany and Japan is not fortuitous," but "directly related to the features of the German and Japanese political economies which the Anglo-American economic tradition cannot encompass, and which commentators brought up in that tradition find alien, or shocking, or both".⁵¹

48. Young, *supra* note 44, at 58.

49. *Id.*

50. *Id.*

51. Colin Crouch & David Marquand, *Introduction* to ETHICS AND MARKETS: CO-

[I]t is only because that struggle [between capitalism and socialism] has loomed so large for so long that we have failed to see that, in most other respects, the "neo-American" and "Rhenish" models are not merely different, but antagonistic The subtleties of "Rhenish" capitalism elude the familiar categories of the mainstream Anglo-American economic tradition.⁵²

The dominant trends in the evolution of banking law and regulation have involved what might be called the "Rhenification" of American banking. From early 1980 onward, the industry has been transformed. First, interstate banking, though fully authorized by federal legislation only in 1994, became a reality by virtue of state initiatives beginning in the early 1980s.⁵³ Second, the power of institutions to engage in nonbanking activities, particularly securities and insurance, gradually has been broadened by regulation, though not by express congressional sanction.⁵⁴ Finally, the

OPERATION AND COMPETITION WITHIN CAPITALIST ECONOMIES 1 (Colin Crouch & David Marquand eds., 1993).

52. *Id.*

53. Interstate banking was restricted by the Douglas Amendment to the Bank Holding Company Act, 12 U.S.C. § 1843(d) (1988), which provided that no bank holding company was permitted to acquire a bank in a state outside the holding company's home state unless expressly permitted to do so by state law. Prior to 1972, no state enacted a law to this effect. During the 1970s, certain states enacted laws permitting acquisitions by out-of-state holding companies in limited circumstances, such as allowing acquisitions of failing banks or special purpose banks. See *Northeast Bancorp, Inc. v. Board of Gov. of Fed. Reserve Sys.*, 472 U.S. 159, 163-64 (1985). In 1982, Massachusetts enacted a law permitting holding companies from other New England states to acquire Massachusetts holding companies so long as the home state of the holding company had enacted a law that permitted acquisitions of that state's holding companies by Massachusetts holding companies. In 1983, Connecticut passed a similar law. The "regionality" and "reciprocity" features of these laws were upheld against constitutional challenge in *Northeast Bancorp. v. Board of Gov. of Fed. Reserve Sys.*, 472 U.S. at 163-64. This led to a wave of similar enactments throughout the nation. See Stanley I. Langbein, *Congress Adopts the Riegle-Neal Interstate Banking and Branching Act*, 1 BANK AND THRIFT ACQUISITION UPDATE 2 (Dec. 1994). Ultimately, the Douglas Amendment was amended by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, P.L. No. 103-328, 108 Stat. 2338, to permit acquisitions by one state's banks of state bank holding companies without regard to "region" or "reciprocity," effective in September 1995.

54. Under the Glass-Steagall Act, 12 U.S.C. § 377 (1994), banking institutions may not affiliate with companies that are "engaged principally in the issue, flotation, underwriting, public sale, or distribution . . . of . . . securities." *Id.* The principal legal initiative expanding bank securities powers came when the Board interpreted this provision to permit bank holding companies to operate so-called "section 20 subsidiaries," which are permitted to engage in securities activities so long as their revenue from activities in which the bank itself is not permitted to engage is limited to five percent of gross revenue. The Board's action was upheld in *Security Indus. Ass'n v. Board of Gov. of Fed. Reserve Sys.*, 839 F.2d 47 (2d Cir.), *cert.*

power of the regulators, especially the deposit insurer, the Federal Deposit Insurance Corporation (FDIC), has been expanded very significantly by legislation that now vests truly sweeping potential power in the agency.⁵⁵

Part II of this Article explores the thrift crisis as an episode in the Rhenification of the United States financial services sector. The dominant consequences of the legislation of the period were two-fold. First, they unified the depository institution industry under the umbrella of the commercial banking industry; the 1989 legislation essentially spelled the beginning of the end of the thrift industry as a separate sector dedicated to financing housing. The essential winner was the commercial banking industry, and at that, not the entire industry, but rather its elite or "large bank" segment. The second dominant consequence was to create a deposit insurer with powers that are truly extraordinary, but to date mostly latent.

Both the process and the outcome suggest cause for constitutional vigilance. Sectors of the economy are in the process of destruction, in part by legislative or regulatory acts, and a state agency of considerable power is emerging. Both are "Rhenish" qualities. The effort here is not to attack the developments or to suggest their dismantling, but to suggest ways in which the judicial process and an emerging understanding of the Constitution can temper the process, thereby preserving Anglo-American values in a system that, because of economic necessity, bears properties that, at least on their surface, exist in some tension with those values.

II. The Thrift Crisis and the Rhenification of the United States Financial Services Sector

A. The First Thrift Crisis and the Garn-St Germain Act

1. The Road to Garn-St Germain

The thrift crisis first began to emerge in 1979. From 1966 to 1979, interrupted by periods of wage price controls (1971-73) and recession (1969-70 and 1974-75), the rate of inflation in the United States had accelerated, and in response, monetary officials gradually had raised interest rates. By

denied, 486 U.S. 1059 (1988). The powers of bank holding company subsidiaries to engage in insurance activities are greatly circumscribed by § 4(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(8) (1994), but insurance activities of banks have been facilitated by the banks themselves through liberal rulings of the Comptroller of the Currency, which were involved or upheld in *United States Bank v. Independent Ins. Agents of America*, 508 U.S. 439 (1993), and *NationsBank v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995).

55. The principal expansions of the powers of the deposit insurers were effected by the provisions adopted under the Garn-St Germain Act, discussed at *infra* notes 134-64, and by FIRREA, discussed at *infra* notes 222-47.

late 1979, the federal funds rate — the rate on interbank funds lent overnight⁵⁶ — had reached 13.25 percent.⁵⁷ In early 1980, the inflation rate measured by monthly price indices spiked to an annual rate near 18 percent, the highest in United States history. Additionally, the Board of Governors of the Federal Reserve System (Board)⁵⁸ raised interest rates to record levels, with the federal funds rate reaching 17.61 percent in April 1980.⁵⁹

56. The federal funds rate is an "intermediate" short-term interest rate, generally slightly higher than certificate of deposit rates paid by banks and well lower than the prime rate — the benchmark of what banks charge on loans. Typically, the funds rate is slightly higher than the rate on short-term Treasury instruments, which tend to be slightly higher than comparable term certificate of deposit rates. Normally, longer term instruments bear higher rates to compensate lenders for the loss of liquidity, the heightened risk of loss over the longer term, and risks of interest rate fluctuations. In inflationary, precontractionary periods, short-term rates may spike to compensate for immediate term inflation, and the rates then may "invert," with short-term rates rising above long-term rates. This occurred during the early 1980 period leading to the recession of mid-1980.

57. See Robert J. Nash, *National Association of MSBs: Legislative Changes are Required to Meet Mortgage Money Crisis*, AM. BANKER, Dec. 3, 1979, at 11.

58. The Board of Governors establishes monetary policy under the Federal Reserve Act (Reserve Act). It is also the "appropriate federal banking agency" under the Reserve Act for state banks that are members of the Federal Reserve System. See 12 U.S.C. § 1813(q) (1994). The Comptroller of the Currency is the principal regulatory body for national banks, and the FDIC is the principal regulatory body for state nonmember banks. The Office of Thrift Supervision (OTS) is the principal regulatory agency for federally chartered thrift institutions, and the FDIC is the principal regulatory body for insured state thrifts. Prior to FIRREA, the principal regulatory agency for federally chartered thrifts and for insured state thrifts had been the Federal Home Loan Bank Board (FHLBB or Bank Board); this body was abolished by FIRREA. See *infra* note 224 and accompanying discussion.

For each of thrifts and banks, there are four major statutory enactments — one governing chartering, another governing a system of banks providing standby credit (the Federal Reserve Banks for commercial banks and the Federal Home Loan Banks for thrifts), a third governing deposit insurance, and a fourth governing holding companies. Chartering banks are governed by the National Bank Act, 12 U.S.C. §§ 21-216d (1994), enacted originally in 1863; chartering thrifts by the Home Owners' Loan Act (HOLA), 12 U.S.C. §§ 1461-70 (1994), originally adopted in 1933. The standby credit banks laws are the Federal Reserve Act, 12 U.S.C. §§ 221-522 (1994), which was originally enacted in 1913, and the Federal Home Loan Bank Act, 12 U.S.C. §§ 1421-49 (1994), originally adopted in 1932. The deposit insurance law governing both industries since FIRREA is the Federal Deposit Insurance Act (FDIA), 12 U.S.C. §§ 1811-35a (1994). From 1934 to 1989, the thrift industry deposit insurance was governed by § 407 of the National Housing Act of 1934, Ch. 847, 48 Stat. 1246, § 406. The Bank Holding Company Act, 12 U.S.C. §§ 1841-50 (1994), was originally enacted in 1956. The Savings and Loan Holding Company Act, which is also § 10 of HOLA, 12 U.S.C. § 1467a (1994), dates from the Spence Act of 1959. See generally STANLEY I. LANGBEIN, *TAXATION AND REGULATION OF BANK AND THRIFT ACQUISITIONS* §§ 2.03-.04, 2.07-.12, 2.14-.16 (1993) (discussing evolution of federal regulation of banks and thrifts).

59. 66 FED. RES. BULL., June 1980, at A27.

The high interest rates squeezed thrift profits principally because thrift operations at the time consisted largely of borrowing through deposits, which are short-term investments and at the time were subject to interest rate ceilings,⁶⁰ and because lending on residential real estate mortgages, which at the time were primarily fixed rate mortgages, was lent out at historic rates that were far lower than those prevailing after the 1979-80 interest rate run-up. Aggravating the situation was the rapid expansion during the period of the "money market certificate," offered by securities firms, which permitted retail investors who otherwise might deposit funds in community institutions to earn a prevailing market rate of return, coupled with check-writing privileges, free of deposit interest ceilings.⁶¹

By late 1979, officials of thrift industry groups, particularly those of mutual savings banks concentrated in the Northeast, and particularly New York, were decrying the situation: "[T]hrift institutions, the major suppliers of mortgage credit, simply cannot compete against the rates that are available to the public in the money market."⁶² The industry proposed two legislative solutions. First, in late 1979, a proposal began to surface that would have made interest on thrift deposits tax exempt.⁶³ That proposal was justified on the grounds that it directed funds to a troubled mortgage market. Second, a proposal emerged to have the federal government buy the low-rate fixed mortgages held on thrift books at face value, which in effect would have compensated the thrifts for the interest rate-related losses on their portfolios.⁶⁴

60. Deposit rate limitations were imposed on financial institutions under 12 U.S.C. § 371a (1976), as in effect prior to the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.), and the Board's Regulation Q, 12 C.F.R. § 217 (1980). Thrift institutions were permitted to charge interest rates one-half percentage point higher than those banks were permitted to charge under these ceilings prior to the adoption of the 1980 statute.

61. By late 1979, money market certificate investments had reached \$179 billion, roughly 23% of total thrift deposits, which at the time amounted to about \$780 billion. See Gordon Matthews, *Outlook Glum for Thrifts in East*, AM. BANKER, Oct. 12, 1979, at 11.

62. Nash, *supra* note 57, at 11.

63. See *id.*

64. See Paul S. Nader, *Now Is the Time for Compassion by Regulators of Banks and Thrifts*, AM. BANKER, Feb. 9, 1981, at 4; James Rubenstein, *Thrifts Faulted on Bailout Plea*, AM. BANKER, Mar. 13, 1981, at 28. There also were abundant proposals for modifying accounting standards applicable to thrifts and for relaxing capital standards imposed on thrifts during what was perceived to be a temporary critical period. See Paul Horvitz, *'Problem' of Thrifts Can be Solved by Creative Accounting*, AM. BANKER, Apr. 20, 1981, at 4; Robert J. Lipshutz, *Sophistication, Creativity, Boldness Needed to Rescue Thrifts; Liquidity, Net Worth Seen As Areas of Prime Concern*, AM. BANKER, Nov. 10, 1981, at 14; Nader, *supra*,

In 1980, the Republican Party gained control of the Presidency through the election of President Reagan and also gained control of the Senate for the first time in twenty-six years. Elected on an express policy of promoting "free market" economics, a promise of a general and substantial reduction in personal tax rates, and a promise of an increase in allowances against corporate taxes, the new Administration was not interested in subsidies of the kind embodied in the thrift industry proposals, whether through the tax system or through portfolio purchases. Nor was support for the proposals forthcoming from either house of Congress.

In the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDAMCA),⁶⁵ however, Congress did enact a virtual repeal of the Regulation Q ceilings that had restricted the rates which could be paid on depository institution deposits.⁶⁶ That enactment relieved some of the pressure from the outflow of funds to money market certificates. Meanwhile, the sharp increase in interest rates in 1980 induced a sharp though brief recession in early 1980 that was followed by a weak recovery. Interest rates declined after the recession, but not to their pre-1980 levels.⁶⁷ The Reagan administration's first major initiative after taking office was to ensure the enactment of its tax reduction program, which was achieved in the Economic

at 6; *The Outlook for S&Ls: An Agenda for the Industry*, AM. BANKER, Apr. 9, 1981, at 4; Rubenstein, *supra*, at 28. The warehousing proposal, or a modification involving the swap of mortgages for higher yielding government paper, did receive some study from then freshman Senator D'Amato. See Lisa J. McCue, *D'Amato Studies Paper Swap for Troubled Thrifts*, AM. BANKER, Apr. 10, 1981, at 2.

65. Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.).

66. See Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, §§ 202-05, 94 Stat. 132, 142-43 (codified as amended in scattered sections of 12 U.S.C.). DIDAMCA transferred the power to control rates from the Federal Reserve Board, the Federal Home Loan Bank Board, and the FDIC to a Deregulation Committee comprised of the Treasury Secretary, the chairs of the Bank Board, the Board, the FDIC, and the National Credit Union Administration Board, with the Comptroller serving as a nonvoting member. *Id.* § 203(a). The Deregulation Committee was directed to phase out all interest rate ceilings within six years, with increases of at least one-quarter point in the ceiling to be effected within eighteen months, and an additional half-point at the ends of each of the third, fourth, and fifth years following the date of enactment. *Id.* § 205(a).

67. The federal funds rate, which had been 11.19% on average during 1979 and 7.93% in 1978, peaked at 19.08% in January 1981 then declined to 16.28% in May 1981, 67 FED. RES. BULL., May 1981, at A25, and 12.42% in late November 1981. 67 FED. RES. BULL., Dec. 1981, at A27. In late 1982, nearing the end of a long recession, the rate was still 8.91%. 68 FED. RES. BULL., Dec. 1982, at A28. In 1983, with the economy resuming growth, interest rates turned up again. The federal funds rate did not return to its average 1978 rate in any year until 1990.

Recovery Tax Act of 1981 (ERTA).⁶⁸ But that enactment created what Keynesian economists call the "structural" budget deficit,⁶⁹ which has persisted ever since. The presence of the deficit made the enactment of anything like the industry's initial proposals — tax-exempt interest on thrift deposits or purchase of the depreciated mortgage pools — still more politically unpalatable.

Compounding the difficulty was the fact that relative novices came to the chairmanships of the congressional banking committees after the 1980 election. For a substantial time prior to 1980, the committee had been chaired by two Wisconsin Democrats, both identified as progressives with some ties to community banking interests, but who were generally regarded as hostile to the Federal Reserve and to money-center institutions. In the Senate, Senator Proxmire lost the chairmanship because of the Republican takeover of the Senate. The chairmanship devolved upon Senator Jake Garn of Utah, a conservative who was something of a mystery to the industry. In the House, Congressman Reuss resigned the chairmanship to accept leadership of another committee and was succeeded by Representative Ferdinand St Germaine of Rhode Island, who had been and remained relatively hostile to industry interests.

In its early mode, the Reagan administration showed little interest in the emerging thrift crisis. The response to the crisis was aggravated by the relative secrecy of the bank examination process,⁷⁰ which meant that little

68. Pub. L. No. 97-34, 95 Stat. 172 (codified in scattered sections of 26 U.S.C.).

69. The "structural" deficit is contrasted to the Keynesian "full employment" deficit; the latter is defined as the difference between government revenues actually collected and those that would be collected were the economy operating at "full employment." The full employment deficit was taken by Keynesian orthodoxy to measure the appropriate amount of stimulus needed to move the economy from underemployment to full employment. The deficits run by Democratic administrations and Congresses from the early 1960s through the early 1980s tended to be limited to the full employment deficits. Those larger deficits that ensued after ERTA have exceeded the measured full employment deficit in all fiscal years since fiscal 1982, the first following the enactment of ERTA. See generally JOSEPH PECHMAN, *FEDERAL TAX POLICY* (5th ed. 1987).

70. Bank examinations are protected from public disclosure by exemption (8) of the Freedom of Information Act, 5 U.S.C. § 552(b)(8) (1994), and in the civil discovery process by a vaguely defined "bank examination" privilege apparently mandated by agency regulation. See 12 C.F.R. § 261.2(b) (1995); see also *Schreiber v. Society for Sav. Bancorp, Inc.*, 11 F.3d 217, 220-21 (D.C. Cir. 1993) (demonstrating application of bank examination privilege); *In re Subpoena Served Upon Comptroller of Currency*, 967 F.2d 630, 633-36 (D.C. Cir. 1992) (discussing bank examination privilege). In recent litigation by Procter & Gamble against Bankers Trust concerning the latter's management of the former's derivatives holdings, the Court of Appeals for the Sixth Circuit refused to apply the bank examination privilege. See *In re Bankers Trust Co.*, 61 F.3d 465, 471-72 (6th Cir. 1995). The decision

information was available to the public, or to Congress, concerning the developing difficulties of the thrifts. Moreover, the overriding concern was to prevent an earnings crisis from becoming a liquidity crisis,⁷¹ which could have occurred if public confidence in the institutions were threatened; thus, regulators and congressmen alike were reluctant to highlight the information that was public. At a minimum, however, the regulators did understand that a problem was emerging. By June 1981, the number of problem institutions had risen to 265 from 120 a year earlier.⁷² Throughout the period, the industry continued to advocate solutions in the form of a tax exemption for savers or the warehousing of below-market mortgages with the federal government.⁷³ Neither Congress nor the President set forth any concrete proposals.⁷⁴

In the spring of 1981, however, the federal regulatory officials — including primarily the Bank Board, which governed the Federal Savings and Loan Insurance Corporation (FSLIC), the insurer of most thrifts, the FDIC, which insured state mutual savings banks, and the Federal Reserve — brought forth proposals that recognized the budgetary constraints and the shyness about publicizing the issues, but at the same time acknowledged the imminence and seriousness of the problem.⁷⁵ These proposals came to be known as the "regulators' bill" and ultimately were adopted into law as part of the Garn-St Germain Act, or the Depository Institutions Act of 1982.⁷⁶ The regulators' bill provided for the expansion of the regulatory agencies' powers to assist institutions by keeping them open.⁷⁷ The most important of

represents a recent instance of emerging judicial hostility to the bank regulatory agencies and the expansion of their powers in the last two decades. *See supra* notes 14-18 and accompanying text (discussing other judicial responses to banking regulators).

71. *See* Phil Battey, *Thrifts Seen Facing Troubles Even If Inflation Rate Drops: Former FHLBB Chairman Says Key Issue Is Keeping Earnings Problem from Becoming Liquidity Crunch*, AM. BANKER, May 20, 1981, at 3 (reporting speech of Garth Marston); Joseph D. Hutnyan, *Thrifts Find that Government Rescue Is Traumatic Affair*, AM. BANKER, Apr. 2, 1982, at 4; Pratt: *No S&L Liquidity Crisis*, AM. BANKER, May 29, 1981, at 1, 20 (reporting speech of FHLBB Chairman Richard Pratt).

72. *See* Lisa J. McCue, *New Insurance Basis Weighted for S&Ls*, AM. BANKER, June 12, 1981, at 1.

73. *See* Rubenstein, *supra* note 64, at 28.

74. *See* James Rubenstein, *Treasury Aid Says S&Ls Will Survive Crunch*, AM. BANKER, May 15, 1981, at 3 (reporting statements of Deputy Treasury Secretary McNamara).

75. *See* Jay Rosenstein, *Regulators Revise Crisis Merger Legislation*, AM. BANKER, May 27, 1981, at 1 (discussing proposed legislation regarding emergency acquisitions).

76. Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended in scattered sections of 12 U.S.C.).

77. *See* Rosenstein, *supra* note 75, at 36.

these measures would have involved merging ailing institutions with healthy institutions, including "interindustry" mergers (between thrifts and banks or bank-holding companies) and "interstate" mergers.⁷⁸ In addition, the measure expanded regulatory authority to assist institutions without closing them through "open bank assistance," which involved a variety of transactions with institutions whereby assistance could be provided through favorable transaction terms and through assisted acquisitions by healthy institutions.⁷⁹ Finally, the provision expanded the powers of federal savings banks (first authorized in 1978) and liberalized provisions by which state mutual savings banks could convert to federal charters and then, having so converted, could convert to stock form (thus converting the premium value of the institution into tangible capital).⁸⁰

The most significant elements of the package were the proposals for merging ailing institutions into healthy ones, and the most significant element of these were proposals for interstate and interindustry acquisitions.⁸¹ These proposals were significant because they touched upon initiatives to deregulate and strengthen the depository institution industry that had been advanced even prior to, and were advanced apart from, the thrift industry problem.⁸² These proposals called for three principal sets of reforms. The first was the elimination of legal barriers to the affiliation of commercial banking entities with entities providing other forms of financial services, principally investment banking, securities advisory, and brokerage services.⁸³ The second called for the removal of barriers to interstate expansion by depository institutions.⁸⁴ The third called for the elimination of differences between different types of depository institutions. Principally, this meant that the thrifts had to confine their activity primarily to residential real estate lending.⁸⁵ The regulators' bill called for emergency acquisition au-

78. *Id.*

79. *Id.*

80. *Id.*

81. See Jay Rosenstein, *Volcker Presses for Interstate, Interindustry Acquisitions; Warns Congress that Authority Is Needed to Act on Troubled Thrifts*, AM. BANKER, Oct. 2, 1981, at 3.

82. See Lisa J. McCue, *Congress Moves on 2 Banking Bill Fronts*, AM. BANKER, Dec. 11, 1981, at 3; Sam Scott Miller, *Financial Markets and Deregulation*, AM. BANKER, Jan. 4, 1982, at 4 (describing proposals for remodeling regulatory structure). See generally JAMES L. PIERCE, *FINANCIAL INSTITUTIONS AND THE NATION'S ECONOMY* (1975).

83. Congress traditionally had been hostile to bank-thrift combinations. See Gordon Matthews, *Bank-Thrift Mergers Seen Imminent*, AM. BANKER, Jan. 23, 1981, at 1.

84. See Rosenstein, *supra* note 75, at 36.

85. See generally *Cabinet Panel to Discuss Thrift Aid*, AM. BANKER, May 21, 1981, at 3.

thority that allowed either interstate or interindustry acquisition; this provided a beginning for progress on the second and third of the three initiatives, which had been urged — at the time for more than a decade — as a means of modernizing, rationalizing, and deregulating the financial services industry generally.

When first advanced by the regulators in the spring of 1981, the regulators' bill received an icy reception. The Reagan administration, preoccupied with the tax program then advancing in Congress, showed no interest in the proposal and refused to support it.⁸⁶ The thrift industry, still pressing for more straightforward relief efforts and suspicious, if not hostile to the emergency acquisition provisions that would lead to commercial bank incursion on the domain of the thrifts, opposed the measure.⁸⁷ The commercial banking industry was attracted by the emergency acquisition features of the proposal, but did not actively seek to advance it largely because of the banking industry's shyness about open conflicts with the thrift industry.⁸⁸ By mid-June 1981, the regulators' bill appeared to be going nowhere.⁸⁹

86. See Joseph D. Hutnyan, *Desertions on Rescue Bill Question Validity of Thrift Crisis*, AM. BANKER, June 5, 1981, at 4.

87. See *id.* (stating that "the United States League of Savings Associations — the nation's largest S&L trade group — denounced the bill as a devious move to encourage commercial banks to pick off S&Ls").

88. The commercial banking industry spent the summer fighting efforts by the thrift industry to restore the interest rate differential of one-quarter of one percent that thrifts were permitted to pay on deposits before the Depository Institutions Deregulation Committee. See Karen Slater, *US Savings League Threatens to Sue Over Deregulation Actions; Charges Decisions Exceeded Congressional Mandate*, AM. BANKER, June 29, 1981, at 1, 16. Senator Garn, the Banking Committee Chairman, later would publicly upbraid banking industry representatives for "'bitch[ing] about' the need for new competitive tools," saying that "'selfishness' and 'greed' among the special interest groups has kept Congress from acting" and that banking industry representatives "gave the impression that banks were 'scared to death of a crippled thrift institutions industry' but not about their non-depository competitors, such as securities firms and large retailers," adding that "unless the bankers were willing to make compromises, 'we're not going to have a bill and the non-depository institutions will roll merrily along, taking all of your money away.'" Jay Rosenstein, *Garn Tells Commercial Banks to Quit Griping About Thrifts*, AM. BANKER, Oct. 21, 1981, at 1. The passage is the beginning of an effort that Senator Garn made over five or six years to secure a united front among depository institutions in advancing deregulation legislation; the effort bore little fruit. The commercial banking industry seems to have been the wiser. Eventually, the decentralized nondepository rivals, other than the insurance industry, failed to prevail in protecting itself, faltering largely as a result of the 1987 Competitive Equality Banking Act legislation and the initiatives of the bank regulators, which were upheld by the courts. The thrifts were more formidable legislative rivals and were felled only by the 1989 legislation, which was enacted really only after the underlying economics of the thrift industry had all but ensured the industry's ultimate evisceration.

89. See Hutnyan, *supra* note 86, at 4.

But the accelerating rate of failures in the industry continued to trouble the regulators and began to concern the banking committees. By late summer 1981, the tax bill had been passed, the industry's troubles were continuing to multiply, and the regulators, this time with Representative St Germaine's support, revived the drive for the measure.⁹⁰ To mollify the thrift industry, however, and perhaps as well to detract from the tendency of the measure to benefit (or encourage) the commercial banking industry, a third major feature was added to the initiative as it emerged in the late summer and early fall of 1981. This proposal quite significantly expanded the investment and activity authority of thrifts to make them more like commercial banks and, in some respects, conferred powers upon them beyond those granted to commercial banks.⁹¹ The thrift industry supported this feature of the proposal, but the commercial banking industry opposed it.⁹² In October 1981, the House adopted a measure incorporating the regulators' bill, providing for emergency acquisitions and open bank assistance, but without adding thrift powers.⁹³ Late in the year, Senator Garn publicly admonished the representatives of the various factions of the depository institutions industry to agree among themselves on measures for congressional adoption.⁹⁴

90. See Joseph D. Hutnyan, *Congressional Support Seems to Grow for Crisis Mergers*, AM. BANKER, Oct. 1, 1981, at 1; Jay Rosenstein, *Move Is On to Revive Bank and Thrift Aid*, AM. BANKER, Aug. 3, 1981, at 6.

91. See Joseph D. Hutnyan, *Two 'Thrift' Bills Likely to Dominate Washington*, AM. BANKER, Aug. 28, 1981, at 4. The proposal was sponsored by the FHLBB, apparently without support from the other regulatory agencies, but it won early Treasury backing at a time when the Treasury continued to refuse to support the emergency combination bill on the ground that it was a disguised federal subsidy. *Id.*

92. See *id.* (stating that "[b]ank lobbies are sure to blast any move to strengthen their competitors"). Throughout most of the period that the legislation was considered, it included provisions to broaden bank powers to underwrite municipal revenue bonds, as well as other expansions of bank powers. This secured the support of most of the banking industry, although the Independent Bankers Association of America (IBAA) opposed the legislation throughout because of its opposition to the expansion of thrift powers. See Jay Rosenstein, *Lobbies Bid Congress Give Wider Powers*, AM. BANKER, June 10, 1982, at 1. In the end, the Senate version of the bill took away most of what the commercial banking industry had sought. See Joseph D. Hutnyan, *Heinz Version of Banking Bill Seems Near to Gaining Favor*, AM. BANKER, Aug. 19, 1982, at 1. The industry made a last ditch effort to kill the entire bill after the Senate eliminated any expansion of its powers. See Joseph D. Hutnyan, *Irate, Frustrated Bankers Lashing Out at Garn Bill*, AM. BANKER, Sept. 10, 1982, at 4.

93. See Jay Rosenstein, *Emergency Bank Aid Likely to Pass Congress This Year*, AM. BANKER, Nov. 9, 1981, at 1. By December, Rep. St Germain had begun hearings on expanded thrift powers, with indications that he might support them. Meanwhile, Senator Garn had promised a vote on them by February. See McCue, *supra* note 82, at 3.

94. See Joseph D. Hutnyan, *Garn Puts Onus on Lobbies for Consensus Bill*, AM.

The Reagan administration remained neutral throughout late 1981, explicitly refusing to oppose the regulators' bill.⁹⁵

Meanwhile, known mostly to the regulators, the crisis was worsening.⁹⁶ While Congress was considering the regulators' bill, the Board and FHLBB took unilateral steps to prod elements of Congress into adopting the emergency acquisition features.⁹⁷ Much of the reluctance to adopt the provision stemmed from the powers of the state governments and from congressional protectiveness of the thrift industry, many of the members of which were prominent in their local communities and had ties to members of the

BANKER, Nov. 20, 1981, at 4; Rosenstein, *supra* note 88, at 1.

95. See Hutnyan, *supra* note 91, at 4; Rosenstein, *supra* note 90, at 6; *State Groups Fight Crisis Merger Bill*, AM. BANKER, Oct. 28, 1981, at 15 [hereinafter *State Groups Fight*].

96. See Jay Rosenstein, *House Committee Delays Vote on Thrift Emergency Bill; Skeptical Members Say Regulators Have Yet to Make Their Case for It*, AM. BANKER, Oct. 3, 1981, at 3 (Rep. Stephen Neal asked Banking Committee Chairman St Germain "whether there was a crisis that required the committee to act quickly"; "Mr. St Germain responded, 'If the chair didn't feel there were some imminent situations out there, the chair would not have convened this'; when asked for more details by Mr. Neal, Mr. St Germain said, "I would suggest you check with some of the regulators"). The exchange reveals the limited information that was available even then to members of Congress. Rep. Neal ordinarily was sensitive to the concerns of the banking industry, particularly the "regional" banks, some of which stood to benefit from, though they were not then supporting, the acquisition provisions of the regulators' bill.

97. See Karen Slater, *Mutuals Ask for Capital Aid; FDIC Resisting Action*, AM. BANKER, Aug. 14, 1981, at 1 (reporting FDIC resistance to requests from state savings banks for capital assistance leading to "suggestions that the FDIC is attempting to use a hard-line position on capital aid as leverage to win Congressional approval for interstate and interindustry takeovers of troubled institutions as well as for broader capital infusion powers"); *Regulators Sketch Thrift-Takeover Options; Rescues Could Take Form of New Limited Banks, Straight Asset Sales*, AM. BANKER, Oct. 28, 1982, at 1; Rosenstein, *supra* note 81, at 3. By spring 1982, the Bank Board was frequently effecting forced mergers prior to the adoption of the final Garn-St Germain legislation. See Joseph D. Hutnyan, *Thriffs Find that Government Rescue Is Traumatic Affair*, AM. BANKER, Apr. 2, 1982, at 4. There were complaints from the industry that the FHLBB and FSLIC might have "been acting in a 'high handed' manner during supervisory merger transactions," and that regulators had been "a little too creative" in their attempts to find ways to deal with the record number of troubled associations that demand[ed] their attention." *Thrift Industry Exults at Humbling of Regulators: See Courts Precluding Any More Fidelity Cases*, AM. BANKER, June 11, 1982, at 3. At the time, the Board frequently effected "phoenix" transactions, where a number of troubled institutions were combined into a single institution that would rise like the mythical bird from the rubble of its constituent parts. See Laura L. Mulcahy, *NJ Commissioner to Propose Plan to Cover Disposition of Ailing Thrifts: Application to Troubled Suburban S&L Said Coincidental*, AM. BANKER, July 13, 1982, at 3. This practice was largely discontinued after Garn-St Germain, subject to a brief revival in 1988 in connection with widespread failures in Texas. See *infra* note 204 and accompanying discussion.

House.⁹⁸ Under the Bank Holding Company Act (BHCA), the Board could approve the acquisition by a company controlling a bank of a company engaged in an activity "so closely related to banking as to be a proper incident thereto."⁹⁹ The Board historically had left open the question whether the operation of a thrift could be held to constitute an activity "closely related to banking." In 1982, during the pendency of the regulators' bill, the Board and FHLBB approved Citicorp's acquisition of Fidelity Savings & Loan Association of San Francisco, a solvent thrift. In doing so, the Board held that the operation of the thrift was "closely related" to banking.¹⁰⁰ Additionally, the Chairman of the Board testified that the Board would consider generally permitting bank holding company acquisitions of thrifts if Congress did not act on the emergency acquisitions bill. The Chairman also noted that the Board's policy would permit acquisitions of healthy, as much as ailing, thrifts.¹⁰¹

In February 1982, as the House was considering the expansion of thrift powers advocated by the Administration and the Senate, proposals for more direct aid to the thrift industry resurfaced. Estimates began to surface suggesting that between \$30 billion and \$120 billion eventually would be needed to resolve the crisis.¹⁰² The liberal Brookings Institution published a study saying that as many as 1000 thrifts (twenty-five percent of the total) were in danger of failing.¹⁰³ The industry, this time joined by Representative St Germain, advanced a proposal for government loans to thrifts that would have permitted the institutions to borrow from the government to maintain their capital at two percent of assets.¹⁰⁴ The subsidy plans, however, having

98. When the regulators' bill was reported by the House Committee and came up for consideration by the full House, the principal opposition came from the National Association of Savings and Loan Supervisors and the Conference of State Bank Supervisors, which represented the bank and thrift regulatory officials of the states. See *State Groups Fight*, *supra* note 95, at 1, 15.

99. 12 U.S.C. § 1843(c)(8) (1994).

100. Citicorp, 68 FED. RES. BULL. 656 (1982). The approval was invalidated by a federal district court, but was reinstated by the Ninth Circuit Court of Appeals. The Supreme Court denied certiorari. See *Fidelity Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 540 F. Supp. 1374 (N.D. Cal.), *rev'd*, 689 F.2d 803 (9th Cir. 1982), *cert. denied*, 461 U.S. 914 (1983).

101. See Rosenstein, *supra* note 81, at 3.

102. Karen Slater, *Two-Thirds of Thrifts Forecast to Need US Aid by 1990*, AM. BANKER, Oct. 30, 1981, at 3 (reporting estimates by Richard W. Kopcke, vice president and economist, Federal Reserve Bank of Boston).

103. Linda W. McCormick, *Pressure for Federal Aid to Thrifts Grows*, AM. BANKER, Feb. 23, 1982, at 1.

104. See Joseph D. Hutnyan, *Thrift Rescue Plans Getting Serious*, AM. BANKER, Feb.

immediate budgetary impact, encountered difficulty. Ultimately, Representative St Germain had to content himself with proposals for "capital certificates," under which the government issued promissory notes to the thrifts to maintain capital at two percent, and the notes had to be paid only upon the failure of the institution.¹⁰⁵

In April, the Administration abandoned neutrality and endorsed the regulators' bill, subject to a priority system that favored intrastate intra-industry mergers over interindustry mergers, intrastate interindustry mergers over interstate intraindustry mergers, and interstate intraindustry mergers over interstate interindustry mergers.¹⁰⁶ The Administration also endorsed the modified bailout capital certificates program.¹⁰⁷ In October, the measure was adopted as the Depository Institutions Act of 1982.¹⁰⁸ It commonly has been known as the Garn-St Germain Act.

2. *Garn-St Germain*

Because of their role in the management of the thrift crisis not only prior to FIRREA, but beyond, and because the provisions of the regulators' bill in particular mark the beginning of a vast expansion of regulatory authority, particularly on the part of the deposit insurers, the provisions of Garn-St Germain that formed the tripartite approach to the "first" crisis are worth describing in slight detail. As noted, each of the three major prescriptions for the ills of the industry derived from a different source: the regula-

12, 1982, at 1; McCormick, *supra* note 103, at 1. The thrift assistance plans were "inspired by the Democrats . . . to use the crisis to embarrass the White House." Joseph D. Hutnyan, *Rescue the Thrifts and You Question Reaganomics*, AM. BANKER, Feb. 26, 1982, at 4. The plans were supported by the thrift industry and FHLBB, but the Board remained neutral, though critical. See Linda W. McCormick, *Volcker Says No to Thrift Bailout*, AM. BANKER, Feb. 24, 1982, at 1; *Volcker Stand on Thrift Aid Clarified*, AM. BANKER, Mar. 2, 1982, at 3. Consumer interests opposed the bailout plans unless the thrift powers expansion plans were scaled back. See Lisa J. McCue, *Consumer Groups Say Aid to Thrifts Should Be Tied to Their Continued Role as Mortgage Lenders*, AM. BANKER, Mar. 22, 1982, at 2.

105. See Joseph D. Hutnyan, *Thrift Aid Plans Will Have to Go Back to the Drawing Board*, AM. BANKER, Mar. 12, 1982, at 5. In early May, the Administration and Senator Garn endorsed the more limited capital certificate program. See Joseph D. Hutnyan, *Thrifts' Plea to White House: Stay Out of the Battle*, AM. BANKER, Apr. 30, 1982, at 4; Lisa J. McCue & Linda W. McCormick, *Certificate Aid to Thrifts Gains at Capitol as Garn Reverses Stand*, AM. BANKER, May 5, 1982, at 1. The ABA supported the more limited guarantee program. As passed by the House, the guarantee was limited to \$8.5 billion.

106. See Lisa J. McCue, *Reagan Council Endorses Aids to Thrifts but Bars Direct Bailout*, AM. BANKER, Apr. 27, 1982, at 1.

107. See *id.*

108. P.L. 97-320, 96 Stat. 1469 (codified as amended in scattered sections of 12 U.S.C.).

tors *qua* regulators (not as officials of any political administration) advanced the regulators' bill; the Democratic majority in the House supported the capital certificate program; and the Republican administration promoted the liberalization of thrift powers.

a. Legislation Prior to Garn-St Germain Adumbrating the Regulators' Bill and the Expansion of Thrift Powers. In its original form, the deposit insurance law gave the insurer primitive and cumbersome powers both in paying of insurance and in protecting the insurance fund by supervising weakening institutions. The original provisions were adopted as Section 8 of the Banking Act of 1933,¹⁰⁹ which added Section 12B to the Federal Reserve Act.¹¹⁰ Under that law, if a bank were closed because it became unable to meet the demands of depositors, the Comptroller was to appoint the FDIC as the receiver of any national bank, and any state authority was permitted to appoint the FDIC as the receiver of any state bank.¹¹¹ The FDIC was to form a "new bank."¹¹² The new bank was to issue stock as soon as the FDIC deemed desirable, and if stock could not be sold, then the FDIC was to transfer the bank to another institution. If no such institution could be found, the bank's affairs were to be wound up and liquidated.¹¹³ The provisions were amplified a couple of years later by the Banking Act of 1935 (1935 Act),¹¹⁴ which authorized transactions between the FDIC and closed banks, including sales and pledges of bank assets to the FDIC in exchange for cash or loans, guarantees to an acquiring bank against losses on assets of a closed or open bank acquired by the beneficiary bank, mergers and consolidations of insured banks with other insured banks, or transactions by which an insured bank would acquire the assets and assume the liabilities of another insured bank.¹¹⁵ In addition, the 1935 Act provided that the FDIC

109. Ch. 89, 48 Stat. 162. The provisions of the deposit insurance law originally were codified at 12 U.S.C. § 364 (Supp. VII 1934). They were transferred to the separate Federal Deposit Insurance Act by Act of Aug. 17, 1950, ch. 729 §§ 5-7, 64 Stat. 457. See LANGBEIN, *supra* note 58, § 2.07 & n.71 (discussing Banking Act of 1933). The FDIA is currently codified at 12 U.S.C. § 1811-35a (1994). See also *supra* note 58 and accompanying text.

110. 12 U.S.C. §§ 221-522 (1994).

111. See LANGBEIN, *supra* note 58, § 2.07 (discussing creation of Federal Deposit Insurance Corporation).

112. See 12 U.S.C. § 1821(m) (1994) (current descendant of "new bank" provision).

113. See LANGBEIN, *supra* note 58, § 2.07 (discussing FDIC's obligations under Banking Act of 1933).

114. Law of Aug. 23, 1935, ch. 614, 49 Stat. 684.

115. See Federal Reserve Act § 12B(l)(9), (u)(4), as in effect after the enactment of the Banking Act of 1935. These provisions survive today as 12 U.S.C. § 1823(c)-(d) (1994), as modified principally by the open bank assistance provisions of Garn-St Germain and the

could terminate an institution's insurance if it found the institution was engaged in unsafe or unsound practices.¹¹⁶ The 1934 National Housing Act legislation governing insurance of thrift institutions largely paralleled those provisions,¹¹⁷ though the statutory language was sparser, leaving greater room for administrative amplification — a circumstance that was characteristic of the federal thrift legislation of the 1930s.¹¹⁸

The decades-long expansion of the power of the deposit insurers began with the Financial Institutions Supervisory Act of 1966 (FISA),¹¹⁹ a product of the liberal activist 89th Congress. The motivation for that statute was the cumbersomeness of the tools under the original laws: The deposit insurers could terminate insurance or could seek to have the chartering body (which in the case of federal thrifts was the same body as the insurer) throw the institution into receivership or conservatorship.¹²⁰ FISA for the first time gave the deposit insurers authority to issue "cease and desist" orders for violations of law, agency rules, or unsafe or unsound practices.¹²¹ It conferred authority for removal or suspension of officers, directors, or others "participating in the affairs" of an institution¹²² and spelled out expansive grounds for the appointment of receivers for federal institutions.¹²³ FISA amended the provisions of the National Housing Act and the Federal Deposit Insurance Act in parallel fashion. FISA thus marks the beginning of the long process of combining the laws governing bank and thrift insurance, which

amendments to those provisions enacted by subsequent legislation, principally FIRREA. See LANGBEIN, *supra* note 58, § 2.08 (discussing Banking Act of 1935 and its effect on FDIC). See generally STEPHEN K. HUBER, *BANK OFFICER'S HANDBOOK OF GOVERNMENT REGULATION* 1-15 (2d ed. 1989) (giving historical overview of banking in United States).

116. See Federal Reserve Act § 12(i)(1), 12 U.S.C. § 264(i)(1) (1994), as enacted by Act of Aug. 23, 1935, ch. 614, 49 Stat. 684, 690.

117. Law of June 27, 1934, ch. 847, 48 Stat. 1246 § 406(a)-(c).

118. See LANGBEIN, *supra* note 58, § 2.12 (discussing National Housing Act of 1934).

119. Pub. L. No. 89-695, 80 Stat. 1028.

120. National Housing Act of 1934, ch. 847, 48 Stat. 1246, §§ 406(a), 407(a).

121. Financial Institutions Supervisory Act of 1966 [hereinafter FISA], Pub. L. No. 89-695, sec. 101(a), § 5(d)(2)-(3), 80 Stat. 1028, 1028-29 (codified as extensively amended at 12 U.S.C. § 1818(b)-(d) (1994)). See LANGBEIN, *supra* note 58, § 2.18 (discussing pre-FISA period and changes made by FISA).

122. FISA, Pub. L. No. 89-695, sec. 101(a), § 5(d)(4)-(5), 80 Stat. 1028, 1030-32 (codified as extensively amended at 12 U.S.C. § 1818(e)-(g) (1994)). See LANGBEIN, *supra* note 58, § 2.18 (discussing new powers conferred by FISA).

123. FISA, Pub. L. No. 89-695, sec. 101(a), § 5(d)(6), 80 Stat. 1028, 1032-33 (codified as extensively amended at 12 U.S.C. § 1464(d)(2) (1994)). See LANGBEIN, *supra* note 58, § 2.18 (discussing FISA power to appoint receiver).

culminated as a legal matter in FIRREA and which is now in the process of being culminated as a financial matter.¹²⁴

The germ of the 1982 approach actually was born in 1978 legislation — the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRIRCA).¹²⁵ FIRIRCA effected the first expansion of thrift powers. Under the Home Owner's Loan Act (HOLA), as enacted in 1933, federally chartered thrifts could hold first lien mortgages on residences, or combined residences and businesses within a defined radius of the thrift's location, subject to maximum amount limitations, and also could hold stock in federal home loan banks. The 1978 legislation expanded thrift powers to make "residential" investments include property up to \$60,000 in value within a 100-mile radius of the thrift office, government-insured and quasi-governmental securities (such as obligations of the Federal National Mortgage Association or those guaranteed by the Government National Mortgage Association), and bank obligations.¹²⁶ The 1978 legislation also permitted up to thirty percent of the thrifts assets to be invested in nonhousing related items — up to twenty percent in commercial real estate loans, five percent in construction loans and certain other items, and five percent in revenue bonds of states and municipalities.¹²⁷ The statute extended the 1935 Banking Act provisions allowing loans, sales, and pledges of assets between the deposit insurer, the insured institution, and the thrift industry and, for the first time, extended purchase and assumption authority, though limited to cases where an institution was in default or danger of default.¹²⁸

Finally, the statute provided, for the first time, for federally chartered savings banks.¹²⁹ At the time, seventeen states provided for chartering

124. FIRREA made both industries subject to the FDIA and made the FDIC the insurer of both industries. But the premiums paid by the industries are determined separately and paid into separate funds — the Bank Insurance Fund (BIF) for commercial banks and the Savings Association Insurance Fund (SAIF) for thrifts. A provision combining the funds was included in H.R. 2491, the omnibus budget reconciliation measure passed by Congress but vetoed by President Clinton in 1995.

125. Pub. L. No. 95-630, 92 Stat. 3641.

126. Financial Institutions Regulatory and Interest Rate Control Act of 1978 [hereinafter FIRIRCA], Pub. L. No. 95-630, sec. 1701, § 5(c)(1), 92 Stat. 3641, 3714-16 (codified as amended at 12 U.S.C. § 1464(c)(1) (1994)).

127. *Id.* See LANGBEIN, *supra* note 58, § 2.24 (discussing expansion of thrift investment powers under FIRIRCA).

128. FIRIRCA, Pub. L. No. 95-630, sec. 105(b)(2), § 406(f), 92 Stat. 3641, 3647 (codified at 12 U.S.C. § 1729(f) (1988), *repealed by* Pub. L. No. 101-73, 103 Stat. 183 (1989)). See LANGBEIN, *supra* note 58, § 2.22 (noting that FDIC had purchase and assumption authority from beginning, but that FSLIC did not until FIRIRCA).

129. FIRIRCA, Pub. L. No. 95-630, tit. XII, 92 Stat. 3641, 3710-12 (codified as

savings banks; the 1978 legislation did not allow the chartering of new federal savings banks, but allowed only the conversion of state mutual savings banks to federal mutual savings banks.¹³⁰ The motivation for this provision was to permit savings banks, which were then insured by the FDIC and are still insured as banks, to secure FSLIC insurance, which at the time bore a lower premium. Upon conversion to federal charters, these banks switched insurers and became insured by the FSLIC. This statute also authorized the imposition of cease and desist orders against officers, directors, and other persons "participating in the affairs" of an institution and authorized the imposition of civil money penalties by the deposit insurers for the first time.¹³¹

In 1980, DIDAMCA expanded the range of loans that thrifts were permitted to make to include consumer loans, up to twenty percent of assets.¹³² Together with the twenty percent permitted by the 1978 legislation,¹³³ this meant that the aggregate of construction loans, commercial loans, consumer loans, and revenue bond investments that thrifts could make, even prior to Garn-St Germain, equaled forty percent of the thrift's assets.

b. The Regulators' Bill. The regulators' bill comprised three principal initiatives: provisions for open bank assistance,¹³⁴ provisions for emergency acquisitions,¹³⁵ and provisions for mutual-to-stock and "supervisory" conversions of thrifts.¹³⁶

amended at 12 U.S.C. §§ 1462(d), 1464(a), 1464(i), 1726(a), 1831(c) (1988), *repealed by* Pub. L. No. 101-73, 103 Stat. 183 (1989)). For current corresponding provisions, see 12 U.S.C. §§ 1462(4), 1464(a),(i) (1994).

130. FIRIRCA, Pub. L. No. 95-630, sec. 1202, § 5(a), 92 Stat. 3641, 3710-11 (codified as re-enacted and amended at 12 U.S.C. § 1464(i) (1994)).

131. FIRIRCA, Pub. L. No. 95-630, tit. I, 92 Stat. 3641, 3641-72 (codified as amended at 12 U.S.C. §§ 1813(u), 1818(b),(e),(i) (1994)).

132. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 401, 94 Stat. 132, 145 (codified as amended at 12 U.S.C. § 1464(c)(B)).

133. FIRIRCA, Pub. L. No. 95-630, § 1701, 92 Stat. 3641 (codified as amended at 12 U.S.C. § 1464(c)(2)(A)).

134. Garn-St Germain Depository Institutions Act of 1982 [hereinafter Garn-St Germain], Pub. L. No. 97-320, § 111, 96 Stat. 1469, 1469-71 (codified as amended at 12 U.S.C. § 1823(c) (1994)).

135. *See* 12 U.S.C. § 1823(k) (1994); Garn-St Germain, Pub. L. No. 97-320, § 116, 96 Stat. 1469, 1476-79 (codified as amended at 12 U.S.C. § 1823(f) (1994)); *see also* Garn-St Germain, Pub. L. No. 97-320, § 122(a), 96 Stat. 1469, 1480-81 (codified at 12 U.S.C. § 1729(f) (1988), *repealed by* Pub. L. No. 101-73, 103 Stat. 183 (1989)).

136. Garn-St Germain, Pub. L. No. 97-320, § 121, 96 Stat. 1469, 1479-80 (codified at

i. Open Bank Assistance. The open bank assistance provisions extended the provisions of the 1935 law (for banks) and the 1978 law (for thrifts) to allow the deposit insurers to engage in transactions with institutions that were not subject to closure but were in need of assistance. The insurers were permitted to assist open banks in order "to prevent the closing" of an institution, "to restore [a] closed bank to normal operations," or to lessen the risk posed by "severe financial conditions . . . which threaten[ed] the stability of a significant number of insured [institutions] possessing significant financial resources."¹³⁷ The insurers were permitted to make loans to, deposits in, or contributions to any such institution, to purchase assets or securities of the institution, or to assume its liabilities.¹³⁸ In connection with a purchase and assumption (P&A) transaction, the insurers were permitted to engage in these transactions with either the troubled or the acquiring institution.¹³⁹ In such transactions, the insurers could guarantee either institution against loss by reason of the transactions or against the loss with respect to any asset.¹⁴⁰ The amount of the assistance was limited to the amount that the insurer "determine[d] to be reasonably necessary to save the cost of liquidating, including paying the insured accounts" of the troubled institution.¹⁴¹ This restriction was lifted — and it is this provision that is most controversial in relation to the "too big to fail" policies — where the insurer determines that "continued operation" of the institution is "essential to provide adequate banking services in its community."¹⁴²

ii. Emergency Acquisitions. The most significant of the provisions of the regulators' bill were the provisions for emergency or extraordinary acquisitions. At the time, as noted above, the Board ordinarily did not permit banks or bank holding companies to acquire thrifts, so the thrift and

12 U.S.C. § 1464(p) (1988), *repealed* by Pub. L. No. 101-73, 103 Stat. 183 (1989); *see also* 12 U.S.C. § 1464(p) (1994) (current statutory provision).

137. Garn-St Germain, Pub. L. No. 97-320, sec. 111, § 13(c)(1), 96 Stat. 1469, 1469 (codified as amended at 12 U.S.C. § 1823(c)(1) (1994)).

138. *Id.* at sec. 111, § 13(c)(1), (c)(2)(A), 96 Stat. 1469, 1469-70 (codified as amended at 12 U.S.C. § 1823(c)(1), (c)(2)(A) (1994)).

139. *Id.* at sec. 111, § 13(c)(2)(A), 96 Stat. 1469, 1469-70 (codified as amended at 12 U.S.C. § 1823(c)(2)(A) (1994)).

140. *Id.* at sec. 111, § 13(c)(2)(A)(iii), 96 Stat. 1469, 1470 (codified as amended at 12 U.S.C. § 1823(c)(2)(A)(iii) (1994)).

141. *Id.* at sec. 111, § 13(c)(4)(A), 96 Stat. 1469, 1470 (codified as amended at 12 U.S.C. § 1823(c)(4)(A) (1994)).

142. Garn-St Germain, Pub. L. No. 97-320, sec. 111, § 13(c)(4)(A), 96 Stat. 1469, 1470 (codified as substantially amended at 12 U.S.C. § 1823(c)(4)(A) (1994)).

bank industries were kept separate.¹⁴³ Also at the time, most states prohibited entry by out-of-state institutions, and federal law incorporated state law as to either bank or bank holding company expansion.¹⁴⁴ The emergency acquisition provisions gave large thrifts and banks an opportunity to circumvent both provisions. Because such restrictions lent institutions not subject to them enhanced premium value¹⁴⁵ and because premium value operated to diminish the amount of cash assistance that had to be extended in rescue transactions, the emergency acquisition provision promised significant savings on the deposit insurance payout bill.

For FDIC-insured institutions, banks, and mutual savings banks, emergency acquisitions were limited to target institutions with \$500 million in assets or more.¹⁴⁶ Banks had to be closed; mutual savings banks could be subject to acquisition if "in danger of closing."¹⁴⁷ Banks could be subject only to P&A transactions; mutual savings banks could be subject to P&A transactions, mergers, or stock acquisitions.¹⁴⁸

Savings and loan associations could be subject to an emergency acquisition if "severe financial conditions exist[ed] which threaten[ed] the stability of a significant number of insured institutions possessing significant financial resources," if the institution were in default or could be restored to normal

143. See *supra* notes 97-98 and accompanying text (discussing controversy surrounding interindustry acquisitions).

144. See 12 U.S.C. § 36(c) (1994) (prohibiting branching by national banks except where permitted by state law); *id.* § 1842(d) (prohibiting bank holding company expansion across state lines where not expressly permitted by state law). Barriers to interstate banking began to erode by virtue of state laws and interstate arrangements, where the states permitted entry based on "region" or based on reciprocity by the states whose institutions sought entry. These arrangements were upheld against statutory and constitutional challenge in *Northeast Bancorp v. Board of Governors of the Fed. Reserve Sys.*, 472 U.S. 159 (1985). In the intervening time, barriers have eroded greatly, though most state laws still require "regionality" or "reciprocity." In the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338, Congress eliminated most remaining barriers to bank holding company expansion, effective September 29, 1995, and eliminated barriers to interstate branching, unless a state "opts out" of interstate branching laws, effective June 1, 1997, or unless a state elected to "opt in" to those laws at an earlier date. See 12 U.S.C. §§ 36(e)-(g) (1994).

145. See *supra* note 19-28 and accompanying text (discussing concept of premium value).

146. *Gam-St Germain*, Pub. L. No. 97-320, sec. 116, § 13(f)(2)(A), (f)(3)(A)(i), 96 Stat. 1469, 1476-77 (codified as amended at 12 U.S.C. § 1823(f)(2)(A), (f)(3)(A) (1994)).

147. *Id.* See LANGBEIN, *supra* note 58, § 2.31 (discussing regulation of acquisitions).

148. *Gam-St Germain*, Pub. L. No. 97-320, sec. 116, § 13(f)(2)(A), (f)(3)(A)(i), 96 Stat. 1469, 1476-77 (codified as amended at 12 U.S.C. § 1823(f)(2)(A), (f)(3)(A) (1994)). See LANGBEIN, *supra* note 58, § 2.31 (discussing different treatment of acquisitions of banks from those of mutual savings banks).

operations, or if a default could be prevented.¹⁴⁹ Thrifts could be subject to either a P&A transaction or a merger.¹⁵⁰

In any case, the FDIC or FSLIC was required to notify the state authority of the target institution. The state authority had forty-eight hours to object. If it did object, the deposit insurers nevertheless could proceed with the transaction upon a unanimous vote of the federal insurer's board.¹⁵¹

The regulators' bill permitted interstate and interindustry acquisitions subject to a hierarchy, with a first priority (and a second opportunity to bid if the original bid were within the lesser of fifteen percent or \$15 million of the otherwise low bid) given to in-state, same industry acquirers; a second priority given to interstate, same industry acquirers; a third priority given to same state, interindustry acquirers; and a last priority given to out-of-state other industry acquirers.¹⁵² In soliciting bids, the deposit insurers were to find prospective purchasers "it determine[d], in its *sole discretion*" were qualified, and the insurers then were able to acquire the subject institution's assets and liabilities — the deposit insurer's "calculations and estimations" were to be "determinative."¹⁵³ The statute thus was unfriendly to judicial review in the context of these acquisitions.

iii. Supervisory Conversions. The third element of the regulators' bill provided for conversions of mutual institutions into stock institutions, including supervisory conversions. As indicated above, FIRIRCA for the first time provided for federally chartered savings banks.¹⁵⁴ De novo char-

149. Garn-St Germain, Pub. L. No. 97-320, sec. 123(a), § 408(m)(1)(A)(i), 96 Stat. 1469, 1483 (codified at 12 U.S.C. § 1730a(m)(1)(A)(i) (1988), *repealed by* Pub. L. No. 101-73, 103 Stat. 183 (1989)).

150. *Id.*

151. *Id.* at sec. 123(a), § 408(m)(1)(B), 96 Stat. 1469, 1483 (codified at 12 U.S.C. § 1730a(m)(1)(B) (1988), *repealed by* Pub. L. No. 101-73, 103 Stat. 183 (1989)); *id.* at sec. 116, § 13(f)(3)(C), 96 Stat. 1469, 1477 (codified as amended at 12 U.S.C. § 1823(f)(2)(B), (f)(3)(E) (1994)).

152. *Id.* at sec. 116, § 13(f)(6)(A)-(C), 96 Stat. 1469, 1478 (codified as amended at 12 U.S.C. § 1823(f)(6)(A)-(B) (1994)); *id.* at sec. 123(a), § 408(m)(3)(A)-(B), 96 Stat. 1469, 1483-84 (codified at 12 U.S.C. § 1730a(m)(3)(A)-(B) (1988), *repealed by* Pub. L. No. 101-73, 103 Stat. 183 (1989)). See LANGBEIN, *supra* note 58, § 2.31 (noting hierarchy of bids by category of offeror for both FDIC and FSLIC).

153. Garn-St Germain, Pub. L. No. 97-320, sec. 116, § 13(f)(5), (f)(6)(D), 96 Stat. 1469, 1477-78 (codified as amended at 12 U.S.C. § 1823(f)(5), (f)(6)(D) (1994)) (emphasis added); *id.* at sec. 123(a), § 408(m)(2), (m)(3)(E), 96 Stat. 1469, 1483-84 (codified at 12 U.S.C. § 1730a(m)(2), (m)(3)(E) (1988), *repealed by* Pub. L. No. 101-73, 103 Stat. 183 (1989)).

154. See *supra* notes 129-31 and accompanying text (discussing creation of federal

tering was not allowed — only conversions from state institutions, and then only into federal institutions organized in mutual form. Garn-St Germain provided that converting state institutions could, at the time of conversion, change directly into a stock form organization.¹⁵⁵ De novo federal institutions still were not recognized, but federal stock savings banks were recognized for the first time. In addition, the FDIC, which chartered state savings banks, was permitted to mandate a supervisory conversion of a state institution if "necessary to prevent the closing" of the bank, or if "severe financial conditions exist[ed] that threaten[ed] the stability" of the bank, and the conversion was "likely to improve the financial condition" of the institution.¹⁵⁶ This action required Bank Board concurrence and forty-eight-hour notice to state officials, whose objections could be overridden by a unanimous vote of the FDIC Board.¹⁵⁷

iv. Net Worth Certificates. The provision for net worth certificates was largely the child of the Democratic majority in the House of Representatives, which to a considerable extent took the side of the thrift industry. Net worth certificates were available to any institution with a net worth of less than three percent of assets and were to be in an amount equal to 50% of operating losses for institutions with a net worth in the 2-3% range; 60% in the 1-2% range; or 70% in the less than 1% range.¹⁵⁸ Institutions were to have capital at least equal to 0.5% of assets after counting the certificates.¹⁵⁹ The net worth certificates did not involve the transfer of any tangible assets to the issuer; the certificates were to be purchased with promissory notes and were to pay dividends equal to the interest due on the notes.¹⁶⁰ They were thus noncash transactions. If the issuer had positive net worth for six

mutual savings banks).

155. Garn-St Germain, Pub. L. No. 97-320, sec. 121, § 5(p), 96 Stat 1469, 1479-80 (codified as amended at 12 U.S.C. § 1464(p) (1994)). See LANGBEIN, *supra* note 58, § 2.30 (noting new direct conversion to stock form).

156. Garn-St Germain, Pub. L. No. 97-320, sec. 112, § 5(o)(2)(F), 96 Stat. 1469, 1471-72 (codified at 12 U.S.C. § 1464(o)(2)(F) (1988), *repealed by* Pub. L. No. 101-73, 103 Stat. 183 (1989), *replaced by* 12 U.S.C. § 1464(o) (1994)). The current § 1464(o) is substantially the same as the original, but does not contain § 1464(o)(2)(F).

157. *Id.*

158. *Id.* at sec. 203, § 13(i)(5), 96 Stat. 1469, 1492, *repealed by id.* § 206, 96 Stat. 1469, 1496 (1985 Sunset Provision).

159. *Id.* at sec. 203, § 13(i)(2)(E), 96 Stat. 1469, 1493, *repealed by id.* § 206, 96 Stat. 1469, 1496 (1985 Sunset Provision).

160. *Id.* at sec. 203, § 13(i)(1)(B), 96 Stat. 1469, 1493, *repealed by id.* § 206, 96 Stat. 1469, 1496 (1985 Sunset Provision).

months, the deposit insurers were not permitted to force an acquisition on the institution; if the issuer had a positive net worth for more than nine months, the insurers were proscribed from imposing certain management changes on the institutions.¹⁶¹

v. *Thrift Powers*. The thrift powers provisions were the "deregulatory" provisions advocated by the Reagan administration as its condition of support for the bill.¹⁶² Under the bill, thrifts were permitted to invest in commercial real estate up to forty percent of assets; in revenue bonds of states and municipalities up to ten percent of its equity and reserves, without regard to whether the proceeds were used for residential real estate purposes; in commercial loans up to ten percent of assets after 1983; and in leasing of personalty up to ten percent of assets.¹⁶³ Together with prior enactments, the provisions in theory permitted an institution to invest its reserves and equity, plus eighty percent of its assets in nonresidential lending (40% in commercial real estate lending; 20% consumer lending; 10% leasing; 10% commercial loans; plus reserves invested in industrial development bonds). The provisions were imitated at the state level, some states conferring powers far broader than those allowed by HOLA.¹⁶⁴ In essence, these provisions gave the green light to the "go-go thrifts" of the 1980s.

B. *The Second Thrift Crisis and the Road to FIRREA*

The Garn-St Germain Act (the Act), signed in October 1982, brought to a close the "first" thrift crisis. For about two years after the Act, the problems in the industry appeared to be under control. The Bank Board resolved a number of the problem institutions through P&A transactions,¹⁶⁵ and the deposit insurers — the FSLIC with respect to most thrifts, the FDIC with respect to state mutual savings banks — encouraged the conversion of

161. *Id.* at sec. 203, § 13(i)(3), 96 Stat. 1469, 1493-94, *repealed by id.* § 206, 96 Stat. 1469, 1496 (1985 Sunset Provision).

162. *See supra* notes 104-05 and accompanying text (discussing political compromise leading to Garn-St Germain).

163. Garn-St Germain, Pub. L. No. 97-320, sec. 322, 324, 325, 330, §§ 5(c)(1)(B), (c)(1)(H), (c)(1)(R), (c)(2)(A), 96 Stat. 1469, 1499 (codified as amended at 12 U.S.C. §§ 1464(c)(1)(B), (c)(1)(H), (c)(1)(R), (c)(2)(A)).

164. *See generally* H.R. REP. NO. 54(I), 101st Cong., 1st Sess. 297 (1989).

165. During the 1981-1982 period, 730 thrifts, or approximately one-sixth of a total of about 4600 FSLIC-insured institutions, were merged or liquidated. *See* Robert Trigaux, *Congressional Study Calls Thrift Insurance Fund Fragile: Future Health Remains Closely Tied to Continued Low Level of Interest Rates*, GAO Says, AM. BANKER, Dec. 7, 1983, at 3.

mutual institutions into stock form.¹⁶⁶ The conversion technique, like the P&A technique, allowed the agency to harness the premium value of institutions in the service of the rescue effort. And the FSLIC — not the FDIC — promoted combinations through the adoption of regulatory accounting principles, which permitted institutions to record both the premium value of the institutions, measured by the excess of the liabilities assumed over the sum of the value of the assets plus the amount of assistance provided by the insurer, and the amount of assistance as assets on the books of the thrifts, boosting the capital of combined, or converting, institutions.¹⁶⁷

Even during this period, however, reports surfaced concerning the management difficulties that thrifts were encountering in exploiting the powers newly granted them by the 1982 legislation.¹⁶⁸ But the economy improved and interest rates declined during the 1982-84 period, and for the most part the difficulties of the institutions were off the front pages.¹⁶⁹

166. The Bank Board liberalized its rules governing conversions in March 1983, for the first time permitting a converting mutual institution to sell a controlling block of stock to a single purchaser. See Harry M. Zimmerman, Jr., et al., *Recent Bank Board Rules Promise Accelerated Pace of S&L Conversions*, AM. BANKER, July 11, 1983, at 4; see also Lisa J. McCue, *Isaac Urges Mutuals to Adopt Stock Ownership Form*, AM. BANKER, May 18, 1983, at 3; Thomas P. Vartanian & John D. Hawke Jr., *Conversions May Spur Thrift Industry Rebirth*, AM. BANKER, Apr. 14, 1983, at 4. Conversions had been a subject of controversy since regulations authorizing them had first been proposed in 1955. See LANGBEIN, *supra* note 58, § 3.32 (discussing controversy behind and reasons for conversions from mutual to stock form); JULIE L. WILLIAMS, SAVINGS INSTITUTIONS: MERGERS, ACQUISITIONS AND CONVERSIONS ¶ 7.01 (Supp. 1995). The difficulty with conversions concerns identifying who is "entitled" to the premium value of the institutions and also concerns the opportunity that conversions present for what is perceived as "insider abuse" — the concerns clearly stemming from ambiguity or uncertainty in prevailing legal, accounting, and economic conceptions regarding the "premium value" of entities generally. See *supra* notes 19-28 and accompanying text (discussing premium value). The difficulties have arisen anew in the last few years in relation to state programs authorizing mutual conversions. See Stanley I. Langbein, *Public Resentment Over State-Supervised Mutual Savings Bank Conversions Spurs OTS, FDIC Action, Congressional Inquiry, and Administrative Concern*, 1 BANK AND THRIFT ACQUISITION UPDATE 2 (June 1994); WILLIAMS, *supra*, ¶ 7.01(6).

167. See *infra* notes 248-52 and accompanying text (detailing advantages and disadvantages of various accounting approaches to acquisitions).

168. See John Drukker, *One Year After Garn-St Germain: An Assessment; Savings Institutions Got New Powers with that Act, but the Bulk Have Done Little with Them*, AM. BANKER, Nov. 14, 1983, at 21; Leonard Shane, *Sorry, but Savings Institutions are Not Banks, Despite Garn-St Germain*, AM. BANKER, Nov. 14, 1983, at 33.

169. In December 1983, the General Accounting Office reported that the industry would face new dangers if short-term interest rates rose above 11.5%. See Trigaux, *supra* note 165, at 3. In November 1983, the federal funds rate was between 9% and 9.5%. 69 FED. RES. BULL., Dec. 1983, at A26. The GAO had been directed by § 205 of the Garn-St Germain

In 1984, however, Continental Illinois Corporation, then the ninth largest banking institution in the nation, experienced difficulties that required intervention by the FDIC, which was extended in the form of open bank assistance.¹⁷⁰ The action led to criticism that the FDIC had adopted a "too big to fail" policy, a circumstance that led the FDIC, as well as the Bank Board and the Resolution Trust Corporation (RTC), to eschew open bank assistance in the future.¹⁷¹ The charge was that the "too big to fail" policy involved the deposit insurers in actions that benefited shareholders, uninsured depositors, and nondepositor creditors when the first may have borne some responsibility for the circumstances leading to the institution's failure, and the latter two lacked any expectation of protection under the deposit insurance laws.¹⁷² The criticism appears to have been the germ of the treatment that these parties would receive under FIRREA, which as elaborated below, bears provisions aimed at penalizing shareholders and takes extraordinary precaution against benefiting uninsured depositors and nondepositor creditors, even at the risk of punishing members of each category for doing nothing wrong.¹⁷³

In 1985, the problems of the thrift industry began their dramatic return to the limelight. The General Accounting Office (GAO), charged by Garn-St Germain with monitoring the net worth certificate program, audited the FSLIC's annual report, and the audits revealed that the collection of devices for deferring the payments of insurance — the net worth certificate program, FSLIC guarantees of Home Loan Bank advances, yield maintenance obligations, and the like — rendered determinations of the solvency or net position of the fund quite difficult.¹⁷⁴ A series of GAO reports from 1985 to 1988 repeatedly criticized the Bank Board initiatives in resolving institutions, from the net worth maintenance program to forbearance agreements, to the "man-

Act to report to Congress semiannually concerning the net worth certificate program. The GAO took this authority and went much further with it, issuing during the 1980s a series of reports warning Congress of the magnitude of the developing crisis. See *infra* notes 174-75 and accompanying text.

170. See Andrew Albert, *Regan Hints US Will Limit Thrift Backing: Says Financial Corporation Different from Continental*, AM. BANKER, Sept. 11, 1984, at 1.

171. See Lisa J. McCue, *FDIC Bailout Data Disputed by St Germain*, AM. BANKER, Oct. 5, 1984, at 1; Robert Trigaux, *Isaac Faces New Bailout Debate: Likely to Hear Ideas Urging Tougher Market Discipline*, AM. BANKER, Oct. 4, 1984, at 1.

172. See GENERAL ACCOUNTING OFFICE, DEPOSIT INSURANCE: SUMMARY OF ANALYSIS OF REFORM PROPOSALS 24-33 (1986).

173. See *infra* notes 237-43 and accompanying text.

174. See GENERAL ACCOUNTING OFFICE, EXAMINATION OF THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION'S FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 1984 AND 1983 (1985).

agement consignment" program adopted by the Board.¹⁷⁵ It was clear, however, that in this second phase of the crisis, it was not interest-spread difficulties that were at the heart of the crisis, but asset quality problems. The problems were particularly acute in Texas, where the collapse of oil prices in 1985 and 1986 led to a collapse in real estate prices, which led, in turn, to the souring of real estate loans held by the thrifts; similar problems occurred in other "oil patch" states, in Florida, and also in California. All of these states had amended their thrift chartering laws to extend to thrifts chartered under those laws a new range of powers even broader than those extended to federal thrifts by Garn-St Germain. In Texas, in particular, the real estate difficulties weakened the commercial banking industry as well as the thrift industry and led to a number of FDIC and FSLIC rescues.

By late 1985, the Chairman of the Bank Board was sounding warnings that the FSLIC was insolvent and in need of additional funding to resolve problem thrifts.¹⁷⁶ The Chair's fellow Board members publicly expressed reservations about the warnings, and the thrift industry officially, publicly, and persistently minimized the problems.¹⁷⁷ The industry's objective appears to have been to block congressional funding of the FSLIC and thereby deny the regulators the ability to cause the absorption of smaller institutions by larger ones or to cause the absorption of thrifts, whether large or small, by large banks.¹⁷⁸ Again, the role of the premium value of institutions is evident: The thrifts hoped to force the kind of outright taxpayer bailout they had sought in 1981 and 1982, rather than an extension of the practices under the regulators' bill, which transferred the enterprise value of the institutions (that even insolvent institutions had) into the hands of more consolidated entities.

By 1986, there was pressure for congressional action. For one thing, the provisions of the regulators' bill adopted in 1982 and the provisions

175. See generally GENERAL ACCOUNTING OFFICE, FAILED THRIFTS: NO COMPELLING EVIDENCE OF A NEED FOR THE FEDERAL ASSET DISPOSITION ASSOCIATION (1988); GENERAL ACCOUNTING OFFICE, THRIFT INDUSTRY: THE MANAGEMENT CONSIGNMENT PROGRAM (1987); GENERAL ACCOUNTING OFFICE, THRIFT INDUSTRY: FORBEARANCE FOR TROUBLED INSTITUTIONS 1982-1986 (1987); GENERAL ACCOUNTING OFFICE, THRIFT INDUSTRY: COST TO FSLIC OF DELAYING ACTION ON INSOLVENT SAVINGS INSTITUTIONS (1986); GENERAL ACCOUNTING OFFICE, THRIFT INDUSTRY: NET WORTH AND INCOME CAPITAL CERTIFICATES (1986).

176. See Nina Easton & Bartlett Naylor, *At Last, Relief is in Sight for the Nation's S&L Fund*, AM. BANKER, May 27, 1986, at 17.

177. See Nina Easton & Bartlett Naylor, *Thrift Group Attacks FSLIC Bailout: But US League Opposition to Treasury Plan Faces Uphill Battle*, AM. BANKER, Dec. 15, 1986, at 2; Robert M. Garsson, *Shaky S&Ls May Stay Open to Keep Fund Afloat*, AM. BANKER, Sept. 15, 1986, at 10.

178. See Easton & Naylor, *supra* note 177, at 2.

authorizing the net worth certificate program were expiring; there would be a series of congressional extensions of the provisions before legislation finally was passed in mid-1987.¹⁷⁹ The Reagan administration remained largely aloof from the crisis, as it did from most banking issues throughout its term, but in early 1986 a new Undersecretary of the Treasury developed a proposal for infusing \$15 billion into the FSLIC by a combination of increased premiums imposed upon the thrifts, purchases of FSLIC obligations by the Federal Home Loan Banks, and principally, by the formation of a financing corporation that would issue obligations that it then would use to purchase zero coupon obligations of the FSLIC.¹⁸⁰ The advantage of these devices was that they did not reflect any expenditure in the federal budget on behalf of the thrifts and thus did not aggravate the ongoing political conflict about the budget deficit. Although an official of the Congressional Budget Office initially objected that the plan should not be accounted for off-budget, the Administration prevailed on the point, and it was agreed that the debt represented by the bonds would not be a budget item.¹⁸¹

By this time (mid-1986), however, other legislative matters were troubling the banking industry and the members of Congress concerned with it. The industry had been pressing for several years for expanded powers, particularly the power to enter the securities business, which the industry was restricted from doing by the Glass-Steagall Act, a portion of the Banking Act of 1933.¹⁸² Securities powers were of special concern to the large money center banking institutions. Since the early 1980s, nonbanking enterprises had been developing institutions known as "nonbank banks," which exploited the definition of the term "bank" in the Bank Holding Company Act (BHCA). Under the BHCA, in order to be considered a bank, a company had to be engaged in both taking deposits and making commercial loans.¹⁸³ The nonbank banks refrained from one or the other of these activities, and thus their affiliated holding companies escaped the limitations on nonbanking activities imposed by the BHCA on bank holding companies.¹⁸⁴

179. See Garsson, *supra* note 177, at 10.

180. See Easton & Naylor, *supra* note 176, at 17.

181. See Nina Easton & Bartlett Naylor, *Plan to Recapitalize FSLIC Hits Snags: Effect on Federal Budget Disputed; Industry Opinion Shifting*, AM. BANKER, July 14, 1986, at 9; Bartlett Naylor & Nina Easton, *Congressional Budget Expert Rejects Treasury FSLIC Plea*, AM. BANKER, July 9, 1986, at 1.

182. The Glass-Steagall Act encompasses §§ 16, 20, 21, and 32 of the 1933 Act. These provisions are now codified at 12 U.S.C. §§ 24, 377, 378a, 78 (1994).

183. See 12 U.S.C. § 1841(c) (1982).

184. See generally JONATHAN R. MACEY & GEOFFREY P. MILLER, *BANKING LAW AND REGULATION* 300-01 (1993).

The Board resisted the practice and sought to exercise jurisdiction over the nonbank banks, while the Comptroller of the Currency approved the practice. Eventually, the Board's regulatory effort was defeated by decision of the Supreme Court.¹⁸⁵ The larger banks were ambivalent about the nonbank bank device; they did not welcome competition from larger industrial concerns, but at the same time, the device represented a way of expanding bank affiliations with nonbanking concerns.¹⁸⁶ One bank even stated that it was considering severing its lending and deposit-taking businesses into nonbank banks and then diversifying through its holding company.¹⁸⁷

Notwithstanding the commercial banks' position, however, Congress did not respond, and the Administration remained aloof.¹⁸⁸ By early 1986, however, the regulatory agencies, led by the Board, undertook a number of initiatives to reinterpret the Glass-Steagall Act and afford expanded opportunities for banks to enter the securities business. In addition, the Board sought legislation curtailing the nonbank bank practice.¹⁸⁹ When the Administration's 1986 proposal for helping the thrift industry was put forth, it quickly became embroiled in the debate over expanded banking powers and nonbank banks.¹⁹⁰ The Chairman of the Senate Banking Committee, the Administration's principal congressional ally on banking matters, sought to tie the thrift assistance to legislation expanding commercial bank powers and legislation conditioning the continuation of nonbank banks on the nonbank

185. See *Board of Governors of Fed. Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361 (1986).

186. See Robert M. Garsson, *100th Congress Preps for Financial Service Struggle: FSLIC Aid Still Dominates Hill Agenda, While Industry's Divisions Remain Keen*, AM. BANKER, Jan. 5, 1987, at 8. The smaller, community or independent banks, however, were emphatically and unequivocally opposed to the nonbank bank practice. *Id.* The banking industry also was divided over expanded powers, including particularly the repeal of the restrictions on bank investment banking activity imposed by the Glass-Steagall Act, which the independent bankers persistently opposed. See Philip T. Sudo, *Small Banks Add to Chorus Against Glass-Steagall*, AM. BANKER, Mar. 2, 1987, at 9. The divisions consistently placed the American Bankers Association, the principal trade association of commercial bankers, in an awkward position because its membership includes both money center and independent banks. See Robert M. Garsson & Jed Horowitz, *Lobbyists Seek United Front on Bank Powers*, AM. BANKER, Mar. 13, 1987, at 1.

187. See Robert Trigaux, *Butcher Says Chase May Not Remain a Bank at All*, AM. BANKER, Feb. 23, 1987, at 2.

188. See Bartlett Naylor, *House Banking Panel Members Express Chagrin Over Inaction*, AM. BANKER, Jan. 3, 1986, at 1; *Regulatory Confusion Is Fault of Reagan, Says Head of SunTrust Banks*, AM. BANKER, Mar. 25, 1987, at 6.

189. See Robert M. Garsson, *Volcker Backs Efforts to Close Nonbank-Bank Loophole*, AM. BANKER, Feb. 23, 1987, at 19.

190. See *supra* notes 182-87 and accompanying text.

banks' acquiring troubled thrifts, thereby contributing to the resolution of the crisis (again, a proposal for enlisting the premium value of existing institutions in the rescue process).¹⁹¹ But in the 1986 session of Congress, the thrift industry, aided principally by House Democrats, notably the Speaker of the House himself, succeeded in derailing the financing plan it opposed.¹⁹² As finally presented to the Congress in October, the proposal involved only the financing plan and the extension of the regulators' bills.¹⁹³ Even as pared down, the legislation died with the expiration of the 99th Congress.

When the 100th Congress returned in early 1987, both Houses were under Democratic control, and the Administration was preoccupied with the Iran-contra arms scandal. The Senate Banking Committee quickly took up the FSLIC recapitalization plan along with a comprehensive bill that, in its original form, included an effort to secure expanded banking powers.¹⁹⁴ The expansion was endorsed by the new Chairman of the Senate Banking Committee.¹⁹⁵ The Chairman, however, was a noted ally of the independent bankers, who were ambivalent about expanded powers because of their tendency to strengthen the larger institutions at the expense of the smaller ones. The result, by March, was a bill that not only did not expand banking powers, but one that included a one-year moratorium on the grant by regulators of any additional securities, insurance, or real estate powers.¹⁹⁶ The bill also abolished nonbank banks and reduced the amount of the recapitalization proposed to \$7.5 billion from the \$15 billion originally proposed.¹⁹⁷ The commercial banking industry responded angrily and opposed the bill.¹⁹⁸ The

191. See Robert Trigaux & Bartlett Naylor, *Garn Bill Promises Soul-Searching Debate*, AM. BANKER, June 26, 1986, at 3.

192. See Bartlett Naylor, *In 1987, Congress Faces Renewed Legislative Push: Despite Capitol Hill Inertia, Pressure for Financial Services Laws May Spur Passage*, AM. BANKER, Oct. 27, 1986, at 17.

193. See Bartlett Naylor, *Treasury Sets Backup Plan to Fund FSLIC: Recapitalization Option Ready in Case Bill Fails*, AM. BANKER, Oct. 16, 1986, at 1:

194. See Jay Rosenstein, *ABA Leaders Endorse Limited Expansion of Bank Powers*, AM. BANKER, Feb. 13, 1987, at 11. The bill involved a limited expansion of bank powers, supported by the larger commercial banking institutions but generally opposed by the smaller banks, and a ban on nonbank banks, which the smaller banks sought, but as to which the money center commercial banks were ambivalent. See *supra* note 186 and accompanying discussion.

195. See Rosenstein, *supra* note 194, at 11.

196. See Robert M. Garsson, *House Panel Begins Action on FSLIC Recap; Banks Sharply Divided on Senate-Passed Bill*, AM. BANKER, Mar. 31, 1987, at 1.

197. See *id.*

198. See Robert M. Garsson, *ABA Support of Proxmire Bill in Doubt as Panel Vote Nears*, AM. BANKER, Mar. 2, 1987, at 1; Jay Rosenstein, *Briefing: Proxmire's Promises are*

Reagan administration, provoked by the "reregulatory" features of the bill, threatened to veto the legislation.¹⁹⁹ The measure nonetheless moved through the House, which reduced the recapitalization amount to \$5 billion (reflecting the influence of a thrift industry still bent on forcing a bailout of existing institutions).²⁰⁰ It passed with a recapitalization figure of \$8.5 billion,²⁰¹ as well as the nonbank bank ban and the moratorium on new powers. Almost everyone at the time knew the amount authorized would be inadequate.²⁰²

Fading, AM. BANKER, Mar. 2, 1987, at 10; Philip T. Sudo, *Bankers See Freeze as Delaying the Inevitable*, AM. BANKER, Mar. 12, 1987, at 15. The result in the Senate Banking Committee — a moratorium of new powers, a failure to enact new powers, and a ban on nonbank banks — involved action uniformly in keeping with the objectives of the independent banks. See *supra* note 186 and accompanying discussion.

199. See *Reagan Threatens to Veto Bill with 'Unacceptable' Provisions*, AM. BANKER, Mar. 26, 1987, at 1. Although the Administration was never crystal clear on what its objections to the bill were, it appears that both the moratorium and the nonbank bank prohibition offended its conception of "deregulation" — which to it meant the elimination of legal proscriptions on the activities of institutions. The Administration repeated the veto threat throughout the summer, even after differences between the House and Senate versions had been ironed out in conference. See Robert M. Garsson, *Can the Banking Bill Survive Threatened Presidential Veto?*, AM. BANKER, July 20, 1987, at 5 (stating that "[t]he thought of the President of the United States going on television to talk to the American people about nonbank banks seemed too comical to take seriously"); Jim McTague, *Briefing: Hands-On Reagan Readies a Veto*, AM. BANKER, July 27, 1987, at 10 (reporting that "[p]eople at the White House and the Treasury say President Reagan is fully aware that he is going to veto the banking bill. The commander-in-chief, they claim, also knows why. . . . This is a new, hands-on, tuned-in Ronald Reagan emerging in chats with staffers at the Treasury and the White House").

200. See Robert M. Garsson, *Veto Avoided, Banking Bill Nears Passage; US League Acquiesces on Compromise Measure*, AM. BANKER, Jan. 31, 1987, at 1.

201. The 1987 legislation had created the Financing Corporation (FICO), a mixed government corporation whose stock was owned by the Federal Home Loan Banks, and which was managed by a directorate comprised of the Director of the Office of Finance of the Bank Board and two presidents of home loan banks appointed by the Bank Board. See 12 U.S.C. § 1441(b)(1) (1988) (amended 1989). Stock subscriptions of up to \$3 billion were to be made, with the first \$1 billion allocated according to a table set forth in the statute, and the remainder allocated in accordance with the aggregate assets of the institution members of the banks in question. This allocation method meant a disproportionate contribution was made by the banks in areas with large thrifts, which meant primarily California: The San Francisco bank was required to acquire almost 20% of the stock; the Atlanta bank over 14%; while the Boston bank's share was under 2% and the Pittsburgh bank's just over 4%. *Id.* § 1441(d)(4) (amended 1989, 1991). The Financing Corporation was authorized to borrow up to \$10.825 billion, but was limited to borrowing \$3.75 billion per year, and additional borrowing after the second year required congressional approval. *Id.* § 1441(e)(1), (e)(2) (amended 1989, 1991, 1992). A supplemental assessment was imposed on thrifts to fund expenses and interest on the FICO obligations. *Id.* § 1441(f)(1)-(2) (amended 1989).

202. One motivation for a veto was to procure a "clean" recapitalization bill with the original \$15 billion authorized and without the powers-limiting features of the bill. The \$15

Nevertheless, the President signed the bill.²⁰³

The period between the enactment of the Competitive Equality Banking Act of 1987 and the beginning of 1989 was the time when public attention to the thrift crisis became intense. The failures reported through 1988, mostly in Texas, were of ever increasing size; assistance amounts began to exceed \$1 billion each and did so with some regularity.²⁰⁴ A new Bank Board Chairman, who had been a key Republican Senate staffer during the 1980-1986 period of Republican control of the Senate, assumed office and, unlike his predecessor, persistently downplayed the magnitude of the problem (though like his predecessor he watched fellow Board members publicly disagree with him, but this time in the opposite direction).²⁰⁵ Graphic reports of insider abuse, use of institution funds to purchase yachts, paintings, furnishings, Oriental rugs, or to finance wildcat oil schemes became commonplace.²⁰⁶ Public

billion was known to be inadequate. The thrift industry had fought the recapitalization plan consistently, securing reductions in the amount authorized in the House version of the bill below the \$10 billion authorized by the Senate.

203. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 (codified as amended in scattered sections of 12 U.S.C.).

204. By August 1988, estimates were that the Texas thrift industry had plunged into a collective insolvency that to that date had cost the FSLIC \$12 billion. On August 18, 1988, the Bank Board announced a \$1.3 billion bailout of twelve Texas thrifts that were acquired by LSST Financial Services Corp. The following day, the Bank Board announced a combination of eight Texas thrifts with \$2.4 billion in assistance, which were combined in a single thrift in a "revisal" of the deposit insurers' "Phoenix" program of the early 1980s. See Steve Klinkerman, *Bailouts Mark End of High-Flying S&Ls: Regulator to Pump \$2.4 Billion into Latest Texas Rescue*, AM. BANKER, Aug. 22, 1988, at 1; *supra* note 97 and accompanying discussion. The closing of Lincoln Savings and Loan — the institution whose insolvency led to the resignation of Speaker Wright, the investigation of five senators who came to be known as the "Keating five" after Lincoln's CEO, the ultimate resignation of M. Danny Wall as Chairman of the Office of Thrift Supervision, and the imposition of fines against and suspension of partners of the thereto distinguished New York law firm Kaye Scholer Fierman Hays & Handler — involved an estimated amount of \$2.5 billion. See Jim McTague & Barbara A. Rehm, *Closing Lincoln Could Cost US \$2.5 Billion: Transfer of S&L's Assets By Owner Under Scrutiny*, AM. BANKER, Apr. 24, 1989, at 1.

205. See Jim McTague, *Wall's Estimate of S&L Bailout Will Rise Again: Bank Board Colleagues Disagree on Price Tag*, AM. BANKER, Sept. 13, 1988, at 1; Jim McTague, *Wall Says Thrift Rescue to Cost \$8 Billion More*, AM. BANKER, July 11, 1988, at 7; Jim McTague, *Wall Ups Estimate by \$20 Billion for Rescue of Insolvent Thrifts*, AM. BANKER, July 8, 1988, at 1; Jim McTague & Barbara A. Rehm, *Wall Disputing Estimates on FSLIC Bailout*, AM. BANKER, Nov. 15, 1988, at 1; Robert Trigaux & Jim McTague, *Bank Board Chief Is Up Against the Credibility Wall*, AM. BANKER, July 11, 1988, at 3.

206. See H. Erich Heinemann, *Pious Phrases Aside, Cause of S&L Crisis Was Fraud, Greed, and Mismanagement*, AM. BANKER, Sept. 26, 1988, at 4; Lynn Homa, *Maxwell Slams Thrifts*, AM. BANKER, Oct. 26, 1988, at 3.

estimates of the eventual cost of a rescue climbed steadily each month.²⁰⁷ An insolvent FSLIC resolved institutions with a variety of devices that would demand capital in the future — net worth maintenance agreements, yield maintenance agreements, and capital asset guarantees — which made estimates of the amount of the FSLIC's insolvency or of the magnitude of the demands that the crisis would make critically difficult. A series of transactions spectacularly favorable to acquirers who were exploiting the tax incentives that had been adopted in 1981, but were expiring in 1988, excited public charges of regulatory favoritism or regulatory "giveaways."²⁰⁸

With a pending Presidential election, however, there was virtually no action in Congress. Both parties shied away from the issue, principally out of fear of "blame" for the crisis.²⁰⁹ The Republican President had proposed and supported the expansion of thrift powers that had so visibly backfired.²¹⁰ The budget deficit was a political problem for the President; it had led to deferring action on the thrift crisis, and the deferral had undoubtedly exacerbated the problem. The Democrats had controlled Congress; their fingerprints were visible on the largely successful effort by the thrift industry to delay a bailout and understate the problem — an effort that in the end also would backfire badly. Moreover, the charges of impropriety included charges that certain members of Congress had intervened improperly con-

207. See *Brookings Fellow Places S&L Bailout at \$58 Billion*, AM. BANKER, Sept. 29, 1988, at 12; Robert M. Garsson, *Proxmire Now Backs S&L Bailout: Urges \$20 Billion from US, \$30 Billion from Thrifts*, AM. BANKER, Sept. 22, 1988, at 1; Jim McTague, *FSLIC and Fiscal Gymnastics: Or, How to Account for a \$100 Billion Bailout*, AM. BANKER, Dec. 30, 1988, at 1; Jim McTague, *GAO: \$50 Billion May Be Needed to Bail Out Thrifts*, AM. BANKER, Sept. 19, 1988, at 5; Jim McTague, *Martin Puts S&L Bailout at \$45 Billion — Minimum*, AM. BANKER, Sept. 20, 1988, at 3; Jim McTague, *Wall's Estimate of S&L Bailout Will Rise Again: Bank Board Colleagues Disagree on Price Tag*, AM. BANKER, Sept. 13, 1988, at 1; Jim McTague, *Wall Says Thrift Rescue to Cost \$8 Billion More*, AM. BANKER, July 11, 1988, at 7; Jim McTague, *Wall Ups Estimate by \$20 Billion for Rescue of Insolvent Thrifts*, AM. BANKER, July 8, 1988, at 1; Barbara A. Rehm, *ABA Proposes Federal Bailout for Sick Thrifts: Calls Crisis Top Priority; \$74 Billion Price Tag Seen*, AM. BANKER, Sept. 21, 1988, at 1.

208. See generally GENERAL ACCOUNTING OFFICE, FAILED THRIFTS: BANK BOARD'S 1988 TEXAS RESOLUTIONS (1989).

209. The Democratic Presidential candidate spoke of the issue only once, in early October 1988, implying that the incumbent President was partly to blame for the crisis because of the role played by the expansion of thrift powers in bringing about the difficulty and the role of the Vice President as head of an interagency task force that in 1984 made recommendations concerning the future of the industry. See *Dukakis Says Bush Is Partly to Blame for Thrift Crisis*, AM. BANKER, Oct. 3, 1988, at 5.

210. See *Deregulation Started Thrifts Snowballing Downhill*, AM. BANKER, Dec. 30, 1988, at 6.

cerning regulatory actions against individual thrifts; most (though by no means all) of those charges were against Democratic members.²¹¹

But with the election of a new President, the repeated delay of action came to an abrupt halt. With the election behind, the new Administration and the new Congress became suddenly anxious to resolve the crisis as quickly as possible, so that the issue would be shuttled from public view as soon before the *next* election as possible. Within three weeks of taking office, the Bush administration announced its proposal for handling the thrift crisis.²¹² That complex and massive proposal would become FIRREA. The proposal was implemented in part almost as soon as it was announced. Before enactment, the regulatory restructuring proposal and the transfer of the function of administering thrift deposit insurance to the FDIC (while abolishing the FSLIC) were accomplished.²¹³ New receiverships and conservatorships of thrifts were frozen during legislative consideration of the measure.²¹⁴ The measure, however, moved quickly and efficiently through Congress with little change. The two houses of Congress passed bills in June, and the Conference Committee resolved problems in early August.²¹⁵ The President signed the bill on August 9, 1989, just before the moratorium on thrift exits from the thrift to the bank insurance fund was about to expire.²¹⁶

In fact, during the course of its consideration, the legislation engendered little controversy. The two most difficult issues in the legislation concerned whether to place the entire bailout on budget and whether to impose new, toughened, bank-like capital standards on thrifts that had been allowed to use regulatory accounting practices in connection with acquisitions or conversions effected under Bank Board supervision. The principal funding mechanism of the bill involved the issuance of obligations by the newly formed

211. On the role, for example, of Jim Wright, the Speaker of the House, who had been instrumental in blocking congressional approval of the legislation to fund the Financing Corporation in 1986, see *Ethics Report: How Wright Tried to Get Regulator Fired*, AM. BANKER, Apr. 29, 1989, at 16; Marla Dickerson, *Lawmakers Accept a Measure of Blame for S&L Crisis*, AM. BANKER, Apr. 26, 1989, at 13.

212. See *President's Plan to Restructure Regulation of Thrifts*, AM. BANKER, Feb. 8, 1989, at 4.

213. See Jim McTague, *FDIC Takes Control of 222 S&Ls: Agency Begins Merger with FSLIC; Southwest Plan Halted*, AM. BANKER, Feb. 8, 1989, at 1.

214. See *id.*

215. See Robert M. Garsson, *Bush Threatens Veto on S&L Bill in Budget Fight*, AM. BANKER, Aug. 4, 1989, at 1.

216. See Robert M. Garsson, *President's Pen Ends Era of Deregulation for Thrift Industry*, AM. BANKER, Aug. 10, 1989, at 1.

Resolution Funding Corporation (Refcorp), which in turn, was to lend the proceeds to the Resolution Trust Corporation — the agency formed to handle thrifts going into insolvency in the years following FIRREA's adoption.²¹⁷ The House bill would have placed the amounts of the obligations on budget, which obviously would have compounded the Administration's political difficulties with the "structural" budget deficit.²¹⁸ The Conference Committee, however, followed the Senate version by leaving the bonds off budget.²¹⁹ In the final stages of the House's consideration of the bill, the thrift industry made a major push to amend provisions that would have abrogated undertakings by the Bank Board that permitted the use of regulatory capital standards.²²⁰ Amendments protecting the thrifts were defeated on the House floor by substantial votes.²²¹

Although it is very long and textually intricate, FIRREA, as one of the seven major banking enactments of the last seventeen years, has the simplest evolutionary history and, in terms of the political and interest group competition that produced it, is relatively simple. The most important objective of the enactment was to fund the bailout. It did this by creating a new financing entity, Refcorp, which operated in a manner similar to that of the Financing Corporation established by the 1987 legislation.²²² Refcorp's funding, however, was much greater than the Financing Corporation's (\$50 billion initially, which was enhanced by the 1991 FDICIA legislation),²²³ and provision was made for ultimate use of taxpayer funds in connection with the rescue.²²⁴

217. See Garsson, *supra* note 215, at 1.

218. See *supra* note 69 and accompanying text (discussing structural budget deficit).

219. See Garsson, *supra* note 215, at 1.

220. See Robert M. Garsson, *House Affirms Tough S&L Capital Rules: Industry Fails to Sway Vote on Protection of Goodwill*, AM. BANKER, June 16, 1989, at 1 [hereinafter Garsson, *House Affirms*]; Robert M. Garsson, *Tough S&L Rule on Core Capital Likely to Stick: House Panel's Measure Expected to Be Enacted*, AM. BANKER, May 4, 1989, at 1. These efforts are discussed in a number of the courts of appeals decisions considering the capital standards issue. See *infra* notes 285-311 and accompanying text.

221. See Garsson, *House Affirms*, *supra* note 220, at 1.

222. 12 U.S.C. § 1441(b) (Supp. I 1989) (amended 1991, 1992); see *supra* note 201 and accompanying text (discussing Financing Corporation).

223. See Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, Pub. L. No. 102-233, § 101, 105 Stat. 1761; see also *infra* note 224 and accompanying discussion (describing RTC and Refcorp).

224. The original amount of \$50 billion was comprised of \$18.8 billion raised in a Treasury bond offering and transferred to the Resolution Trust Corporation (RTC) and \$31.2 billion transferred to the RTC by the Resolution Funding Corporation (Refcorp). See 12 U.S.C. §§ 1441a(b)(14)(A), 1441b(e)(8), b(f)(1) (Supp. I 1989) (amended 1991, 1992).

Refcorp, like the 1987 Act's Financing Corporation, is a mixed ownership government corporation with a directorate comprised of the director of the Bank Board's Office of Finance and two FHLB presidents. *Id.* § 1441b(c)(1). It, however, is subject to direction by the Oversight Board, which originally consisted of the Secretaries of the Treasury and Housing and Urban Development, the Chairman of the Board of Governors of the Federal Reserve, and two other members appointed by the President. *Id.* § 1441a(a)(1)-(2) (amended 1991, 1992). The Oversight Board's composition was crafted carefully so that there were two Executive Branch officials, balanced by two nominees especially named for the purpose (and who thus were not Executive Branch officials), plus the independent Fed Chairman. This left ambiguous the extent to which control over the bailout was vested in the "executive" or was an "independent agency" type arrangement under greater congressional control.

Refcorp was to raise the \$31.2 billion through stock subscriptions by the FHLBs of \$1.2 billion and a debt offering of \$30 billion. *Id.* § 1441b(e)(8), b(f)(1). The \$30 billion was to be used to purchase "capital certificates" of the RTC. *Id.* § 1441b(f)(1). Refcorp then was required to establish a Funding Corporation Principal Fund (FCPF) in the amount of the discounted present value of the face amount of Refcorp's obligation, to be invested in zero coupon Treasury obligations to finance repayment of principal on the Refcorp obligations. *Id.* § 1441b(g)(2). Interest on the Refcorp obligations was to be funded first by any assets of Refcorp outside the FCPF, second by distributions from the RTC of excess funds collected in the process of the receiverships, third from contributions from the FHLBs of not more than \$300 million annually, and finally, by contributions from the Treasury. *Id.* § 1441b(f)(2) (amended 1992).

The RTC itself in its original form was a mixed ownership government corporation and agency that was subject to supervision by the Oversight Board. *Id.* § 1441a(a), (b)(1)(B) (amended 1991, 1992). Under FIRREA as originally enacted, the FDIC served as the "manager" of the RTC, which meant that as a practical matter it acted for the RTC. The Oversight Board was empowered to "replace" the FDIC as the RTC manager for specified causes. *Id.* § 1441a(b)(1)(C) (amended 1991). The RTC was vested with jurisdiction over thrifts entering receivership or conservatorship in the three years following the date of enactment of FIRREA (August 9, 1989 to August 8, 1992). *Id.* § 1441a(b)(3)(A) (amended 1991, 1992, 1993).

The Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, Pub. L. No. 102-233, § 101, 105 Stat. 1761, provided an additional \$25 billion in Treasury funding for the RTC, through April 1, 1992. *See* 12 U.S.C. § 1441a(i)(1)(3) (Supp. II 1991). The amount was increased to the limit of the RTC's needs by the Resolution Trust Corporation Completion Act of December 17, 1993, Pub. L. No. 103-204, § 2, 107 Stat. 2369, 2370-71. The 1991 statute also extended the jurisdiction of the RTC to receiverships or conservatorships commenced through October 1, 1993. 12 U.S.C. § 1441a(b)(3)(A)(ii) (Supp. III 1991) (amended 1993). The 1993 law extended the period to a date between January 1 and July 1, 1995, as determined by the Oversight Board. The Board in fact determined the date to be April 1, 1995, which was the date on which RTC receiverships and conservatorships ended. *Id.* § 1441a(b)(3)(A)(ii) (Supp. V 1993). The statute also created a chief executive officer of the RTC, appointed by the President and subject to Senate confirmation. *Id.* § 1441a(b)(8)(C) (Supp. V 1993). Additionally, the statute eliminated the FDIC's role as the "manager" of the RTC, thus constituting the RTC as an agency separate from the FDIC, though its powers and duties as receiver or conservator continued to be governed by the same provisions of the FDIA as govern the FDIC. *See* Resolution Trust Corporation

In connection with funding the rescue with borrowings and taxpayer funds, the legislation contemplated two other sources of funds: deposit insurance premiums from healthy thrifts and the insolvency estates of the insured thrifts. The statute increased the premiums paid by thrifts so that there was a substantial difference between bank and thrift premiums.²²⁵ It imposed exit fees on institutions leaving the thrift fund and entrance fees on institutions entering the bank fund. It also placed a moratorium on transactions by which an institution converted from thrift form to bank form.²²⁶

Refinancing, Restructuring, and Improvement Act of 1991, Pub. L. No. 102-233, § 310, 105 Stat. 1761, 1769 (repealing 12 U.S.C. § 1441a(b)(8)). Management of the RTC was vested in the chief executive officer and the Oversight Board, which was renamed the Thrift Depositor Protection Oversight Board, and reconstituted by expanding its membership from five to seven persons, taking the HUD Secretary off the Board and placing on the Board the Director of OTS, the Chair of the FDIC, and the RTC chief executive officer. This left the Oversight Board with mixed executive and independent agency status, with a board comprised of two executive officers (the Treasury Secretary and OTS Director), two independent agency heads (the FDIC Chair and Board of Governors Chair), and three specially appointed officers. 12 U.S.C. § 1441a(a)(1)-(3), (b)(8)(C)-(D) (Supp. V 1993).

In addition, FIRREA expanded the membership of the FDIC. Prior to FIRREA, the FDIC had a three-member board, comprised of the Comptroller and two Presidential appointees confirmed by the Senate, one of whom was Chair. When it placed thrifts in the SAIF under FDIC control, Congress made the OTS Director a member of the FDIC Board, which it expanded to five members to ensure that the special Presidential appointees remained a majority. With the expansion to five members, however, it became possible for the Senate to put the corporation in a position where the two Executive Branch officers could constitute a majority for a period of time by acting with glacial slowness in confirming the appointments to the full-time directorship positions. The Senate wasted little time in availing itself of this opportunity.

225. The premiums for BIF members were set at 0.0833% of the deposit base for 1989, rising to 0.12% for 1990, and 0.15% for 1991. For SAIF members, the fees were set at 0.208% until December 31, 1989, rising to 0.23% for 1991 through 1993, falling to 0.18% from 1994 through 1997, and through 0.15% thereafter. 12 U.S.C. § 1817(b)(1)(C)-(D) (Supp. I 1989) (amended 1990, 1991). FDICIA created authority on the part of the FDIC to reduce assessment rates for BIF members if BIF reserves exceeded the designated reserve ratio. 12 U.S.C. § 1817(b)(1)(C) (1994).

226. The statute imposed a five-year moratorium on "conversion transactions," generally defined as transactions by which a BIF member became an organized insured by the SAIF or a SAIF member became an organization that would be insured by the BIF (e.g., a conversion of a federal savings bank into a state savings bank or the conversion of an S&L into a bank). 12 U.S.C. § 1815(d)(2) (Supp. I 1989) (amended 1993). The moratorium was subject to an exception for mergers of institutions that were commonly controlled; these were permitted, even when involving a SAIF member and a BIF member, provided that a portion of the resulting institution's deposit, the "adjusted attributable deposit amount" (AADA) remained subject to SAIF premiums. These were so-called "Oakar banks," named for the provisions of the "Oakar amendment" that authorized them, named in turn for Rep. Mary Oakar of Ohio, the sponsor of the amendment. The amendment was adopted during the conference

The statute also effected a regulatory reorganization of the banking agencies by abolishing the Bank Board and FSLIC,²²⁷ which had come under intense criticism for their handling of the crisis. It transferred the deposit insurance functions of the Bank Board to the FDIC and transferred the chartering and holding company regulatory functions to a newly created agency in the Treasury — the Office of Thrift Supervision (OTS).²²⁸ To manage the resolution of the thrifts then in difficulties, the legislation created the RTC, which was to be administered by an Oversight Board that included officials of both independent agencies and the executive branch, and whose day-to-day administration would be executed by the FDIC (with its legal authority coming from the FDIA).²²⁹

The statute overhauled the federal thrift chartering law and amended the deposit insurance laws in ways that imposed restrictions on state thrift chartering laws. The principal thrust of this effort was the enactment of provisions restricting thrift powers. FIRREA amended the provisions of the Home Owners Loan Act of 1932 to cut back on the 1982 extensions.²³⁰ It included provisions restricting the power of state chartered thrifts to hold

committee consideration of the legislation during July 1989 and was supported heavily by the commercial banking industry (and opposed by the thrift industry). FDICIA lifted the conversion moratorium generally, subject to a requirement based on the Oakar amendment, that the AADA portion of deposits remain subject to premiums to the fund by which the acquired institution was insured before the transaction. 12 U.S.C. § 1815(d)(3) (Supp. III 1991) (amended 1992, 1994).

227. See Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 401, 101 Stat. 183, 354-57. As noted above, the existence of the Bank Board and FSLIC effectively were ended as of the date the Administration proposed the legislation. On that date, the FDIC assumed responsibility for the receiverships and conservatorships under FSLIC control at that time. Functions of the Bank Board were transferred to the Treasury at the time, in what would become the OTS. The transfer of functions was hailed as a victory by elements of the commercial banking industry, particularly the independent bankers, who, at the time of the proposal of FIRREA, predicted that the transfer would meet with severe opposition from the thrift industry. This opposition was not forthcoming.

228. *Id.* § 402, 101 Stat. 183, 357-60.

229. See *supra* note 224 and accompanying discussion.

230. FIRREA restricted federal thrift nonresidential real estate loans to 400% of capital, subject to discretionary variation by the OTS; consumer loans and investments in corporate debt and commercial paper to 30% of assets; and investments in personalty (leases) and commercial loans to 10% of assets. 12 U.S.C. § 1464(C)(2)(B)-(D) (Supp. I 1989) (amended 1991, 1992). These were down from 40% of assets under the 1982 Act (down, unless an institution's capital exceeded 10% of assets, which would rarely be the case) from unlimited investment in corporate debt and commercial paper plus 20% of assets in consumer loans and from 10% of assets *each* in personal property leases and commercial loans. See *supra* notes 165-66 and accompanying text.

junk bonds, equity investment in real estate, or to collect brokered deposits.²³¹ Most significantly, it imposed a "qualified thrift lender" test (QTL) on thrifts, which required that, to continue as thrifts, they hold seventy percent of their assets as residential real estate loans or securities backed by such loans.²³² Failure to do so relegated the thrift to the powers of a national bank.²³³ One-thrift holding companies, which always have been permitted to engage in any industrial activity, were to be subject to BHCA restrictions if their thrifts were not QTLs, *unless* the thrifts had been acquired in an assisted transaction effected under the provisions of the regulators' bill.²³⁴ Indeed, a thrift holding company, all of whose thrifts had been acquired in such transactions, was freed of else-imposed restrictions on nonbanking (nonthrifting) activities.²³⁵ Finally, and perhaps most significantly for the litigation that the statute generated, the statute imposed capital standards upon thrifts identical to those imposed on banks, together with a new tangible capital standard specially applicable to thrifts.²³⁶ The new capital standard abrogated the forbearance agreements that had been agreed to throughout the 1980s by the Bank Board in structuring combinations of smaller thrifts with larger ones, and the new standard also set in motion the saga detailed below.

Additionally, the statute overhauled the deposit insurance law, which became a single law applicable to both banks and thrifts. The deposit insurance law constitutes, in part, a comprehensive special bankruptcy law applicable to financial institutions. The overhaul of the deposit insurance laws included most of the provisions, noted at the outset, that burden parties who are relative strangers to the crisis (nondepositor creditors, uninsured depositors, holding companies or other shareholders, lessors, lessees, and other parties engaged in transactions with the institutions), and which have generated litigation following the pattern suggested at the outset.²³⁷ FIRREA expanded the circumstances in which the federal chartering agency could place an institution in receivership or conservatorship;²³⁸ established a claims

231. 12 U.S.C. §§ 1831e, 1831f (Supp. I 1989) (amended 1991, 1994).

232. *Id.* § 1467a(m)(1) (Supp. I 1989) (amended 1991, 1992).

233. *Id.* § 1467a(m)(3)(A) (Supp. I 1989) (amended 1991, 1992). The restrictions on thrift investments, and particularly the restrictive QTL test, were heavily supported by the commercial banking industry and opposed by the thrift industry.

234. *Id.* § 1467a(c)(3) (Supp. I 1989).

235. *Id.* § 1467a(m)(3)(B) (Supp. I 1989).

236. *Id.* § 1464(t) (amended 1991, 1992). See *infra* notes 263-67 and accompanying text.

237. See *supra* notes 15-18 and accompanying text.

238. 12 U.S.C. § 1821(c)(4)-(5) (amended 1991, 1992, 1994). See LANGBEIN, *supra*

procedure for processing claims, the provisions governing which are highly ambiguous;²³⁹ expanded the rights of the deposit insurer as receiver against lessors of the institution or the institution's lessees, as well as other parties dealing with the institution;²⁴⁰ provided a minimum gross negligence standard in suits against the officers and directors of an insured depository institution;²⁴¹ and revised and strengthened the statutory "side agreement" rule.²⁴² With respect to uninsured creditors of the institution, in connection with P&A transactions, the statute provided that no such creditor was entitled to more than it would receive if the institution were liquidated.²⁴³

Finally, the statute provided for the acquisition of healthy thrifts by bank holding companies. Under the BHCA, there had been a long-standing question concerning whether the acquisition of a thrift by a bank holding company (BHC) was permissible.²⁴⁴ At the time of and as an inducement to congressional enactment of the 1982 legislation, the Board had approved some acquisitions by BHCs of healthy thrifts, but it had not instituted a policy of regularly doing so, in part from fear of court challenges.²⁴⁵ FIRREA expressly permitted BHCs to acquire any thrift,²⁴⁶ and a special provision added in the final stages of consideration of the bill — the Oakar Amendment — permitted BHCs to convert acquired thrifts to banks, notwithstanding the moratorium imposed on such transactions, if the institution continued to pay thrift rather than bank premiums with respect to a portion of its deposits; such amount to be determined by the level of deposits the institution had on hand at the time of the conversion.²⁴⁷

Complex though the provisions may have been, with respect to the political environment in which the statute was enacted and in relation to the fault lines that subsist among and divide the industry, the policy thrust of the statute is relatively clear and well defined. The statute was a crushing defeat for the thrift industry, one that threatened its very existence. The premium increases imposed much of the cost of the bailout on the healthy thrifts, which were trapped as thrifts by the moratorium and exit fees. The QTL

note 58, § 2.45.

239. 12 U.S.C. § 1821(d)(3)-(14) (amended 1991, 1992, 1993, 1994).

240. *Id.* § 1821(e) (amended 1991, 1994).

241. *Id.* § 1821(k).

242. *Id.* § 1823(e) (amended 1994).

243. *Id.* § 1821(i)(2).

244. *See supra* note 99 and accompanying text.

245. *Id.*

246. 12 U.S.C. § 1843(i) (Supp. I 1989).

247. *See supra* note 226 and accompanying discussion.

tests and the powers restrictions stripped the industry of what it had thought it had won in 1982, however Pyrrhic that victory may have turned out to be. To whatever extent competition for retaining premium value of institutions was at issue, the banking industry won and the thrift industry lost under the legislation, and the larger banking interests won more than the smaller. This was reflected in the provision for BHC acquisitions of thrifts, intensified by the Oakar Amendment, the QTL restrictions on one-thrift holding companies, and the enhanced power of the regulators to force receiverships or conservatorships. As between large banks and large thrifts, the imposition of bank capital standards, particularly the retroactive abrogation of the forbearance agreements, favored the banking industry. As between small thrifts and small banks, the transfer of functions from the Bank Board to the OTS under Treasury control was a victory for the small banks.

III. The Supervisory Goodwill Litigation Under FIRREA

The discussion below proceeds by briefly describing capital standards and the regulatory forbearance program pursued by the Bank Board in the early 1980s, including a brief description of why that program affected the pricing of transactions in which healthy thrifts were enlisted to take over ailing thrifts during the "first phase" of the thrift crisis. Next, the provisions that abrogated those forbearance agreements are presented in some detail. The trend of the case law in the lower courts leading to the *Winstar* decision then will be discussed. Finally, a discussion of how the Supreme Court's recent approach to the Takings Clause might be applied to the question of supervisory goodwill is set forth.

A. A Description of the Problem

1. Capital Standards and Intangible Capital Generally

The most serious litigation problem posed by FIRREA to date has arisen from the imposition of bank-type capital standards on thrifts. As indicated above,²⁴⁸ next to the question whether to place the bailout on or off budget, the question of imposing bank-type capital standards on thrifts was the most contentious issue raised in consideration of the legislation, one that was not resolved until the final days of the legislation. When the legislation was in the final stages of consideration, the thrifts made plain their intention to bring suit to block enforcement of the capital standards provision on constitutional grounds. The provisions were adopted notwithstanding the

248. See *supra* notes 217-21 and accompanying text.

opposition, and within weeks of the legislation's passage the thrifts made good on their pledge.

"Capital standards" are requirements imposed by regulators that require institutions to maintain on their balance sheets a certain amount of capital, which is expressed as a percentage of assets. Capital standards have been elevated over the last decade and now play a central role in bank regulation. The statutory basis for the capital standards imposed upon banks is the International Lending Standards Act of 1983 (ILSA), which directed the bank regulatory agencies to adopt capital adequacy standards.²⁴⁹ At the time, the capital standards applied by the agencies were "leverage" standards, which measure capital as a percentage of assets. The current leverage requirement is six percent, of which three percent must consist of Tier 1, or "core," capital; the remainder is Tier 2.²⁵⁰

In 1987, the Board of Governors of the Federal Reserve and the Bank of England agreed for the first time on the development of risk-weighted capital standards. These standards also count Tier 1 and Tier 2 capital as a percentage of assets, but measure assets by weighting them for risk. The risk weighting not only accounts for risk, but also seeks to account for off balance sheet items (OBSIs), which are items that create risk though they are not reflected on the balance sheet. These items include many swap or derivatives transactions, standby letters of credit, loan commitments, and the like. The risk weighting divides assets into four categories, weighted at zero,

249. 12 U.S.C. § 3907 (1994). The statute authorizes each of the banking agencies (including the Bank Board prior to FIRREA and the OTS subsequently) to "cause" institutions "to achieve and maintain adequate capital by establishing minimum levels of capital" and "to establish such minimum level of capital . . . as the agency . . . deems to be necessary or appropriate." *Id.* § 3907(a)(1)-(2). It provides further that the failure of an institution to maintain its minimum level of capital can be treated as an unsafe or unsound practice subject to enforcement proceedings under § 8 of the FDIA and provides for the issuance of capital directives by the agencies. Prior to the enactment of ILSA, strict review of agency enforcement orders predicated upon challenges to the adequacy of an institution's capital had cast doubt upon the agencies' authority to impose capital adequacy standards. *See First Nat'l Bank of Bellaire v. Comptroller*, 697 F.2d 674, 685-86 (5th Cir. 1983). With respect to the application of the ILSA provision to the OTS, that provision also is subject to the provisions of § 5(t) of the HOLA, as amended by FIRREA.

250. Tier 1 capital under contemporary standards typically consists of common stockholders' equity, including retained surplus; noncumulative perpetual preferred stock; and minority interests in equity capital accounts of consolidated controlled subsidiaries. Tier 2 capital includes allowances for loan and lease losses, up to a maximum of 1.25% of risk-weighted assets; cumulative perpetual preferred stock and long-term preferred stock (maturities of 20 years or more); hybrid (mandatory convertible) debt securities; and term subordinated debt or intermediate term preferred stock (maturities of over 5 years or more), the latter categories limited to a maximum of 50% of Tier 2 capital. *See* 12 C.F.R. § 325, Appendix A (1995).

twenty, fifty, and one hundred percent. The zero percent category includes principally government paper; the twenty percent category includes mostly bank deposits or other claims on banks of member countries in the Organization for Economic Cooperation and Development; the fifty percent category includes principally mortgages secured by one- to four-family dwellings; and the one hundred percent category includes all other assets. Weighting OBSIs requires placing the items into one of the four categories and applying the corresponding weight to derive a credit equivalent amount (CEA) for the item. The CEA is then weighted according to its risk category and included in assets.

In their current form, both sets of regulations provide for subtracting intangible assets from capital. The rules have been tightened over the years to exclude intangible assets from inclusion in capital; at present only mortgage servicing rights and the rights to service certain credit-card receivables are included in capital.²⁵¹ The subtraction method proceeds as follows: Suppose that the capital adequacy rule is the risk-weighted figure under current regulations (8%), of which at least half (4%) must be Tier 1, or core, capital.²⁵² Suppose that assets are 2000, which includes 200 of goodwill (from an acquisition accounted for under a purchase method of accounting). Suppose total capital is 350, including 275 of core capital. The 200 in goodwill will be subtracted from the 2000 assets figure, from the 350 total capital figure, and from the 275 core capital figure. The capital adequacy measures will thus be 150/1800 (or 8.33%) for total capital; 75/1800 (or 4.17%) for core capital; and the institution will meet its capital standards. If instead, the core capital figure was 250, the institution's core capital ratio would be 2.78% ((250-200)/1800), and the institution would not meet its capital standard, notwithstanding that its core capital is 12.5% (250/2000) of assets computed without the deduction for goodwill.

*2. Regulatory Accounting Practices (RAPs), Supervisory
Goodwill, and Forbearances in the Implementation of the Regulators'
Bill Under Garn-St Germain in the Early 1980s*

In the early 1980s, the Bank Board, as part of its policy of "giving time" to troubled thrifts to work out their difficulties, began a program of allowing "forbearance" to thrifts under regulatory accounting principles. The most important device adopted was the allowance of regulatory accounting procedure (RAP) goodwill and supervisory goodwill. These practices came under heavy criticism during the enactment of FIRREA; however, the

251. *Id.* item B(1).

252. *Id.*

practice should be evaluated in light of the regulatory space development of the thrift crisis — which created an early period of accounting to minimize the seriousness of the crisis (to justify limited action in the belief that time would cure the difficulties of the industry), followed by a period of emphasizing difficulties (to create a crisis atmosphere leading to expedited legislation so that the matter was moved away from public attention). The practices also should be evaluated in light of institution's premium value. Institutions generate enterprise value, a value that is not subject to determinate accounting practice. The omission of a goodwill item is in some ways as problematic as allowing it from the standpoint of the substantive economics of an institution.

Supervisory goodwill worked as follows: A healthy institution acquired a troubled institution. At the time of the acquisition, the target had liabilities in excess of its assets. The Bank Board provided assistance, which might have been a cash payment or a promise to make payment in the future — for instance, a yield maintenance agreement with respect to certain assets that guaranteed a minimum annual yield to the assets or a note given to the institution in purchasing a net worth or income capital certificate. Suppose the healthy institution had, prior to the acquisition, assets of 5000 and capital of 400, and faced a capital requirement of six percent, which it plainly met. (We need not distinguish among types of capital requirement for these purposes because the objective is simply to identify the idea behind supervisory goodwill.) Suppose the acquired institution had assets of 1000 and liabilities of 1500 and that the acquiring institution is willing to enter the transaction upon the payment of 200 in assistance by the Bank Board.

RAP goodwill would allow for the treatment of the 300 excess of the liabilities over the sum of the assets and the assistance ($1000-1500+200$) in goodwill; supervisory goodwill would allow for the inclusion of 200 in assets. Many observers, including some of the courts considering the question, have looked at this situation and characterized it as "upside down" because it allows an excess of liabilities over book assets to be treated as an asset. This mistakes the idea behind this accounting. The justification for including the 200 assistance in capital is that it *is* an asset, at worst an obligation of a government corporation (but one that a strong public interest suggests the government ultimately will back up). The justification for including the 300 excess is that this represents the "enterprise value" of the institution, and this value is real.

Moreover, a crude algebraic example reveals that the capital rules agreed upon are a material element in determining the amount of assistance the agency has to offer, which is the "price" agreed to by the parties; and,

at the same time, this algebraic example suggests the measure of the "cost" of the capital rules to the government.

3. *Capital Standards, Forbearance, and the Pricing of Assistance in Assisted Transactions*

The problem of capital ratios for institution managers can be briefly, if crudely, summarized as follows: Assume an institution faces a cost of capital as to which it is a "taker," that is, its bargaining does not affect the price. There is a fixed rate cost of debt (r_d) and of equity (r_e). In addition, the institution seeks a rate of return on assets (r_a) and faces a required capital ratio (k). Denominating its total assets A and total liabilities L , its earnings (which includes growth in equity) will be determined by the spread between its return on its assets ($r_a A$) and its cost on its liabilities ($r_d L$), which will equal the demanded return to equity ($r_e k A$) (the corporate equity will be $k A$). The equation thus generated can be resolved to express the capital ratio in terms of the relationship between the "sought" spread between the rate of return on assets and the "taken" spread between the rate of return on equity and rate of return on debt:

$$k = \frac{r_a - r_d}{r_e - r_d}$$

An increase in the capital ratio, accordingly, increases the rate of return on assets that the manager must seek to obtain the requisite return on equity, assuming fixed cost of capital (both debt and equity). Equally clearly, capital that demands a lower rate of return also reduces the rate of return to assets the manager must find to achieve the requisite rate of return. Best of all is phantom capital — intangible capital — which requires no rate of return; this means the capital ratio can be satisfied with a still lesser rate of return to assets.

It appears that phantom capital of this sort is thus an evil because it enables the manager to escape responsibility for achieving a high rate of return and thus masks poor performance and ultimately, perhaps, undercapitalization. That is not so clear, however, if one bears in mind the reality of the premium value of institutions: The return is intangible but real. If one does not account for the premium value by taking into account intangible capital to some extent, one may be requiring excessive capitalization, which ultimately will depress earnings and eventually lead to capital problems. The point here is not to resolve this question, but merely to note its existence and the novelty and indefiniteness of capital adequacy theory on this point (which corresponds to like indefiniteness on others). It bears noting only because, during the FIRREA legislative history, much was made of the "evils" of

forbearance accounting and the allowance of supervisory goodwill and other intangible capital.

The above discussion may be clarified by simple numbers. Suppose the capital ratio is 10 percent, the rate of return on liabilities is 8 percent, and the demanded return on equity 20 percent. Suppose the assets of the institution are 500. If the institution meets its capital ratio, its liabilities will be 450 ($500 - (500 \times 10\%)$); its debt cost 36 ($450 \times 8\%$); and the demanded equity return 10 ($(500 \times 10\%) - (500 \times 8\%)$). Thus, it will need to achieve a rate of return on assets of 9.2% ($(10 + 36) / 500$).

Now, suppose this solvent institution is faced with the prospect of purchasing an insolvent institution that, because of economies of scale, entry into new markets, or some other synergistic effect, will enable it to enhance its rate of return on assets. Suppose the target institution has assets of 70 and liabilities of 90, but for whatever reason, the acquiring institution is willing to acquire the institution upon payment of assistance by the deposit insurer of 10. Thus, liabilities (90) exceed the assets and assistance payments ($70 + 10$) by 10. There are three ways of counting the capital of the new (combined) institution, using a purchase method, which, for these purposes, means that the capital position of the target preacquisition is irrelevant. One way is to treat the acquired capital as 0 ($(70 - 90) + 10 + 10$) — which gives credit both for the assistance payment of 10 (which in many cases was contingent or otherwise "phantom" because it was given by an insolvent FSLIC in the form of exotic devices like yield maintenance agreements or acquisition notes on capital certificates), and for the supervisory goodwill of 10 (the excess of the liabilities assumed over the sum of the assets and assistance payments). A second method is to treat the acquired capital as -10 — which gives credit only for the assets and assistance payments ($(70 - 90) + 10$). The third method is to give credit only for the assets; the acquired capital is thus -20 ($70 - 90$). In any case, the institution will have to raise some additional capital to meet its capital requirement. Allowing the phantom capital will reduce the blended, demanded return on equity (to 19.33% if 20 is allowed as capital, or to 19.67% if 10 is allowed). The amount by which the rate of return on assets will have to be increased will be lower depending on how liberal the capital rule is. If one assumes, as is likely, that the change in the rate of return on assets to be affected by the transaction is fixed, then the variable will be the amount of assistance that the institution demands as a condition of entry into the transaction — *so that the capital rule agreed to by the parties is intimately linked to the price charged.*

Let us plug in a set of numbers to see how the capital rule can affect the parties' decisions concerning entry into the transactions. Suppose the combi-

nation will increase the rate of return on assets to 9.4%. Assume that the 10 of assistance from FSLIC is in the form of a capital maintenance certificate that is invested in an FSLIC note, with matching returns on the note and certificate so that there is no net cash flow associated with the note. After combination, the institutions will have "hard" assets of 580 (exclusive of the FSLIC note or other asset embodying the assistance) — the 500 it had originally, the 70 it acquires, and the 10 acquired with a requisite hard capital contribution of 10. Its aggregate return will be 54.52 (9.4% of 580). The amount it will need to earn is 55.2 (9.2% of 600, because it still has the same percentage mix of liabilities and hard equity — 540 liabilities, 60 equity). Assume that a shortfall to this will be made up by a yield maintenance payment from FSLIC, which is the "real" cost to it of the transaction. If the full 20 is counted as equity, the acquirer must make an infusion of only 10, and the FSLIC yield maintenance payment is 0.68, which represents 6.8% of the amount of the cost of liquidating the institution. If only the 10 represented by the certificate is counted, the required infusion will be 20; the hard capital structure now will comprise 540 of liabilities and 70 of equity, with a demanded return of 57.2 (43.2, or 8% of the liabilities, plus 12, or 20% of equity); the earnings will be 55.46 (9.4% of assets of 540); and the shortfall will be 1.74 (57.2-55.46), which represents 17.4% of the liquidation cost. If neither the certificate nor the supervisory goodwill is reflected as capital, the demanded return will rise to 59.2, the earnings to 56.4, and the shortfall to 2.8, which represents 28% of the liquidation cost of the institution. At that rate, the transaction is likely to be too costly to the FSLIC in relation to the cost of liquidating the institution.

This example assumes that the FSLIC would make up in yield maintenance payments the full cost of a change in the capital rule. In practice, a change would be factored into a negotiation between the acquirer and insurer, resulting in a payment that made up part, but not all, of the cost. Thus, the example demonstrates two points: First, the amount of the regulatory capital allowed is a material determinant of the price; and second, on the final rule (requiring an *annual* maintenance payment equal to 28% of liquidation cost), the amount probably would prohibit the deal because the liquidation of the institution likely would be the more economical course for the deposit insurer to pursue.

B. The FIRREA Provisions at Issue

FIRREA abrogated the forbearances that the Bank Board had allowed in connection with thrift acquisitions and conversions during the 1980s. One objective of FIRREA was to impose bank-like capital standards on the thrift

industry.²⁵³ FIRREA added a new Section 5(t) to the Home Owners' Loan Act,²⁵⁴ which requires the Director of the Office of Thrift Supervision by regulation to "prescribe and maintain uniformly applicable capital standards for savings associations."²⁵⁵ These standards were to include a leverage limit, a tangible capital requirement, and a risk-based capital requirement.²⁵⁶ The capital requirements were to be promulgated as final regulations within 90 days of the date of FIRREA's enactment, to be effective within 120 days of the enactment date,²⁵⁷ and the standards involved were to be "no less stringent than the capital standards applicable to national banks."²⁵⁸ The statute specified further that the leverage limit was to require that savings associations maintain core capital in an amount not less than 3 percent of the association's total assets²⁵⁹ and a tangible capital requirement not less than 1.5 percent of total assets.²⁶⁰ The statute also required a risk-based capital requirement, which was permitted to "deviate from the risk-based capital standards applicable to national banks to reflect interest-rate risk or other risks." However, "such deviations" were not permitted "in the aggregate" to "result in materially lower levels of capital being required of savings associations under the risk-based capital requirement than would be required under the risk-based capital standards applicable to national banks."²⁶¹

The statute contained express provisions governing intangible capital. The statute expressly permitted savings associations to include, in calculating capital for purposes of the leverage and risk-based limits, ninety percent of the fair market value of "readily marketable purchased mortgage servicing rights," on terms "no less stringent" than those applicable to both state nonmember banks and national banks.²⁶² A similar rule applied to the tangible capital requirement, subject to the power of the FDIC to prescribe a maximum percentage of such value that could be included by a thrift.²⁶³ Core capital was defined as "core capital as defined by the Comptroller of the Currency for national banks, less any unidentifiable intangible assets,

253. See *supra* notes 217-21, 236 and accompanying text.

254. 12 U.S.C. § 1464(t) (1994).

255. *Id.* § 1464(t)(1)(A).

256. *Id.* § 1464(t)(1)(A)(i)-(iii).

257. *Id.* § 1464(t)(1)(D).

258. *Id.* § 1464(t)(1)(C).

259. *Id.* § 1464(t)(2)(A).

260. *Id.* § 1464(t)(2)(B).

261. *Id.* § 1464(t)(2)(C).

262. *Id.* § 1464(t)(4)(A).

263. See *id.* § 1464(t)(4)(B)-(C)(i).

plus any purchased mortgage servicing rights excluded from the Comptroller's definition of capital but included in calculating the core capital of savings associations" under Section 5(t)(4).²⁶⁴ Tangible capital was defined as "core capital minus any intangible assets (as intangible assets are defined by the Comptroller of the Currency for national banks)."²⁶⁵

As a result of a compromise reached in the late stages of the legislation's consideration, the statute set forth a transition rule applicable to "qualifying supervisory goodwill." Savings associations were permitted to include qualifying supervisory goodwill in calculating core capital in an amount of up to 1.5 percent of total assets until 1992, 1 percent during 1992, 0.75 percent during 1993, 0.375 percent during 1994, and zero thereafter.²⁶⁶ The statute also provided for the amortization of supervisory goodwill over the shorter of twenty years from April 12, 1989, or the period otherwise remaining under the amortization schedule in effect on April 12, 1989.²⁶⁷

The statute provided that prior to January 1, 1991, the OTS Director could restrict the asset growth of any savings association not in compliance with capital standards and could require a capital plan of any association, beginning sixty days after the promulgation of regulations under Section 5(t).²⁶⁸

C. *The Litigation*

1. *The Injunction Litigation in the District Courts*

a. *The Early District Court Injunctions.* FIRREA was signed on August 9, 1989, and, on November 7, 1989, the OTS proposed capital regulations governing thrifts.²⁶⁹ Shortly thereafter, the OTS began to determine that thrifts whose supervisory goodwill was eliminated under the FIRREA provisions were not in compliance with the capital standards and also began to require "consent letters" authorizing OTS to arrange a sale or merger of the institutions. A number of the institutions responded with lawsuits seeking injunctive relief against the OTS actions.

The cases fall into three categories: those involving single institutions, which ordinarily involved supervisory conversions from mutual to stock

264. *Id.* § 1464(t)(9)(A).

265. *Id.* § 1464(t)(9)(C).

266. *Id.* § 1464(t)(3)(A).

267. *Id.* § 1464(t)(9)(B).

268. *Id.* § 1464(t)(6).

269. 54 Fed. Reg. 46,845 (1989) (to be codified at 12 C.F.R. pts. 561, 563, 567) (proposed Nov. 7, 1989).

form;²⁷⁰ those involving acquisitive transactions, in which assistance was not provided;²⁷¹ and those involving acquisitive transactions in which assistance was provided.²⁷² In all of the cases, the question arose whether there was a contractual promise to allow the thrifts to use supervisory goodwill. All of the transactions, whether assisted or not, required Bank Board approval. Ordinarily, the permission to use supervisory goodwill was embodied in a Bank Board resolution granting approval after a transaction had been negotiated and submitted, instead of in any agreement signed by the party granted permission.²⁷³ Sometimes, too, the authorization was embodied in a letter from the Bank Board. In the cases involving assistance, there was ordinarily an Assistance Agreement executed between the acquiring or resulting party and the FSLIC, which often merged Bank Board resolutions or letters into the agreement.²⁷⁴ In cases in which no assistance was provided, there was ordinarily no agreement signed by any government party.

In the earliest suits, brought before consent letters were requested and decided in January and February 1990, the OTS prevailed.²⁷⁵ In the second of these cases, *Flagship Federal Savings Bank v. Wall*,²⁷⁶ the court went to the merits of the question and held that the "forbearance letter was not a contract but a statement by the FHLBB that it would not prosecute Flagship for failing to meet the statutory capital requirements in force in November of 1988. . . . If this was a contract, it was an illusory one, for one party had

270. See *Flagship Fed. Sav. Bank v. Wall*, 748 F. Supp. 742 (S.D. Cal. 1990); *Far West Fed. Bank v. Director*, 746 F. Supp. 1042 (D. Or. 1990), *rev'd*, 951 F.2d 1093 (9th Cir. 1991); *Century Fed. Sav. Bank v. United States*, 745 F. Supp. 1363 (N.D. Ill. 1990).

271. See *Charter Fed. Sav. Bank v. Director*, 773 F. Supp. 809 (W.D. Va. 1991), *rev'd*, 976 F.2d 203 (4th Cir. 1992); *Carteret Sav. Bank v. Director*, 762 F. Supp. 1159 (D.N.J. 1991), *rev'd*, 963 F.2d 567 (3d Cir. 1992) (involving First Federal Savings & Loans Association of Delray Beach transaction); *Sterling Sav. Ass'n v. Ryan*, 751 F. Supp. 871 (E.D. Wash. 1990) (involving Central Evergreen Federal Association transactions); *Guaranty Fin. Servs., Inc. v. Director*, 742 F. Supp. 1159 (M.D. Ga. 1990) (involving merger conversion), *rev'd*, 928 F.2d 994 (11th Cir. 1991).

272. See *Carteret Sav. Bank v. Director*, 762 F. Supp. 1159 (D.N.J. 1991) (regarding Barton Savings & Loan Association, First Federal Savings & Loan of Montgomery County (Blacksburg, Virginia), and Mountain Security Savings Bank (Wytheville, Virginia) transactions), *rev'd*, 963 F.2d 567 (3d Cir. 1992); *Security Sav. & Loan Ass'n v. Director*, 761 F. Supp. 1277 (S.D. Miss. 1991), *rev'd*, 960 F.2d 1318 (5th Cir. 1992); *Sterling Sav. Ass'n v. Ryan*, 751 F. Supp. 871 (E.D. Wash. 1990) (involving Lewis Federal and Tri-Cities Savings transactions).

273. See cases cited *supra* notes 270, 272.

274. See cases cited *supra* note 272.

275. *El Paso Sav. Ass'n v. Director*, No. EP-89-CA-426-H (W.D. Tex. Jan. 9, 1990); *Flagship Fed. Sav. Bank v. Wall*, 748 F. Supp. 742 (S.D. Cal. 1990).

276. 748 F. Supp. 742 (S.D. Cal. 1990).

the right at any time to cancel its side of the bargain."²⁷⁷ The court further held that "when Congress reserves the power to amend legislation, contracts made pursuant to that legislation are subject to future legislative action," citing *Bowen v. Public Agencies Opposed to Social Security Entrapment (POSSE)*.²⁷⁸ Thus, "[e]ven if there was a contract between FHLBB and Flagship, this contract [was] subject to FIRREA under the *POSSE* doctrine."²⁷⁹ It rejected the plaintiff's argument that Sections 401(f), (g), and (h) of FIRREA grandfathered the forbearance agreements and responded to the plaintiffs' request for an injunction against an "alleged unconstitutional taking of property" by noting that the plaintiffs' remedy was "limited to an action in the Claims Court subsequent to any unconstitutional taking."²⁸⁰

In the subsequent litigation, the Government did not fare well at the trial level. From July to September 1990, six federal district courts decided litigation concerning the abrogation of the forbearance agreements, and five of them issued injunctions.²⁸¹ Three other district courts issued injunctions in 1991.²⁸² In all of these cases, involving a variety of transactions documented in a variety of ways, the courts tended to find that a contract existed between the Bank Board and the acquiring institutions concerning the extension of the regulatory forbearance. Most of the decisions rested on Sections 401(g) and 401(h) of FIRREA. Section 401(g) provided:

(g) Savings Provisions Relating to FHLBB. —

(1) EXISTING RIGHTS, DUTIES AND OBLIGATIONS NOT AFFECTED. — Subsection (a) [eliminating the FSLIC and the FHLBB] shall not affect the validity of any right, duty, or obligation of the United States, the Federal Home Loan Bank Board, or any other person, which —

277. *Flagship Fed. Sav. Bank v. Wall*, 748 F. Supp. 742, 748 (S.D. Cal. 1990).

278. 477 U.S. 41 (1986).

279. *Flagship Fed. Sav. Bank*, 748 F. Supp. at 748.

280. *Id.* at 748-49.

281. Injunctions were granted in the following cases: *Franklin Fed. Sav. Bank v. Director*, No. CIV 2-90-166, 1990 WL 123145 (E.D. Tenn. July 16, 1990), *rev'd*, 927 F.2d 1332 (6th Cir.), *cert. denied*, 502 U.S. 937 (1991); *Sterling Sav. Ass'n v. Ryan*, 751 F. Supp. 871 (E.D. Wash. 1990); *Security Fed. Sav. Bank of Florida v. Director*, 747 F. Supp. 656 (N.D. Fla. 1990); *Guaranty Fin. Servs., Inc. v. Director*, 742 F. Supp. 1159 (M.D. Ga. 1990), *rev'd*, 928 F.2d 994 (11th Cir. 1991); *Far West Fed. Bank v. Director*, 746 F. Supp. 1042 (D. Or. 1990), *rev'd*, 951 F.2d 1093 (9th Cir. 1991). An injunction was denied in *Century Fed. Sav. Bank v. United States*, 745 F. Supp. 1363 (N.D. Ill. 1990).

282. All three decisions were reversed by the courts of appeals: *Security Sav. & Loan Ass'n v. Director*, 761 F. Supp. 1277 (S.D. Miss. 1991), *rev'd*, 960 F.2d 1318 (5th Cir. 1992); *Carteret Sav. Bank v. Director*, 762 F. Supp. 1159 (D.N.J. 1991), *rev'd*, 963 F.2d 567 (3d Cir. 1992); *Charter Fed. Sav. Bank v. Director*, 773 F. Supp. 809 (W.D. Va. 1991), *rev'd*, 976 F.2d 203 (4th Cir. 1992).

(A) arises under or pursuant to the Federal Home Loan Bank Act, the Home Owners' Loan Act of 1933, or any other provision of law applicable with respect to such Board (other than title IV of the National Housing Act); and

(B) existed on the day before the date of enactment of this Act.²⁸³

Only one of the district court decisions, *Far West Federal Bank v. Director*,²⁸⁴ appeared to rest on a finding of likely success on the constitutional grounds.

b. The Courts of Appeals Reversals and Sections 401(g) and 401(h).

In early 1991, some of the cases granting injunctions reached the courts of appeals. The first decision came from the U.S. Court of Appeals for the Sixth Circuit in *Franklin Federal Savings Bank v. Director*.²⁸⁵ After holding the case ripe for review, the court, relying on the legislative history, found that sections 401(g) and 401(h) did not preserve the forbearance agreements.²⁸⁶ Although it noted that the committee reports were silent on the question of abrogation, the court looked to language in those reports concerning the desirability of doing so:

Both sides find comfort in the extensive legislative history of FIRREA. The OTS points to some portions of the legislative history in which some legislators express the view that abrogating the provisions of forbearance agreements allowing the amortization of supervisory goodwill would be a good idea, while Franklin points to other portions of the legislative history in which some legislators suggest that retaining such provisions would be a good idea. Both sides miss the point of looking to the legislative history.²⁸⁷

The court then cited statements of separate views included with the committee reports and a floor debate on the Hyde Amendment (after its sponsor, Representative Henry Hyde of Illinois) that would have given institutions suffering abrogation a hearing on their contract claims.²⁸⁸ It concluded that an assumption underlying the debate was that the forbearance agreements were to be abrogated:

283. 12 U.S.C. § 1437(g)(1) (1994).

284. 746 F. Supp. 1042, 1049-51 (D. Or. 1990), *rev'd*, 951 F.2d 1093 (9th Cir. 1991).

285. 927 F.2d 1332 (6th Cir.), *cert. denied*, 502 U.S. 937 (1991).

286. *Franklin Fed. Sav. Bank v. Director*, 927 F.2d 1332, 1339-41 (6th Cir.), *cert. denied*, 502 U.S. 937 (1991).

287. *Id.* at 1339-40.

288. *Id.* at 1340.

In the course of the floor debate, representatives expressed their understanding of what the statutory language meant. The debate is useful to us because it reveals a shared understanding of a particular text. *Nobody* expressed the view that FIRREA did not abrogate forbearance agreements regarding supervisory goodwill. The only discussion of the procedures themselves came from the *defenders* of the amendment who emphasized that the amendment would not automatically recognize all forbearances.²⁸⁹

The court then held that the OTS position was a "reasonable" one and, relying on *Chevron U.S.A., Inc. v. Natural Resources Defense Council*,²⁹⁰ ruled for the OTS.

There was a dissent filed in *Franklin Federal Savings Bank*. Judge Contie argued that "[w]hen Congress intends to upset previously settled expectations, it is obligated to do so in unambiguous terms" and that "the government failed to identify any provision in FIRREA that *expressly* abrogates all conversion agreements; the government relies instead on strained inferences and select legislative history."²⁹¹ He rejected the Government's arguments "that section 401(g) protects only those rights, duties, and obligations endangered by the abolition of the FSLIC and FHLBB" as "merely manipul[at]ing the express language of section 401(g)."²⁹² He rejected the majority's reading of the consideration of the Hyde Amendment:

Contrary to the government's contention, however, the issue before Congress when it considered the Hyde Amendment was not the validity of existing forbearances; instead, the Hyde Amendment contemplated the establishment of an administrative process to review possible contract claims. Though the appellants are correct that some representatives voted against the Hyde Amendment because they wanted all forbearance agreements abrogated, it is equally clear that many Congressmen opposed the Hyde Amendment because of the contemplated administrative process. Because the Hyde Amendment never presented Congress with the sole issue of whether conversion agreements should be abrogated, the amendment's defeat is irrelevant to this action because the appellants, the appellees, and this court can not determine, with any certainty, why Congress defeated the Hyde Amendment.²⁹³

289. *Id.* at 1340-41.

290. 467 U.S. 837 (1984).

291. *Franklin Fed. Sav. Bank*, 927 F.2d at 1341-42 (6th Cir. 1991) (Contie, J., dissenting).

292. *Id.* at 1342 (Contie, J., dissenting).

293. *Id.* at 1342-43 (Contie, J., dissenting).

The second case, *Guaranty Financial Services, Inc. v. Ryan*,²⁹⁴ decided only two weeks after *Franklin Federal Savings Bank*, similarly relied on legislative history. It quoted the separate supporting and opposing views of committee members expressed in the House Banking Committee report as indicating an understanding that the bill in fact effected abrogation. Thus, opponents complained that "[f]or those institutions with substantial supervisory goodwill, the bill radically change[d] the terms of previously negotiated transactions,"²⁹⁵ while supporters objected that "an overriding public policy would be jeopardized by the continued adherence to arrangements which were blithely entered into by FSLIC."²⁹⁶ The court also noted that the debate on the Hyde Amendment and another amendment offered by Representative Quillen (which would have grandfathered existing forbearances as the Sixth Circuit had) reflected an understanding that the forbearances were abrogated:

Although we draw no inferences from the fate of the two amendments, the comments made on the floor during the debate on Rep. Hyde's amendment, as well as at other points during the congressional debate, only serve to strengthen our conviction that Congress intended that FIRREA would abrogate any capital forbearances after the phase-out period Again, both advocates and opponents of Rep. Hyde's amendment evinced an understanding that the bill would abrogate supervisory goodwill agreements.²⁹⁷

Franklin Federal Savings Bank briefly addressed the takings issue by stating that "[i]f Franklin did have a contractual property interest, we believe that the evidence of congressional intent is strong enough to infer that Congress wanted to effect a taking,"²⁹⁸ whatever relevance that had, and that "[i]n the event that this action were determined to be a taking, Franklin would be entitled to compensation, not to equitable relief."²⁹⁹ *Guaranty*

294. 928 F.2d 994 (11th Cir. 1991).

295. *Guaranty Fin. Servs., Inc. v. Ryan*, 928 F.2d 994, 1005 (11th Cir. 1991) (quoting H.R. REP. NO. 54, 101st Cong., 1st Sess., pt. 1, at 534, *reprinted in* 1989 U.S.C.C.A.N. 86, 327 (additional views of Representatives Hiler, Ridge, Bartlett, Dreier, McCandless, Saiki, Baker, and Paxon)).

296. *Id.* (quoting H.R. REP. NO. 54, 101st Cong., 1st Sess., pt. 1, at 545, *reprinted in* 1989 U.S.C.C.A.N. 86, 336 (supplemental views concerning forbearances from industry-wide capital standards of Representatives Schumer, Morrison, Roukema, Gonzalez, Vento, McMillen, and Hoagland)).

297. *Id.* at 1005.

298. *Franklin Fed. Sav. Bank v. Director*, 927 F.2d 1332, 1341. (6th Cir.), *cert. denied*, 502 U.S. 937 (1991).

299. *Id.*

Financial Services did not address a takings issue apparently because no such issue was raised by the litigants in the case.³⁰⁰

In *Far West Federal Bank v. Director*,³⁰¹ decided in December 1991, the U.S. Court of Appeals for the Ninth Circuit became the third court of appeals to vacate an injunction against the amendment of the capital standards. On both the statutory issue and the takings issue, the court relied upon the earlier decisions: "For the reasons detailed in the exhaustive opinions of the Sixth and Eleventh Circuits, we also agree with the OTS's interpretation."³⁰² The court further stated that "[s]ince a taking, if one occurred, was authorized by Congress, and a suit for compensation is within the jurisdiction of the Claims Court, we do not reach the question of whether a taking occurred."³⁰³ In *Security Savings and Loan Ass'n v. Director*,³⁰⁴ the U.S. Court of Appeals for the Fifth Circuit relied on the earlier decisions on the Section 401(g) issue and followed them in holding that the takings claim should be decided in the Claims Court.³⁰⁵ In *Carteret Savings Bank v. Director*,³⁰⁶ the U.S. Court of Appeals for the Third Circuit, in an extended opinion, accepted the views of the Sixth and Eleventh Circuits concerning the legislative history and the interpretation of Section 401(g).³⁰⁷ It added a statutory language argument, however, and focused upon the definition of supervisory goodwill in Section 5(t)(9)(C) of the statute, which shortened the amortization period for supervisory goodwill to at most twenty years:³⁰⁸ "There would have been no reason to refer to the 'remaining period for amortization in effect' if the new provisions were inapplicable to previously acceptable supervisory goodwill."³⁰⁹ Nonetheless, the court said that the OTS position that the statutory language supported the conclusion that the agreements were intended to be abrogated "is reached through inference, and we cannot agree with OTS that statutory language alone is dispositive."³¹⁰ However, the court proceeded to reach the abrogation result by interpreting the legislative history and by relying on substantially the same elements of

300. The takings issue was not discussed in the district court.

301. 951 F.2d 1093 (9th Cir. 1991).

302. *Far West Fed. Bank v. Director*, 951 F.2d 1093, 1098 (9th Cir. 1991).

303. *Id.* at 1100.

304. 960 F.2d 1318 (5th Cir. 1992).

305. *Security Sav. & Loan Ass'n v. Director*, 960 F.2d 1318, 1322-23 (5th Cir. 1992).

306. 963 F.2d 567 (3d Cir. 1992).

307. *Carteret Sav. Bank v. Director*, 963 F.2d 567, 577-78 (3d Cir. 1992).

308. *See supra* note 265 and accompanying text.

309. *Carteret*, 963 F.2d at 576.

310. *Id.*

the history as had the Sixth and Eleventh Circuits.³¹¹

c. The Later Courts of Appeals Cases and the Takings Problem: Transohio and Charter. Two later cases raised or addressed the issues in slightly different ways that foreshadowed the manner in which the question would be presented before the Federal Circuit. The first four circuits to address the question did not reach the merits of the takings claims and held instead that the claims properly were brought before the Claims Court. In *Transohio Savings Bank v. Director*,³¹² the U.S. Court of Appeals for the District of Columbia Circuit broke rank and decided the takings claim against the plaintiff.³¹³ The court faced an argument under one of its precedents, *Ramirez de Arellano v. Weinberger*,³¹⁴ which as the *Transohio* court noted, held that "when the monetary compensation available through the Tucker Act remedy is so inadequate that the plaintiff would not be justly compensated for the seizure of his property by the United States, an injunctive remedy is not barred."³¹⁵

The *Transohio* court relied on what it termed the "unmistakability" doctrine — that "one who wishes to obtain a contractual right against the sovereign that is immune from the effect of future changes in law must make sure that the contract confers such a right in unmistakable terms."³¹⁶ The court said that the Supreme Court applies this requirement "most forcefully in cases involving the government's regulatory power, *as opposed to the government's power to ease its financial burdens.*"³¹⁷ It then found, quite facetiously, that "this case involves the government's regulatory power — the power to supervise thousands of thrifts,"³¹⁸ a conclusion that did not thoughtfully consider the true context or genesis of FIRREA.³¹⁹ It concluded that "in light of the long history of pervasive thrift regulation, and in light of the events in Congress before and during the negotiation of the agreement in this case, we share the Eleventh Circuit's view . . . [that] the thrift 'in effect

311. *Id.*

312. 967 F.2d 598 (D.C. Cir. 1992).

313. *Transohio Sav. Bank v. Director*, 967 F.2d 598, 624 (D.C. Cir. 1992).

314. 745 F.2d 1500 (D.C. Cir. 1984) (en banc), *vacated on other grounds*, 471 U.S. 1113 (1985).

315. *Transohio*, 967 F.2d at 613 (quoting *Ramirez de Arellano v. Weinberger*, 745 F.2d 1500, 1527 (D.C. Cir. 1984) (en banc), *vacated on other grounds*, 471 U.S. 1113 (1985)).

316. *Id.* at 618 (quoting *Western Fuels-Utah, Inc. v. Lujan*, 895 F.2d 780, 789 (D.C. Cir.), *cert. denied*, 498 U.S. 811 (1990)).

317. *Id.* at 619 (emphasis added).

318. *Id.*

319. *See generally supra* notes 222-24 and accompanying text.

wager[ed] the chance that the rules would be changed against the potential return if they were not."³²⁰ The court then ruled against Transohio on the basis of a second reason: Even if the contract "unmistakably" preserved the thrift's right to use supervisory goodwill, the agreement was ultra vires because a regulatory body could not contract away Congress's power to change the regulations absent an "unmistakable" delegation by Congress of the power to enter into such a contract.³²¹

In *Charter Federal Savings Bank v. Director*,³²² the United States Court of Appeals for the Fourth Circuit reviewed a declaratory judgment against both the OTS and FDIC which held that the Bank was entitled to rescission of its contract to acquire certain Virginia thrifts executed in 1981 and 1982. The district court's opinion was not entirely clear on the point, but it appeared to accept the conclusion that FIRREA had abrogated the contracts; the court of appeals explicitly assumed that it did, stating that the OTS argued and Charter appeared to concede the point before the court of appeals.³²³ The court of appeals reversed the district court, treating the question to be whether the implied-in-fact contracts created a right to continued use of supervisory goodwill notwithstanding changes in regulation.³²⁴ The Fourth Circuit held that they did not:

In the context of supervisory goodwill cases, the D.C. and Eleventh Circuits, relying on *Bowen*, have 'interpret[ed] the contract provisions at issue to mean that the agencies would allow [the thrift] to treat supervisory goodwill as regulatory capital only as long as the regulatory regime permitted the agencies to do so. . . .' We follow these cases and hold that the FHLBB did not promise Charter continued use of supervisory goodwill as regulatory capital in the face of a contrary regulatory scheme.

In our cases, like *Transohio* and *Guaranty*, the FHLBB never expressly waived its right to enforce future regulations governing supervisory goodwill. The FHLBB approved Charter's use of supervisory goodwill under its then statutory discretion to permit such accounting practices, but made no explicit promise to Charter of continued approval throughout the life of the amortization period. . . .

Furthermore, the highly regulated nature of the savings and loan industry convinces us that, absent an explicit statement to the contrary,

320. *Transohio*, 967 F.2d at 620 (quoting *Guaranty Fin. Serv., Inc. v. Ryan*, 928 F.2d 994, 999 (11th Cir. 1991)).

321. *Id.* at 620-21.

322. 976 F.2d 203 (4th Cir. 1992).

323. *Charter Fed. Sav. Bank v. Director*, 976 F.2d 203, 210 (4th Cir. 1992).

324. *Id.* at 212-13.

the FHLBB would not have intended to promise Charter continued treatment of supervisory goodwill as capital for the life of the amortization period.³²⁵

Thus, in the district court actions seeking injunctive or declaratory relief (or contract rescission), the thrifts by the end of 1992 had lost the fight. But the courts of appeals — except for the District of Columbia Circuit in *Transohio Savings Bank* and possibly the Fourth Circuit in *Charter Federal Savings Bank* — had left open the possibility that the thrifts could bring a claim for damages in the Claims Court. In fact, the thrifts already had done so, and the litigation was decided by that court in the thrifts' favor by mid-1990. Once again, however, a decision in favor of the industry by a trial tribunal would be overturned by an appeals court; but that court vacated its opinion rather quickly, thereby setting the stage for an ultimate victory by the thrifts at the appellate level.

2. The Claims Court Litigation

a. The Claims Court's Decisions. In July 1990, well before the decisions in *Charter Federal Savings Bank* and *Transohio Savings Bank*, the Claims Court decided as a matter of contractual interpretation that the government, in negotiating forbearances through the Bank Board, had agreed that supervisory goodwill could continue to be used notwithstanding changes in the statute or regulatory policy. In *Winstar Corp. v. United States*,³²⁶ the Claims Court stated:

[T]he government expressly intended to contract for the particular treatment of goodwill at issue in this case, notwithstanding changes in GAAP or in the statutory scheme. There is no support for the defendant's argument that these statements merely were representations of the then-existing regulatory policy. Rather, they illustrate the reality that the promise of continued treatment of goodwill as a capital asset that could be amortized over 35 years was a negotiated and critical term of this particular transaction. It was critical because it was clear that without it no purchaser would have engaged in the transaction.³²⁷

The court rejected the Government's attempt "to mischaracterize plaintiffs' claim as one which improperly seeks to bind the government's power to

325. *Id.* at 212 (citations omitted).

326. 21 Ct. Cl. 112 (1990), *aff'd*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996).

327. *Winstar Corp. v. United States*, 21 Ct. Cl. 112, 115 (1990), *aff'd*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996).

regulate" by reference to the fact that the case was a takings claim, not an injunction suit:

It is critical to this case, and apparently misconstrued by defendant, that plaintiffs are not claiming that the government contractually bound Congress not to change its regulations. Rather, plaintiffs claim that in their particular transaction with the government, it was agreed that they would be permitted to treat supervisory goodwill in a particular way for a fixed number of years. Thus, while Congress' power to regulate is not impaired, the government may be compelled to pay for the results of its actions, especially when in so doing the government actually is paying because it received a benefit.³²⁸

The *Winstar* court expressly indicated that it was simply interpreting the implied-in-fact contract and noted that "it is preferable to resolve disputes in such a way as to avoid constitutional considerations."³²⁹ The court denied the Government's motion to dismiss and cross motions for summary judgment and ordered supplemental briefing on the questions of whether a breach occurred, of whether injury occurred, and of the appropriate measure of relief.³³⁰

The Government filed a motion for clarification, and the court responded with an opinion that calls into question the coherency of the court's own insistence that it was not deciding a constitutional question. In the second opinion (*Winstar II*),³³¹ the Claims Court addressed principally the government's argument that the court's earlier decision was inconsistent with *Bowen v. Public Agencies Opposed to Social Security Entrapment (POSSE)*³³² and an argument that the *POSSE* decision was inconsistent with the "sovereign acts" doctrine.³³³ In *POSSE*, the Supreme Court unanimously upheld amendments to the Social Security Act that eliminated the rights of the state governments to withdraw their employees from the Social Security system.³³⁴ The Claims Court distinguished *POSSE* on the grounds that, in

328. *Id.* at 116.

329. *Id.* at 117.

330. *Id.*

331. *Winstar Corp. v. United States (Winstar II)*, 25 Cl. Ct. 541 (1992), *aff'd*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996).

332. 477 U.S. 41 (1977). This is the case on which the Government relied throughout the litigation in the district courts and courts of appeals in response to "takings" arguments. *See supra* notes 275-80 and accompanying text.

333. *See Winstar II*, 25 Cl. Ct. at 544-53.

334. *See Bowen v. Public Agencies Opposed to Social Security Entrapment (POSSE)*, 477 U.S. 41, 51-56 (1977).

the prior cases, the parties contracting with the government — the state and local governments — had no rights under the regulatory scheme:

In *POSSE*, however, unlike the case here, no such vested rights were created as the basic elements of contract formation were absent. In contracts involving the government, as with all contractual relationships, rights vest and contract terms become binding when, after arm's length negotiation, all parties to the contract agree to exchange real obligations for real benefits. In *POSSE*, the Court determined that such vested contract rights did not exist. Although the Court did not explicitly so state, the facts of *POSSE* make it clear that the provisions of the original Social Security Act were not promulgated after negotiation, arm's length or otherwise, between Congress and the plaintiffs who filed suit. As is the case with all legislation, the only 'negotiations' or bargaining involved in the enactment of the original Social Security Act and its amendments took place in the halls of Congress. The 'rights' at issue in *POSSE*, then, were solely government-created. They were really policy decisions made by the democratic process.³³⁵

In response to the "sovereign acts" argument — which holds that "the government is not contractually liable, absent an express agreement to the contrary, for the consequences of acts performed in its sovereign capacity"³³⁶ — the court held that the "doctrine grants the government immunity only where the government action alleged to constitute a breach is 'public and general' in nature," as opposed to circumstances in which "the government abrogates through a limited and focused action specific government obligations to a particular class of individuals or entities it has contracted with."³³⁷ The Claims Court held that, in the case of the supervisory goodwill agreements, "taking away plaintiffs' right . . . was not the necessary means to a broad public end, rather it was the government's end goal," and that "[a]lthough the court accepts as a given that the government sought to promote the public welfare in enacting FIRREA as a whole, those specific provisions of the Act altering the capital treatment of supervisory goodwill were intended to, and did, impact only upon plaintiffs and those similarly situated."³³⁸

In *Statesman Savings Holding Corp. v. United States*,³³⁹ the Claims Court decided two claims by larger thrifts, Statesman and Glendale Federal

335. *Winstar II*, 25 Cl. Ct. at 545-46 (citations omitted).

336. *Id.* at 550.

337. *Id.* at 551.

338. *Id.* at 552.

339. 26 Cl. Ct. 904 (1992)

Bank. The *Statesman* decision was handed down after *Transohio*, and the court answered the two arguments of *Transohio*.³⁴⁰ In answering the "unmistakeability" argument, premised on *POSSE*, the court held that the doctrine applied to interpretations of contracts under which it is claimed that the government waived a sovereign power, rather than to the question whether actions under a contract, required by a subsequent sovereign act, constitute contract breaches triggering a right to compensation.³⁴¹ In answering the question whether the thrifts' interpretation required that the agency be construed to have had the power to bind the exercise of Congress's power, the Claims Court's language bordered on vitriolic:

Whether an agency has the power to bind Congress is a false issue in all of the *Winstar* cases. . . . All agencies of the executive branch, other than the President, are established by the Congress, with certain powers and certain duties. By exercising these powers and fulfilling these duties an agency immediately and continuously creates legal effects on private rights. This exercise of power in no way 'binds' Congress as a legislative body. It can, however, and continuously does, create rights on the part of private individuals that are held against and restrict government action. Once a salary check is paid, a surplus auto sold, a grant finally delivered, a license issued, a promotion secured, a contract let, or a title transferred, a legal right is created that under the Constitution binds the government. That property right cannot be taken away or diminished by the government without process of law, and in many cases even with process of law, it is immune to recapture. To suggest, then, that an agency action cannot confer rights which the government must honor is to suggest a notion that is as novel as it is anathema to our constitutional system.

. . . .

In recognizing that binding contractual rights were created and that those rights must be honored, the court stresses what the contrary conclusion entails. The *Transohio* court interpreted the contract between the

340. See *Statesman Sav. Holding Corp. v. United States*, 26 Cl. Ct. 904, 916-23 (1992), *aff'd sub nom. Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995).

341. See *id.* at 919-21. The point follows from the court's interpretation of *POSSE* in *Winstar II*: In *POSSE*, the government's prior practice of permitting state withdrawal from the Social Security system was regarded as an act of sovereign dispensation, not a restraint on government action procured by bargaining on the part of its contract partner. See *Bowen v. Public Agencies Opposed to Social Security Entrapment (POSSE)*, 477 U.S. 1, 55 (1977) ("The termination clause was not . . . a term over which the States had any bargaining power or for which the State provided independent consideration."). The Supreme Court, according to the Court of Claims, simply was saying that if that sovereign dispensation had been meant to be surrendered, the contracts in question had to say so unmistakably. See *id.* at 55-56. The Claims Court's interpretation of *POSSE* is probably correct, although the matter may not be quite so clear as the Claims Court assumed. See *infra* notes 374-89 and accompanying text.

government and the acquiring thrifts as embodying nothing more than a gamble The Claims Court and its predecessor, the Court of Claims, was formed with the purpose of instilling confidence in dealing with the federal government that the government would honor its obligations to its citizens. . . . To conclude that all dealings with the government constitute nothing more than 'a very elaborate and expensive form of gambling' is thus at variance with the very ideal upon which this court, the Tucker Act, and ultimately the rule of law is based.³⁴²

The Court consolidated the *Statesman*, *Glendale*, and *Winstar* cases and certified them on interlocutory appeal to the Federal Circuit.³⁴³

b. The Federal Circuit. A divided panel of the Federal Circuit reversed the Claims Court in the three cases in *Winstar Corp. v. United States*.³⁴⁴ The panel held that the agreements between the thrifts and the Bank Board were subject to the sovereign acts doctrine. It disagreed with the Claims Court's view that the purpose of FIRREA's abrogation of the contracts "was to take away plaintiffs' rights to use supervisory goodwill,"³⁴⁵ holding that "FIRREA's capital reforms are 'general and public' acts to which the Sovereign Acts Doctrine applies," citing references in the legislative history to the accounting practices as "gimmicks," and holding that those "methods which had been approved were disapproved for all the industry because of the perceived harm to the public."³⁴⁶ The court then construed the contracts at issue to allocate the risk of a change in the regulations on which the use of supervisory goodwill was predicated entirely on the thrifts, relying heavily on *POSSE* and the "unmistakability" doctrine and reflecting the interpretation of *POSSE* in *Transohio* rather than the Claims Court's interpretation. The panel brushed aside the Claims Court's view that the "unmistakability" doctrine did not apply to claims for damages:

This distinction in remedies, though significant to the law of takings, is not relevant to the plaintiffs' claims for breach of contract. A breach requires a binding promise. . . . Specific performance and damages are merely alternative remedies for breach, for which damages is the primary

342. *Statesman*, 26 Cl. Ct. at 917, 918, 919 (citation omitted).

343. *Id.* at 923-24.

344. 994 F.2d 797, 813 (Fed. Cir. 1993).

345. *Winstar Corp. v. United States*, 994 F.2d 797, 808 (Fed. Cir. 1993), *vacated and rev'd*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996) (quoting *Winstar Corp. v. United States*, 25 Cl. Ct. 541, 552 (1992), *aff'd*, 64 F.3d 1531 (Fed. Cir. 1995)) (emphasis omitted).

346. *Id.* at 808, 809.

remedy. Where no contractual duty exists, no breach of contract is possible and no judgment for damages can be obtained. Because these contracts did not obligate the Bank Board (or OTS) to regulate in a manner inconsistent with FIRREA, the change in treatment of goodwill does not violate a contractual duty and cannot support a claim for damages for breach.³⁴⁷

The court declined to consider the constitutional takings claim, holding that "[t]o the extent a plaintiff's other claims are not premised upon the taking of a *contract right* to continue to use goodwill as regulatory capital, such claims remain for decision."³⁴⁸

Judge Newman dissented, relying largely on grounds that had been advanced by the Claims Court. She argued that "acts of government that directly abrogate existing contractual obligations, even if undertaken for reasons of general welfare, are not immune from liability"³⁴⁹ and cited passages in the legislative history discussing the forbearance transactions as evidence that "these contracts were targeted, and not an incidental side-effect of a general and public law."³⁵⁰ She disputed the majority's conclusion that, even assuming the application of the sovereign acts doctrine, the loss should fall entirely upon the thrifts: "The government thus expressly agreed that in the event of regulatory change, the negotiated forbearances and accounting procedures would govern."³⁵¹

On August 18, 1993, the court entered an order vacating its earlier judgment, withdrawing the opinion, and granting rehearing en banc.³⁵² More than two years later, the en banc court affirmed the Federal Claims Court.³⁵³ The court found that contracts unquestionably existed in the three cases before it, resting upon integration clauses in the two cases involving assistance that referred specifically to Bank Board regulations. It then held that "[t]here can be little question that the application of FIRREA and the regulations thereunder to deny or restrict plaintiffs' contractual rights to use supervisory goodwill with the associated amortization periods . . . in partial satisfaction of their capital requirements was a breach of the FSLIC's and the Bank Board's agreements with [the thrifts]."³⁵⁴

347. *Id.* at 812.

348. *Id.* at 813.

349. *Id.* at 815.

350. *Id.* at 816.

351. *Id.* at 818.

352. *Id.* at 819.

353. *Winstar Corp. v. United States*, 64 F.3d 1531, 1551 (Fed. Cir.1995), *cert. granted*, 116 S. Ct. 806 (1996).

354. *Id.* at 1544.

It then addressed two further questions: the argument as to the "unmistakability" doctrine under *POSSE* and the question of the "sovereign acts" doctrine. As to the former, the Federal Circuit relied heavily upon the lower court's opinion in finding that "the Court in *POSSE* recognized that the government has the power to enter into contracts which confer vested rights,"³⁵⁵ citing *Perry v. United States*³⁵⁶ and *Lynch v. United States*.³⁵⁷ The court stressed the difference between an injunctive claim and a claim for damages and held, following the Claims Court, that the unmistakability doctrine "controls how contractual rights with the government are created" rather than "the effect of the government's breach of contract."³⁵⁸

As to the sovereign acts doctrine, the court held that "government action whose principal effect is to abrogate specific contractual rights does not immunize the government from contractual liability,"³⁵⁹ citing *Everett Plywood Corp. v. United States*³⁶⁰ and *Sun Oil Co. v. United States*.³⁶¹ Referring to Sections 5(t)(3)(A) and 5(t)(9)(B), the court stated that "[t]he statute plainly singles out supervisory goodwill for special treatment, albeit treatment less harsh than other forms of intangible assets."³⁶² It stated that "the FIRREA provisions at issue here targeted thrifts that had undergone supervisory mergers," which was not a "public and general act."³⁶³

IV. The Constitutional Overlay of the Capital Standards Issue

A. The Courts of Appeals Decisions on the Injunctions

Throughout this series of litigation, the courts rarely mentioned constitutional issues. It might be possible to resolve the matter without reference to the constitutional problems, as nearly all of the courts did, despite diametrically opposite results in some cases compared with others. Yet, there were constitutional claims raised before the courts in all but the very earliest cases. The constitutional claims have some validity; however, even if they

355. *Id.* at 1546 (quoting *Winstar Corp. v. United States (Winstar II)*, 25 Cl. Ct. 541, 545 (1992), *aff'd*, 64 F.3d 1531 (Fed. Cir. 1995)).

356. 294 U.S. 330 (1935).

357. 292 U.S. 571 (1934).

358. *Winstar*, 64 F.3d at 1547 (quoting *Statesman Sav. Holding Corp. v. United States*, 26 Cl. Ct. 904, 920 (1992), *aff'd sub nom. Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995)), *cert. granted*, 116 S. Ct. 806 (1996).

359. *Id.* at 1549.

360. 651 F.2d 723 (Ct. Cl. 1981).

361. 572 F.2d 786 (Ct. Cl. 1978).

362. *Winstar*, 64 F.3d at 1549.

363. *Id.* at 1550-51.

are rejected, their presence and relative strength typically influence the disposition of nonconstitutional issues. Furthermore, related constitutional issues have been raised explicitly with respect to kindred difficulties growing out of FIRREA and, in one case, initially accepted by the trial court.³⁶⁴ Thus, it is worth considering, with considerably greater care than is reflected in any of the opinions, the application of the "takings" doctrine to the question of the abrogation of the supervisory goodwill agreements.

As a prefatory matter, it should be noted that the courts of appeals' resolutions of the injunction suits may have been unfortunate, if not mistaken, and that a more careful consideration of the constitutional objections of the thrifts might have led to different results. Sections 401(g) and 401(h) certainly *appear* to preserve the rights of the thrifts under the forbearance agreements, and the government's interpretation of those provisions — that they apply only to agreements affected by the transfer of functions — is on its face a strained one, for which one might demand some level of justification in legislative history or otherwise. The courts of appeals, however, did not demand explanation or support for this argument, but rather looked to textual sources, especially legislative history, for the more precise question whether Congress intended to abrogate the forbearance agreements. As the discussion above indicates, the basis for the courts' conclusion that Congress intended to abrogate was principally statements made by individual congressmen or groups of identified congressmen either in floor debates or in separate views appended to committee reports. Neither the statute itself nor the committee reports explicitly addressed the question. But whatever the merits of relying on legislative history generally³⁶⁵ or upon statements by individuals particularly,³⁶⁶ there is more than usual reason to be suspicious of such sources in this case. The question of abrogation was, as noted above, a significantly contested issue through the final days of crafting the legislation; it was one on which the most important interest and lobbying groups — the commercial banking industry and the thrift industry — focused.³⁶⁷ The thrifts publicly made known their intention to litigate the question before

364. *Branch ex rel. Maine Nat'l Bank v. United States*, 31 Fed. Cl. 626, 632-37 (Cl. Ct. 1994), *rev'd*, 69 F.3d 1571 (Fed. Cir. 1995).

365. The leading adherent of disregarding legislative history generally is of course Justice Scalia — a view he has expressed in such decisions as *Sable Communications v. FCC*, 492 U.S. 115, 131-33 (1989) (Scalia, J., concurring); *Green v. Bock Laundry Machine Co.*, 490 U.S. 504, 527-30 (1989) (Scalia, J., concurring); and *Edwards v. Aguillard*, 482 U.S. 578, 610-40 (1987) (Scalia, J., dissenting).

366. See Muriel Morisey Spence, *The Sleeping Giant: Textualism as Power Struggle*, 67 S. CAL. L. REV. 585 (1994).

367. See *supra* notes 217-21 and accompanying text.

final enactment. As Congress addressed the question in neither text nor committee reports, it probably was evading the question altogether. The consideration of the Hyde Amendment — which provided for a hearing procedure without specifying statutory standards as to what was being heard (that is, without saying one way or another whether agreements were being abrogated and what Congress intended to provide in the way of compensation if they were) — only reinforces that conclusion.

Given such a visible form of congressional evasiveness, taken together with the fact that Congress was "upset[ting] previously settled expectations"³⁶⁸ and that constitutional concerns were present, might not the courts have been more judicious in deciding not to read Section 401(g) in its most apparently normal way? The fact that the courts uniformly (eight panels of eight different circuits) reached this result — that Sections 401(g) and 401(h) did not preserve the thrifts' rights under the forbearance agreements — with only a single dissenting judge (Judge Contie in *Franklin Federal Savings*) displays tendencies that characterized the performance of the federal courts generally in the immediate aftermath of FIRREA. Courts did not take constitutional questions seriously — in part because of a judicial reluctance to become involved in or "constitutionalize" an area of intense federal regulation and in part because of an attitude that only property rights were at issue, the importance of which has been downplayed since the late 1930s.³⁶⁹ Courts were deferential to the regulatory agencies, whether explicitly invoking the *Chevron* doctrine or not. Courts were tolerant of FIRREA itself and prone to accept the account of the thrift crisis that attributed it to insider dealing, lax if not corrupt regulation, and other avoidable conduct — rather than an outcome of a larger political and economic process that had a constructive end but unavoidable casualties and almost certainly unavoidable costs as well.

Moreover, injunctive relief might well have had salutary practical consequences. When it enacted FIRREA, Congress did not provide the RTC with sufficient funding to resolve all failing thrifts — it had to revisit the funding question twice, in the Resolution Trust Corporation Improvement Act of 1991³⁷⁰ and in the Resolution Trust Corporation Completion Act of 1993.³⁷¹ Had the abrogation question been resolved against the government

368. *Franklin Fed. Sav. Bank v. Director*, 927 F.2d 1332, 1341 (6th Cir.) (Contie, J., dissenting), *cert. denied*, 502 U.S. 937 (1991).

369. See Richard A. Epstein, *Takings: Descent and Resurrection*, 1987 SUP. CT. REV. 1, 19-20 (noting lax standard of judicial review for land use regulation).

370. Pub. L. No. 102-233, 105 Stat. 1761 (1991).

371. Pub. L. No. 103-204, 107 Stat. 2369 (1993).

at an early date, the damages question would have been averted and a compromise could have been reached in connection with legislation that was going to be enacted in any event. In 1987, FSLIC appropriated its secondary reserve to fund the thrift crisis.³⁷² This action too would have been subject to court challenge, but the challenge was avoided by a compromise reached under the Competitive Equality Banking Act.³⁷³ Should the matter be resolved in the thrifts' favor by the Supreme Court, the amount involved — \$15 billion — will have to be appropriated somehow. In the end, the matter will probably require a legislative solution that will almost surely be more expensive to both the fisc and the thrifts (and to their various constituencies, including nondepositor creditors and other uninsured claimants) than solutions that might have been achieved had the courts of appeals sustained the early injunctions issued by the district courts.

Considerations of this sort have led to a change in approach by the federal courts to FIRREA litigation generally. That change warrants an examination of the "takings" problem in the capital standards cases, to which we now turn.

B. The "Takings" Question

1. The Reasons for Examining Takings Analysis

The discussion above suggests that, although both the Claims Court and the Federal Circuit purported to rest their divergent conclusions on contract grounds, neither convincingly avoided constitutional concerns, if indeed they really avoided the constitutional question at all. In *Winstar II*, the Claims Court contended with the constitutionally based *POSSE* decision by reference to the "vested rights" of the plaintiffs.³⁷⁴ However, "vested rights" is suggestive of the "distinct" or "reasonable investment-backed expectations" notion that figures prominently in the modern takings jurisprudence of the Supreme Court.³⁷⁵ In *Statesman Savings Holding Corp.*, the Court drifted further into constitutional rhetoric in responding to the position of the *Trans-ohio* decision that a regulatory agency could not bind Congress: The answer

372. See Linda Ellis, *FSLIC Writeoff Pinches Thrifts in East: Secondary Reserve Losses Were a Factor in Results*, AM. BANKER, July 17, 1987, at 12.

373. Pub. L. No. 100-86, § 307, 101 Stat. 552 (1987).

374. *Winstar Corp. v. United States*, 25 Cl. Ct. 541, 545-46 (1992), *aff'd*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996); see *supra* note 335 and accompanying text.

375. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005 (1984); *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978); see *infra* notes 398-448 and accompanying text.

was that agencies "can . . . and continuously d[o]" create private rights that "cannot be taken away or diminished by the government without process of law, and in many cases even with process of law, it is immune to recapture."³⁷⁶ Whether the *Statesman Savings* court based its decision on contract or Fifth Amendment principles is unclear.

The en banc decision is still less convincing in avoiding takings analysis.³⁷⁷ Regarding the unmistakability doctrine, the Federal Circuit, too, resorts to a discussion of "vested rights" that the parties were held to have contemplated, and the opinion relies upon two takings cases, *Perry v. United States* and *Lynch v. United States*.³⁷⁸ The opinion is quite conclusory, too, in finding that the supervisory goodwill provisions were not public and general acts, but targeted the very numerous thrifts that had supervisory goodwill forbearances.³⁷⁹ The provisions applied to all institutions. The capital rules were general. The difficulty is that this "sovereign act" may have destroyed contractual rights, or values under those rights, for which the government might be required to compensate *even if the contractual rights had arisen under contracts with private parties*. The sovereign acts doctrine is a largely ineffective idea in this context, in which the question really is whether the government has "taken" something for which it would be required to compensate even were its part in the transaction played by a private party. The analysis above, demonstrating that the amount of forbearance is directly determinative of the amount of assistance a private party would demand,³⁸⁰ is germane to the point — it demonstrates that the benefit of the bargain is quantifiable and demonstrates why the rights of a party to the contract should "vest" upon its creation.

376. *Statesman Sav. Holding Corp. v. United States*, 26 Cl. Ct. 904, 918 (1992), *aff'd sub nom. Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996); *see text accompanying note 342, supra*.

377. *See Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995) (holding that change in regulatory capital treatment of supervisory goodwill did not violate contractual duty of FHLBB), *aff'd sub nom. Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995), *cert. granted*, 116 S. Ct. 806 (1996).

378. *See Perry v. United States*, 294 U.S. 330 (1935) (invalidating legislation authorizing redemption of United States Liberty Bonds in currency other than gold); *Lynch v. United States*, 292 U.S. 571 (1934) (invalidating legislation repudiating government's obligation to pay war risk insurance benefits to veterans).

379. *See Winstar Corp.*, 64 F.3d at 1548 (agreeing with Court of Federal Claims that FIRREA provisions were not public and general sovereign acts and that sovereign acts doctrine did not apply).

380. *See supra* part III.A.3 (discussing capital standards, forbearance, and pricing of assistance in assisted transactions).

The question, in fact, is a takings question, not a contract question, and ought to be addressed as such. In the first place, the decisions of the various courts, including finally the Federal Circuit, that there was a "contract" obligating the regulators to allow the use of RAP is quite suspect. The Bank Board resolutions and letters permitting, indeed directing, the use of goodwill, were regulatory *approvals* of transactions executed by private parties, whether with or without assistance. Although the Bank Board has wide discretion in granting or denying such approvals and although judicial review of its action is virtually always unavailing,³⁸¹ in principle, and to an extent in practice that would be demonstrated if the regulators ever acted truly arbitrarily, the regulators are bound to give approval if the private parties meet appropriate conditions. In other words, in allowing the forbearances, the regulators acted in the government's *regulatory*, not its *proprietary*, capacity. Just as clearly, when statutory standards changed (on the assumption, mandated by the holdings in the injunction cases, that Congress had changed them retroactively), the regulators were without discretion to continue applying the old standards — again because they were acting in a *regulatory*, not a *proprietary*, capacity.³⁸²

Thus, it confuses matters greatly to treat the matter like an ordinary breach of contract by the government in its proprietary capacity. The change at issue was a regulatory change mandated by statute that directed administrative action (although there was an administrative interpretation of the statute involved). The fact that the change touched upon rights derived from "agreements" with government corporations is largely coincidental; effects such as those of the retroactive application of Section 5(t) would raise questions whatever the source of the rights or interests touched.

In addition, both the doctrine and the precedent relied upon by the Federal Circuit and the Claims Court demonstrate that the question is really

381. During the 1960s and early 1970s, at the height of an era encouraging judicial review of agency action, with emphasis on expanding review of "informal" action, there were numerous efforts brought, particularly in states like North Carolina and California that were then in the process of liberalizing state branching laws, against federal approvals of new charters or new branches. The nature of this effort is detailed in Kenneth E. Scott, *The Dual Banking System: A Model of Competitive Regulation*, 30 STAN. L. REV. 1, 31-32 (1977). Virtually all challenges to approvals failed. The closest instance of success is *First Nat'l Bank of Fayetteville v. Smith*, 508 F.2d 1371 (8th Cir.), *cert. denied*, 421 U.S. 930 (1974).

382. Even when the deposit insurers act in their "corporate" capacity, for instance, in determining whether an instrument constitutes an insured "deposit" or in administering open bank assistance, *see supra* notes 137-42 and accompanying text (discussing open bank assistance), the insurers act as a regulator under the deposit insurance scheme because they are always furthering the public purposes of depositor protection and risk spreading that govern the deposit insurance scheme.

a takings question, not a contract question. The sovereign acts doctrine is obviously an inadequate tool to protect rights of the kind that the thrifts in the capital standards cases sought to invoke. Quite clearly, Section 5(t) was a sovereign act with a public purpose — it mandated greater capitalization by thrift institutions in exchange for the protection of federally mandated insurance. It applied impartially to all thrifts and conferred advantages on the parties it burdened. It is not a suspect scheme.

The issue is somewhat closer on the question of retroactive application, but even the construction of Congress's purpose in FIRREA that takes forceful account of the *realpolitik* of the capital standards issue — that it was intended to force a swift end to the thrift crisis to shuttle it as quickly as possible away from public attention and that one of its objections was the long-term consolidation of the deposit insurance industry under the aegis of the commercial banking sector — still characterizes even the retroactive application of the provisions as a public purpose. The Federal Circuit precedents applying the sovereign acts doctrine — *Everett Plywood* and *Sun Oil Co.* — are suspect, too, in the same way.³⁸³ In both cases, administrative officers invoked general environmental concerns to abrogate a government contract executed clearly in the government's proprietary capacity (in *Everett Plywood*, for the sale of timber; in *Sun Oil Co.*, for the leasing of offshore tracts for oil and gas exploration). In both cases, the courts found that the official action was unauthorized in any event, but also rejected the government's argument to deny recovery because the acts in question were "sovereign" acts.³⁸⁴ In both cases the environmental concerns that motivated the officials were public policy concerns, however much those concerns may not have properly been within the sphere of the officials in question to consider; in effect, the courts simply were refusing to allow those concerns to override legitimate proprietary interests of the parties involved.

In short, where conflicts of the kind embodied in the capital standards cases are concerned — between the government's interest in regulatory flexibility and private parties' interest in the protection of investment and predictability in dealing with the government — the sovereign acts doctrine is not likely to supply final answers unless it is taken as a doctrine of limited content that for the most part sweeps away private rights.

The Supreme Court decisions relied upon by the Federal Circuit — *Perry* and *Lynch* — recognize considerations of this kind.³⁸⁵ Both cases were

383. See *Everett Plywood Corp. v. United States*, 651 F.2d 723 (Cl. Ct. 1981); *Sun Oil Co. v. United States*, 572 F.2d 786 (Cl. Ct. 1978).

384. See *Everett Plywood Corp.*, 651 F.2d at 731-32; *Sun Oil Co.*, 572 F.2d at 816-17.

385. See *Perry v. United States*, 294 U.S. 330 (1935); *Lynch v. United States*, 292 U.S.

Depression era cases in which the government abrogated significant private rights — pension rights in *Lynch* and the right to have obligations paid in gold coin in *Perry*. In both cases, the Court found that there were contracts with the government, the abrogation of which exceeded congressional power.³⁸⁶ In both cases, too, the Court denied recovery — in *Lynch* because it held that, though the plaintiffs had a substantive right to compensation, the government had not waived sovereign immunity;³⁸⁷ and in *Perry* because the Court found that the right to recover in gold coin could be satisfied by payment of the dollar face amount of the bond because gold coin had been withdrawn from circulation.³⁸⁸ The Court did not in either case trouble itself to consider whether the government action was "public" or "sovereign," which in both cases it almost surely was. The question was whether the public action so disrupted private action as to require compensation.

Furthermore, the takings doctrine is relevant where there is clearly no contract with the government.³⁸⁹ For these reasons, it is worthwhile to re-examine the question of the abrogation of the supervisory goodwill agreements in light of takings analysis.

2. *The Application of Takings Doctrine to the Capital Standards Problem*

The takings clause decisional authority of the Supreme Court is copious, complex, and confusing — a fact that no doubt represents an additional reason why the courts of appeals in the capital standards cases, and particularly the Federal Circuit, shied away from the issue. The Court often begins takings cases by quoting *Penn Central Transportation Co. v. New York City*,³⁹⁰ to the effect that the Court "has been unable to develop any 'set formula' for determining when 'justice and fairness' require that economic injuries caused by public action be compensated by the government, rather

571 (1934).

386. *Perry*, 294 U.S. at 349-51; *Lynch*, 292 U.S. at 579-81. In both decisions, the Court refused to apply the Due Process Clause of the Fifth Amendment to the government action in question; the Contracts Clause of the Constitution, which provides that no state may impair the obligations of contract, does not apply to the federal government.

387. *Lynch*, 292 U.S. at 582-85. *Lynch* is limited in this regard by the Court's subsequent holding in *Armstrong v. United States*, 364 U.S. 40 (1960) (concluding that taking of liens by government constituted Fifth Amendment taking despite immunity of government and its property from suit).

388. *Perry*, 294 U.S. at 354-58.

389. See *infra* notes 390-448.

390. 438 U.S. 104 (1978).

than remain disproportionately concentrated on a few persons."³⁹¹ Instead, the Court has "examined the 'taking' question by engaging in essentially ad hoc, factual inquiries that have identified several factors — such as [1] the economic impact of the regulation, [2] its interference with reasonable investment backed expectations, and [3] the character of the governmental action — that have particular significance."³⁹² These factors are important for analyzing the capital standards problem.

The takings cases of the Supreme Court in the seventeen years since *Penn Central* and especially those of the last ten years, have excited considerable academic attention and controversy.³⁹³ Notwithstanding the lack of a "set formula," these cases appear to fall into two lines, which were identified by Justice Souter in his opinion in *Concrete Pipe & Products of California, Inc. v. Construction Laborers Pension Trust*.³⁹⁴ The first line includes cases dealing with "permanent physical occupation or destruction of economically beneficial use of real property."³⁹⁵ The other line of cases, which might be (and sometimes are) called "regulatory takings" cases, employ a separate analytical framework, one descended from *Penn Central*.³⁹⁶ The former line is more restrictive of government action, more protective of private property rights, and has excited the greatest degree of academic attention.³⁹⁷ Cases in the latter line, if interpreted in certain respects, are potentially more far-reaching because they can create questions concerning

391. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124, *reh'g denied*, 439 U.S. 883 (1978).

392. *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979).

393. See generally *The Jurisprudence of Takings Law*, 88 COLUM. L. REV. 1581 (1988) (issue of several separate articles concerning takings doctrine); Jeremy Paul, *The Hidden Structure of Takings Law*, 64 S. CAL. L. REV. 1393 (1991); Andrea L. Peterson, *The Takings Clause: In Search of Underlying Principles Part II — Takings as Intentional Deprivations of Property Without Moral Justification*, 78 CAL. L. REV. 55 (1990); Andrea L. Peterson, *The Takings Clause: In Search of Underlying Principles Part I — Critique of Current Takings Clause Doctrine*, 77 CAL. L. REV. 1299 (1989).

394. 113 S. Ct. 2264 (1993).

395. *Concrete Pipe & Prods. of California, Inc. v. Construction Laborers Pension Trust*, 113 S. Ct. 2264, 2290 (1993).

396. *Id.*

397. The attention focuses upon the sense that the cases are the "elephant's nose under the tent" in an effort by the conservative wing of the Court to resurrect the pre-New Deal "Constitution of liberty" in contexts far broader than the land use cases in which the doctrine has been articulated. Justice Souter's sharp and, as the text suggests, overdrawn distinction between the two lines seemed an effort to limit the land use cases in this regard, an inclination Justice Souter has shown in other contexts. See *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2925-26 (1992) (Souter, J., dissenting).

a broad range of, if not virtually all, government regulatory initiatives and their consequences for private property rights. But the line between the two lines of decision has not been formally or sharply drawn by the Court, and the course of decision and its consequences for regulation generally is undergoing lively development.

a. Physical Invasions or Occupations. In cases concerning physical invasions or complete occupation of real property, the Court has begun to move away from a doctrinal pattern tolerant of government incursions on private property rights, especially where the government interests asserted involved what may be characterized as aesthetic concerns. The doctrinal pattern restrictive of property rights reached its zenith in *Penn Central Transportation Co. v. New York City*,³⁹⁸ where an ideologically divided Court upheld New York City's refusal, under landmarks preservation legislation, to allow Penn Central to construct an office building at the site of Grand Central Station.³⁹⁹ Justice Brennan wrote for the Court, articulating the three-factor approach noted above,⁴⁰⁰ and was joined by his two colleagues who were most faithful to the received tradition (Justices Blackmun and Marshall), three moderate Justices (Justices White, Powell, and Stewart); the three Justices then sitting who were most suspicious of the received doctrine (Justices Rehnquist and Stevens and Chief Justice Burger) dissented.

Two terms later, the Court began to shift. In *Andrus v. Allard*, Justice Brennan wrote for a unanimous Court, with the Chief Justice concurring only in the judgment, and upheld a congressional prohibition on the sale of parts of protected birds under the Migratory Bird Treaty Act.⁴⁰¹ However, one week later, in a remarkable decision, *Kaiser Aetna v. United States*,⁴⁰² the Court refused to allow the United States to convert a pond that a developer had developed as a marina into an aquatic park without proceeding under the eminent domain power and paying compensation. The roles of the Justices in *Penn Central* were reversed: Justice Blackmun dissented, joined by Justices Marshall and Brennan; Justice Rehnquist wrote the opinion for the 6-3 Court, the center Justices having switched sides. The most remarkable feature of the decision is that the government acted under its Commerce Clause power to regulate navigation, and that power had been held to be

398. 438 U.S. 104 (1978).

399. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 115-22 (1978), *reh'g denied*, 439 U.S. 883 (1978).

400. See *supra* note 392 and accompanying text.

401. 444 U.S. 51 (1979).

402. 444 U.S. 164 (1979).

strictly insulated from challenges under the Takings Clause, even in the era prior to the New Deal under a Supreme Court highly protective of property rights.⁴⁰³ Justice Rehnquist stressed two factors: the magnitude of the private party's investment (with the implication that it had no basis for expecting the government would have substantial interest in taking over the marina) and the extraordinary character of the government's claim (recreational, rather than strictly navigational). The Court stressed that "the factual situation in this case is so different from typical ones involved in riparian condemnation cases"⁴⁰⁴ that "the Government's attempt to create a public right of access to the improved pond goes so far beyond ordinary regulation or improvement for navigation as to amount to a taking."⁴⁰⁵ It stressed the role of local law: The pond "has always been considered to be private property under Hawaiian law," and "what petitioners now have is a body of water that was private property under Hawaiian law, linked to a navigable water by a channel dredged by them with the consent of the Government."⁴⁰⁶ It noted that "[w]hile the consent of individual officials representing the United States cannot 'estop' the United States . . . it can lead to the fruition of a number of expectancies embodied in the concept of 'property' — expectancies that, if sufficiently important, the Government must condemn and pay for before it takes over the management of the landowner's property."⁴⁰⁷ Justice Blackmun disagreed with the majority about the scope of the navigational servitude,⁴⁰⁸

403. See *United States v. Chandler-Dunbar Water Power Co.*, 229 U.S. 53 (1913). In *Chandler-Dunbar*, the Supreme Court held that a riparian owner did not have a right to compensation when the government's construction of a pier cut off his access to navigable water, stating that the "running water in a great navigable stream is [incapable] of private ownership." *Id.* at 69. The Court applied this principle, in a series of equivocal cases reviewed by Justice Rehnquist in *Kaiser Aetna*, to deny any element of compensation for riparian rights to owners of "fast lands" whose property was confiscated for navigational purposes. See *United States v. Rands*, 389 U.S. 121, 122-24 (1967); *United States v. Virginia Electric & Power Co.*, 365 U.S. 624, 627-29 (1961); *United States v. Twin City Power Co.*, 350 U.S. 222, 224-28 (1956). Justice Rehnquist's opinion dismissed this line of cases, observing that "perhaps for the very reason that it is hindsight which we now exercise, the shifting back and forth of the Court in this area until the most recent decisions bears the sound of 'Old, unhappy, far-off things, and battles long ago.'" *Kaiser Aetna v. United States*, 444 U.S. 164, 177 (1979).

404. *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979).

405. *Id.* at 178.

406. *Id.* at 179.

407. *Id.* (citations omitted).

408. *Id.* at 189-90 (Blackmun, J., dissenting) ("However that access or use may have been turned to account for personal gain, and no matter how much the riparian owner had invested to enhance the value, the Court held that these rights were shared with the public at large.").

the importance of the private party's expectations,⁴⁰⁹ and the role of state law.⁴¹⁰

Kaiser Aetna set in motion a series of unclear developments regarding the application of the Takings Clause in real property cases. The Court divided, sometimes stridently, along ideological lines. In *Loretto v. Teleprompter Manhattan CATV Corp.*,⁴¹¹ the Court articulated the idea of a "per se" taking for permanent physical invasions of property. In an opinion by Justice Marshall, joined by four of the members of the *Kaiser Aetna* majority and Justice O'Connor (who had replaced Justice Stewart), the Court held that "when the 'character of the governmental action' . . . is a permanent physical occupation of property, our cases uniformly have found a taking to the extent of the occupation, without regard to whether the action achieves an important public benefit or has only minimal economic impact on the owner."⁴¹² Justice Blackmun dissented, joined by Justices White and Brennan.

The Court expanded the category of per se takings in *Lucas v. South Carolina Coastal Council*,⁴¹³ adding circumstances "where regulation denies all economically beneficial or productive use of land" as the "second situation in which we have found categorical treatment appropriate."⁴¹⁴ Justice Kennedy concurred in the judgment; Justices Blackmun and Stevens filed separate lengthy dissents; Justice Souter filed a statement to the effect that certiorari should have been dismissed as improvidently granted.

The revision of takings law spawned other fairly dramatic and divisive developments between the decisions in *Loretto* and *Lucas*. In *First English Evangelical Lutheran Church v. County of Los Angeles*,⁴¹⁵ the Court held that a county could be liable for a series of temporary takings when a pre-enforcement challenge to a regulation was denied on grounds of ripeness. Chief Justice Rehnquist wrote the opinion of the Court; only Justice Stevens dissented, joined in part by Justices O'Connor and Blackmun. The Court historically has refused to entertain pre-enforcement takings challenges, as

409. *Id.* at 191 (Blackmun, J., dissenting) ("[T]he Government's interest in vindicating a public right of access to the pond is substantial.").

410. *Id.* (Blackmun, J., dissenting) ("[L]ocal law concerns rights of title and use between citizen and citizen, or between citizen and state, but does not affect the scope or effect of the federal navigational servitude.").

411. 458 U.S. 419, 426 (1982).

412. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 434-35 (1982) (citations omitted).

413. 112 S. Ct. 2886 (1992).

414. *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2893 (1992).

415. 482 U.S. 304, 322 (1987).

the courts of appeals did in the supervisory goodwill cases, on grounds that because takings may be effected if compensation is paid, the proper means of vindicating an affected party's rights are in a damages suit after the challenged action has taken place.

In *Nollan v. California Coastal Commission*,⁴¹⁶ the Court held that a state requirement that the owner of a beachfront tract convey an easement along the beach to the state as a condition of the grant of a construction permit constituted the imposition of an unconstitutional condition on a valuable government benefit unless the owner was compensated for the easement. Justice Scalia's opinion said that "our cases describe the condition for abridgment of property rights through the police power as a 'substantial advanc[ing]' of a legitimate state interest,"⁴¹⁷ suggesting a tightening of the traditional rationality standard for testing takings. The decision was 5-4, with Justices Brennan, Marshall, Stevens, and Blackmun dissenting.

The Court's most recent and most far-reaching revision of takings doctrine was an expansion of *Nollan* that concerned the required justification for government land use initiatives. The decision expands the "substantiality" idea of *Nollan* in ways distinctly reminiscent of *Kaiser Aetna*. In *Dolan v. City of Tigard*,⁴¹⁸ Justice Rehnquist's opinion expressly rejected a "reasonable relationship" test for the required "nexus" between a condition imposed on development and the state interest sought to be advanced, on grounds that it was "confusingly similar to the term 'rational basis' which describes the minimal level of scrutiny under the Equal Protection Clause of the Fourteenth Amendment."⁴¹⁹ In its stead, the Court substituted a "rough proportionality" test, which it said "best encapsulates what we hold to be the requirement of the Fifth Amendment."⁴²⁰ The Court stated that "[n]o precise mathematical calculation is required, but the city must make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development."⁴²¹

b. Regulatory Takings. The Court's regulatory takings cases seem to follow a different track, engendering considerably less division on the Court and involving rather different Justices as protagonists. The Supreme Court has on at least five occasions since 1981 granted certiorari to review facial

416. 483 U.S. 825, 841-42 (1987).

417. *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 841 (1987).

418. 114 S. Ct. 2309 (1994).

419. *Dolan v. City of Tigard*, 114 S. Ct. 2309, 2319 (1994).

420. *Id.*

421. *Id.* at 2319-20.

Takings Clause challenges to complex federal regulatory schemes.⁴²² In four of the cases, the Court rejected the challenges. In one case, *Ruckelshaus v. Monsanto Co.*,⁴²³ the Court upheld the challenge. Although the other cases upheld the schemes against the facial attacks, in virtually all of the other cases, the Court at least implicitly, and Justice O'Connor explicitly, indicated that "as applied" challenges to the schemes might be appropriate under the Takings Clause.

i. Monsanto and Investment-Backed Expectations in Fields Occupied by Legislation. *Monsanto* involved data disclosure and data consideration provisions of the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA).⁴²⁴ As originally adopted in 1947, FIFRA provided protection for "information relative to formulas of products,"⁴²⁵ but was silent about health and safety information. In 1972, the statute was amended to provide for the use of data, submitted by one applicant for registration of a pesticide, in consideration of later applicants, provided the later applicant agreed to compensate the first applicant⁴²⁶ — what the Supreme Court characterized as a "mandatory data-licensing scheme."⁴²⁷ The amount of compensation was to be negotiated by the parties or, if they could not agree, was to be determined by the Environmental Protection Agency (EPA), subject to judicial review. The amended provision protected trade secrets or commercial or financial information, but did not define the term.⁴²⁸ The statute also did not specify an effective date for the data consideration provision; a 1975 amendment added a January 1, 1970 effective date.⁴²⁹

In 1978, Congress amended FIFRA to give applicants a ten-year period of exclusive use for data on new active ingredients in pesticides registered

422. *Concrete Pipe & Prods. of Cal., Inc. v. Construction Laborers Pension Trust*, 113 S. Ct. 2264 (1993); *Preseault v. Interstate Commerce Comm'n*, 494 U.S. 1 (1990); *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211 (1986); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984); *Hodel v. Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264 (1981).

423. 467 U.S. 986 (1984).

424. Federal Insecticide, Fungicide, and Rodenticide Act [hereinafter FIFRA], 7 U.S.C. §§ 136-136(y) (1994).

425. FIFRA, ch. 125, § 8(c), 61 Stat. 163, 170 (1947), amended by FIFRA, 86 Stat. 973 (1972).

426. *Id.* § 3(c)(1)(D), 86 Stat. 979-80 (1972) (current version at 7 U.S.C. § 136(c)(1)(F)(ii) (1994)).

427. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 999 (1984).

428. FIFRA, § 10(a)-(c), 86 Stat. 973, 989 (1972) (current version at 7 U.S.C. § 136(h) (1994)).

429. FIFRA, § 12, 89 Stat. 755 (1975).

after September 30, 1978. The statute also allowed all other data submitted after 1969 to be considered in support of another application for fifteen years from the date of the original submission, provided that an applicant agreed to compensate the applicant who submitted the original application. In the absence of an agreement, the statute provided for a binding arbitration proceeding, not subject to judicial review (absent fraud or misrepresentation). Notwithstanding a statutory prohibition against disclosure of trade secrets, a second amendment of the statute provided for the disclosure of all health, safety, and environmental data to qualified requesters, subject to restrictions on disclosure of manufacturing or quality control processes or disclosure to foreign or multinational pesticide companies.

Monsanto, which had incurred costs in excess of \$23.6 million in developing health, safety, and environmental data submitted under FIFRA, sought to enjoin the operation of these provisions. The district court granted the injunction,⁴³⁰ and the government appealed. The Supreme Court vacated the injunction, holding that there was no taking with respect either to information submitted prior to the 1972 amendment or after the 1978 amendment.⁴³¹ However, the Court further held that the EPA's use of the data in the period between the amendments constituted a taking compensable by a Tucker Act damage remedy in the Claims Court. The Court found as a preliminary matter that a trade secret could constitute property subject to the Takings Clause, relying on earlier cases finding "other kinds of intangible interests to be property" subject to the clause.⁴³² On the question whether there was a taking, the Court examined the three factors identified by Justice Brennan's opinion in *Penn Central*:⁴³³ "the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations."⁴³⁴ The Court rested its conclusion on the last of the three factors, finding "that the force of this factor is so overwhelming, at least with respect to certain of the data submitted by Monsanto to EPA, that it disposes of the taking question regarding those data."⁴³⁵

430. *Monsanto Co. v. Acting Administrator*, U.S. EPA, 564 F. Supp. 552 (E.D. Mo. 1983), *vacated and remanded sub nom. Ruckelshaus v. Monsanto Corp.*, 467 U.S. 986 (1984).

431. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984).

432. *See id.* at 1003 (citing *Armstrong v. United States*, 364 U.S. 40, 44, 46 (1960)); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 596-602, *reh'g denied*, 296 U.S. 661 (1935); *Lynch v. United States*, 292 U.S. 571, 579 (1934).

433. 438 U.S. 104 (1978).

434. *Monsanto*, 467 at U.S. 1005 (quoting *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978)).

435. *Id.*

The Court's opinion, however, is unclear about the role "investment-backed expectations" play in the takings area. The district court was relatively straightforward in finding a taking based on a great disproportion between the effect the regulation had on Monsanto's previous investment commitment and the governmental benefit derived from the regulatory scheme. The Supreme Court, by contrast, avoided expressions concerning regulatory purposes or the relation of the scheme to those purposes. It first held that there was no taking in the post-1978 period because the statute placed the company on notice that data would be disclosed according to certain procedures known to the company:

Monsanto argues that the statute's requirement that a submitter give up its property interest in the data constitutes placing an unconstitutional condition on the right to a valuable Government benefit. But Monsanto has not challenged the ability of the Federal Government to regulate the marketing and use of pesticides. Nor could Monsanto successfully make such a challenge, for such restrictions are the burdens we all must bear in exchange for "the advantage of living and doing business in a civilized community." This is particularly true in an area, such as pesticide sale and use, that has long been the source of public concern and the subject of government regulation. That Monsanto is willing to bear this burden in exchange for the ability to market pesticides in this country is evidenced by the fact that it has continued to expand its research and development and to submit data to EPA despite the enactment of the 1978 amendments to FIFRA. Thus, as long as Monsanto is aware of the conditions under which the data are submitted, and the conditions are rationally related to a legitimate Government interest, a voluntary submission of data by an applicant in exchange for the economic advantages of a registration can hardly be called a taking.⁴³⁶

The Court held that, for the period prior to 1972, neither FIFRA nor the Trade Secrets Act⁴³⁷ created "a reasonable investment-backed expectation" that data submitted to EPA would remain confidential.⁴³⁸

However, for data submitted between 1972 and 1978, the Court found that the statutory provisions promised "an extensive measure of confidentiality and exclusive use" that formed the "basis of a reasonable investment-backed expectation."⁴³⁹ Furthermore, it held that Monsanto was not relegated to the FIFRA arbitration procedure to recover its losses from the data

436. *Id.* at 1007 (citations omitted).

437. 18 U.S.C. § 1905 (1994).

438. *Monsanto*, 467 U.S. at 1009.

439. *Id.* at 1011.

disclosure and consideration provisions during that period, but instead could bring a damages action in the Claims Court.⁴⁴⁰

Justice O'Connor filed an opinion concurring in part and dissenting in part.⁴⁴¹ She dissented from the holding regarding the pre-1972 period.⁴⁴² She questioned whether "the degree of Government regulation determines the reasonableness of an expectation of confidentiality"⁴⁴³ and thought that "the extent of Monsanto's pre-1972 expectations, whether reasonable and investment-backed or otherwise, is a heavily factual question."⁴⁴⁴ Therefore, she would have remanded for factual findings on the question.⁴⁴⁵

The *Monsanto* decision, as applied to takings questions in the banking context, is in many respects unsatisfying precisely because of its interpretation of "investment-backed expectations" as determined by the federal statutory scheme. For instance, it is clear from the opinion that, although the Court found that the federal statute created reasonable investment-backed expectations, Monsanto was not limited to damages resulting from *violations* of the statute, but, rather, it could receive compensation for all losses due to the loss of control over its information, even those caused when the EPA fully complied with the statutory provisions.⁴⁴⁶ In this sense, Justice O'Connor's view is more satisfactory than the Court's: She would have based the right to just compensation under the Takings Clause on the sacrifice of rights created by state law, with the central question being the expectations *in fact* of the burdened party.

However, the Court and Justice O'Connor agreed on the post-1978 period.⁴⁴⁷ Still, the explanation — referring exclusively to reasonable investment-backed expectations⁴⁴⁸ — is unsatisfactory there as well because the post-1978 provisions created as much of a government guarantee as did their predecessors from 1972 to 1978. Yet, compliance by the EPA with the later-enacted provisions would exhaust a burdened party's constitutional

440. *Id.* at 1017-20.

441. *Id.* at 1021 (O'Connor, J., concurring in part and dissenting in part).

442. *Id.* (O'Connor, J., concurring in part and dissenting in part).

443. *Id.* at 1022 (O'Connor, J., concurring in part and dissenting in part).

444. *Id.* at 1024 (O'Connor, J., concurring in part and dissenting in part). Justice O'Connor was "puzzled" by the Court's statement that "an 'industry that long has been the focus of great public concern and significant government regulation' can have no reasonable expectation that the Government will not later find public disclosure of trade secrets to be in the public interest." *Id.* at 1022 (O'Connor, J., concurring in part and dissenting in part).

445. *Id.* at 1024 (O'Connor, J., concurring in part and dissenting in part).

446. *Id.* at 1019-20.

447. *Id.* at 1021 (O'Connor, J., concurring in part and dissenting in part).

448. *Id.* at 1005-07.

rights. Without venturing into questions of the adequacy of the government purpose, the Court seemed to be saying that the question was a matter of degree: At some point, the government had to be able to extinguish *Monsanto's* rights without compensation in the interest of the regulatory scheme. The more careful statutory procedures and the lesser substantive burdens imposed in the later statute were enough to avoid a taking, although the Court's opinion does not really explain why.

ii. Other Contemporary Regulatory Takings Cases. A series of cases involving facial challenges to government regulatory schemes buttresses *Monsanto's* conclusion that the Takings Clause limits such schemes, although *Monsanto's* ambiguities are not clarified. *Hodel v. Virginia Surface Mining & Reclamation Ass'n*⁴⁴⁹ upheld against a variety of constitutional challenges the Surface Mining Control and Reclamation Act of 1977,⁴⁵⁰ which enacted comprehensive federal environmental regulation of strip mining. The Court reversed a district court judgment striking down, as unconstitutional takings, provisions that required operators to restore steep-slope surface mines to their original contour and provisions that prohibited mining in certain locations.⁴⁵¹ Justice Marshall's opinion for the Court stated that the lower court decision "ignored this Court's oft-repeated admonition that the constitutionality of statutes ought not be decided except in an actual factual setting that makes such a decision necessary," a rule "particularly important in cases raising allegations of an unconstitutional taking of private property."⁴⁵² Justice Powell, concurring, stressed that "[t]he 'taking' issue remains available to, and may be litigated by, any owner or lessee whose property interest is adversely affected by the enforcement of the Act."⁴⁵³ In connection with this observation, Justice Powell discussed the potential deleterious effects of the Act on certain areas of his native Virginia.⁴⁵⁴

In *Connolly v. Pension Benefit Guaranty Corp.*,⁴⁵⁵ a unanimous Court upheld provisions of the Employee Retirement Income Security Act of 1974 (ERISA)⁴⁵⁶ and the Multiemployer Pension Plan Amendments Act of 1980

449. 452 U.S. 264 (1981).

450. 30 U.S.C. §§ 1201-1328 (1994).

451. *Hodel v. Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 293-94 (1981).

452. *Id.* at 294-95.

453. *Id.* at 306.

454. *Id.* at 306-07 (Powell, J., concurring).

455. 475 U.S. 211 (1986).

456. 29 U.S.C. §§ 1001-1461 (1994).

(MPPAA)⁴⁵⁷ that impose monetary liabilities on an employer withdrawing funds from a multiemployer pension plan. A unanimous Court held that neither the imposition of monetary liability, nor the abrogation of contractual provisions governing the plans that limited employers' liability, constituted a taking.⁴⁵⁸ Justice White's opinion sounded the tones of the era of deference to the administrative state: "In the course of regulating commercial and other human affairs, Congress routinely creates burdens for some that directly benefit others."⁴⁵⁹ "[T]he fact that legislation disregards or destroys existing contractual rights does not always transform the regulation into an illegal taking."⁴⁶⁰ "We are far from persuaded that fairness and justice require the public, rather than the withdrawing employers and other parties to pension plan agreements, to shoulder the responsibility for rescuing plans that are in financial trouble."⁴⁶¹ "Prudent employers then had more than sufficient notice not only that pension plans were currently regulated, but also that withdrawal itself might trigger additional financial obligations."⁴⁶² However, the case involved a facial challenge, and Justice O'Connor (joined by Justice Powell) made explicit in her concurrence that her agreement with the Court's opinion did not foreclose as-applied challenges:

I join the Court's opinion and agree with its reasoning and its result, but I write separately to emphasize some of the issues the Court does *not* decide today. Specifically, the Court does not decide today, and has left open in previous cases, whether the imposition of withdrawal liability under the MPPAA and of plan termination liability under the Employee Retirement Income Security Act of 1974 (ERISA) may in some circumstances be so arbitrary and irrational as to violate the Due Process Clause of the Fifth Amendment. The Court also has no occasion to decide whether the MPPAA may violate the Taking Clause as applied in particular cases, or whether the pension plan in this case is a defined benefit plan rather than a defined contribution plan within the meaning of ERISA.

.....

[B]oth statutes impose liability under certain circumstances on contributing employers for unfunded benefits that accrued in the past under a pension plan whether or not the employers had agreed to ensure that benefits would be fully funded. In my view, imposition of this type of retroactive liability on employers, to be constitutional, must rest on some

457. *Id.* §§ 1381-1461.

458. *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 221-28 (1986).

459. *Id.* at 223.

460. *Id.* at 224.

461. *Id.* at 227.

462. *Id.*

basis in the employer's conduct that would make it rational to treat the employees' expectations of benefits under the plan as the employer's responsibility.⁴⁶³

The Supreme Court in fact entertained an as-applied challenge to the MPPAA in *Concrete Pipe & Products of California, Inc. v. Construction Laborers Pension Trust*, an opinion written by Justice Souter.⁴⁶⁴ In that case, the Court refused to apply the "analytical framework . . . employed in our cases dealing with permanent physical occupation or destruction of economically beneficial use of real property."⁴⁶⁵ Those cases articulated per se rules governing takings.⁴⁶⁶ The Court held that attempts such as Concrete Pipe's to "shoehorn" its claim into per se analysis by dividing its property "into what was taken and what was left for the purpose of demonstrating the taking of the former to be complete and hence compensable" had been rejected previously⁴⁶⁷ in *Penn Central*,⁴⁶⁸ the case that first articulated the three-factor approach.

The Court rejected Concrete Pipe's takings argument after an extended application of the three factors to the facts before it.⁴⁶⁹ As to the character of the government action, the Court rejected the argument that the sole purpose of imposing liability was to protect the solvency of the government fund; as to the impact on the burdened party, the Court rejected the notion that liability was out of proportion to the company's experience.⁴⁷⁰ Regarding reasonable investment-backed expectations, the Court noted that at the time the company entered the Plan, it "was already subject to ERISA, and a withdrawing employer faced contingent liability up to 30% of its net worth."⁴⁷¹ It further noted that "Concrete Pipe's reliance on ERISA's original limitation of contingent liability to 30% of net worth is misplaced, there being no reasonable basis to expect that the legislative ceiling would never be lifted."⁴⁷²

463. *Id.* at 228-29 (O'Connor, J., concurring) (citations omitted).

464. 113 S. Ct. 2264 (1993).

465. *Concrete Pipe & Products of Cal., Inc. v. Construction Laborers Pension Trust*, 113 S. Ct. 2264, 2290 (1993) (citing *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2286, 2890-92 (1992)).

466. *See supra* notes 411-14 and accompanying text (discussing per se takings).

467. *Concrete Pipe*, 113 S. Ct. at 2290.

468. 438 U.S. 104, 124 (1978).

469. *Concrete Pipe*, 113 S. Ct. 2290-92.

470. *Id.* at 2290-91.

471. *Id.* at 2291.

472. *Id.* at 2292 (citations omitted).

Justice O'Connor concurred except with respect to the Court's observation concerning reliance on the thirty percent limitation.⁴⁷³ She quoted her dissent in *Connolly* to the effect that imposition of liability requires a "basis in the employer's conduct" and observed that the *Concrete Pipe* Court "does not hold otherwise."⁴⁷⁴ She said that "petitioner has failed to adduce the two features of this case that might have demonstrated why it did not 'accept' the prospect of full withdrawal liability when it joined the Construction Laborers Pension Trust."⁴⁷⁵

*Preseault v. Interstate Commerce Commission*⁴⁷⁶ may clarify some of the ambiguity of *Monsanto*. *Preseault* involved the National Trails System Act, under which the Interstate Commerce Commission (ICC) has authority to refuse to allow abandonment of railroad rights of way that have fallen out of use and to cause the rights of way to be converted to use as recreational trails.⁴⁷⁷ The U.S. Court of Appeals for the Second Circuit rejected a Takings Clause challenge from owners of reversionary interests in the rights of way, on the grounds that the ICC's authority to refuse to permit abandonment prevented the vesting of any reversionary interest in the rights of way.⁴⁷⁸ The Supreme Court affirmed in a unanimous opinion written by Justice Brennan; however, the Court affirmed on grounds that the statute did not eliminate a Tucker Act remedy, relying principally on the remedial aspects of *Monsanto*.⁴⁷⁹ Justice Brennan's opinion makes little reference to the Second Circuit's theory. Justice O'Connor filed a concurring opinion, stressing disagreement with the court of appeals's theory: "The scope of the Commission's authority to regulate abandonments thereby delimiting the ambit of federal power, is an issue quite distinct from whether the Commission's exercise of power over matters within its jurisdiction effected a taking of petitioners' property."⁴⁸⁰ She noted the distinction between the majority's theory and that of the court of appeals.⁴⁸¹

iii. *Regulatory Takings and the Problem of Extraordinariness.* *Monsanto*, *Connolly*, *Preseault*, and *Concrete Pipe & Products* at least suggest,

473. *Id.* at 2292 (O'Connor, J., concurring).

474. *Id.* at 2292 (O'Connor, J., concurring).

475. *Id.* at 2293 (O'Connor, J., concurring).

476. 494 U.S. 1 (1990).

477. 16 U.S.C. §§ 1241-1251 (1994).

478. *See* *Preseault v. Interstate Commerce Comm'n*, 494 U.S. 1, 10 (1990).

479. *Id.* at 11-17.

480. *Id.* at 22 (O'Connor, J., concurring).

481. *Id.* at 23-24 (O'Connor, J., concurring).

and probably establish, that the mere existence of a party in a heavily regulated industry does not eliminate the possibility that a government action seriously affecting the property rights of the industry members may be held to constitute a taking. They also suggest, however, that in such instances the standard imposed to determine whether a taking has occurred will be strict. It is worth viewing these cases in the context of the development of takings law in recent years to discern how the Supreme Court might view a takings claim in the supervisory goodwill cases.

First, all of these cases were written by Justices whose views of the regulatory state tend to be consistent with the dominant view of the post-New Deal era — Justice Blackmun wrote *Monsanto*; Justice White, *Connolly*; Justice Brennan, *Preseault*; and Justice Souter, *Concrete Pipe & Products*. Justice O'Connor wrote separately in all four cases, expressing a consistent and coherent view that is hospitable to the kind of challenge the thrifts will make to the *Winstar* ruling. Her view is not disputed in the majority opinions, but it should be remembered that the Justices writing those opinions may be more hostile than the Court as a whole to Justice O'Connor's opinions.

Second, there are intermediate cases involving both land use problems and regulatory takings problems. Foremost among those is *Keystone Bituminous Coal Ass'n v. DeBenedictis*,⁴⁸² which revisited the problem addressed in *Pennsylvania Coal Co. v. Mahon*,⁴⁸³ a decision that "has for 65 years been the foundation of [the Court's] 'regulatory takings' jurisprudence."⁴⁸⁴ In *Pennsylvania Coal*, the Court invalidated Pennsylvania's Kohler Act, which prevented coal mining in land underneath homes if the mining would cause the subsidence of those homes (and thus destroyed property and contract rights of the miners).⁴⁸⁵ *Pennsylvania Coal Co.* is noted for its observations that "if regulation goes too far it will be recognized as a taking"⁴⁸⁶ and that "an average reciprocity of advantage . . . has been recognized as a justification of various laws."⁴⁸⁷ The case proceeded from the proposition that the interests of the surface owners was not "a public interest sufficient to warrant so extensive a destruction of the defendant's constitutionally protected rights."⁴⁸⁸ In *Keystone Bituminous Coal*, an ideologically divided Court distinguished

482. 480 U.S. 470 (1987).

483. 260 U.S. 393 (1922).

484. *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 508 (1987) (Rehnquist, C.J., dissenting).

485. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 412-16 (1922).

486. *Id.* at 415.

487. *Id.*

488. *Id.* at 414.

Pennsylvania Coal in upholding the Bituminous Mine Subsidence and Land Conservation Act, a latter day version of the Kohler Act.⁴⁸⁹ Justice Stevens's opinion for the Court found that the "character of the government action . . . lean[ed] heavily against finding a taking [because] the Commonwealth of Pennsylvania had acted to arrest what it perceives to be a significant threat to the common welfare."⁴⁹⁰ Furthermore, the Court found that in the later case, unlike the earlier, there was no basis for a finding that the statute made it "impossible for petitioners to profitably engage in their business, or that there ha[d] been undue interference with their investment-backed expectations."⁴⁹¹ Chief Justice Rehnquist, joined by Justices Scalia, O'Connor, and Powell, dissented, noting that the public purposes of the Subsidence Act were not distinguishable from those of the Kohler Act.⁴⁹² Justice Rehnquist also argued that the Subsidence Act effected a virtually "complete" taking of 27 million tons of coal that were required to be left in the ground and of the support estate held by the miners.⁴⁹³

*Hodel v. Irving*⁴⁹⁴ involved provisions of the Indian Land Conservation Act that attempted to force consolidation of fractionated interests in land held under Indian allotment statutes by restricting the rights of holders to transfer their interests by descent and devise.⁴⁹⁵ Justice O'Connor, in her opinion for the Court, noted that the holders' investment-backed expectations were attenuated and that consolidation effected a weak "reciprocity of advantage" to the affected holders.⁴⁹⁶ However, the Court invalidated the statute because of the complete destruction of both the rights of descent and of devise.⁴⁹⁷ Citing *Kaiser Aetna*, the Court found that "the character of the Government regulation here is extraordinary" and observed that "the right to pass on property — to one's family in particular — has been part of the Anglo-American legal system since feudal times."⁴⁹⁸ Justice O'Connor noted that "total abrogation of the right to pass property is unprecedented and likely unconstitutional."⁴⁹⁹

489. *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987).

490. *Id.* at 485.

491. *Id.*

492. *Id.* at 509-11 (Rehnquist, C.J., dissenting).

493. *Id.* at 515-20 (Rehnquist, C.J., dissenting).

494. 481 U.S. 704 (1987).

495. *See Hodel v. Irving*, 481 U.S. 704, 709 (1987) (describing relevant provisions of Indian Land Consolidation Act).

496. *Id.* at 715.

497. *Id.* at 716-18.

498. *Id.* at 716.

499. *Id.*

Thus, the Court found that "the extraordinary step of abolishing both descent and devise of these property interests even when the passing of the property to the heir might result in consolidation of property . . . in the words of Justice Holmes, 'goes too far.'⁵⁰⁰

It is accepted in the commentary, if not the cases, that harmonizing takings law, particularly the novel applications in the regulatory area, depends upon an implicit theory of property rights and the relation of such rights to the state. The minimum contours of such a theory include: First, the cases on regulatory takings recognize a role for some sort of private rights system — ordinarily associated with state law — that is *exogenous* and in some sense *prior* to the system of rights governed by the regulatory system. This point is implicit in Justice O'Connor's separate opinion in *Monsanto*,⁵⁰¹ and explicit in her opinion in *Preseault*,⁵⁰² and in Chief Justice Rehnquist's dissent in *Keystone Bituminous Coal*;⁵⁰³ it is reflected clearly in the *Preseault* majority⁵⁰⁴ and probably the *Monsanto* opinion as well.⁵⁰⁵

Second, the system of rights is conditioned by the regulatory system, but on an unamplified basis that might be called a "notice" basis. That is, the party's rights are held subject to notice of variations in the regulatory system that can modify those rights. The degree of modification that is permissible is determined, it seems, by the nature of the regulatory system in general, instead of by specific rules or by either general or specific attributes of affected private rights. *Connolly*,⁵⁰⁶ perhaps *Virginia Mining & Reclamation*

500. *Id.* at 718 (quoting *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922)).

501. 467 U.S. 986, 1022 (1984) (O'Connor, J., concurring in part and dissenting in part) ("If the degree of Government regulation determines the reasonableness of an expectation of confidentiality, Monsanto had as little reason to expect confidentiality after 1972 as before, since the 1972 amendments were not deregulatory in intent or effect.")

502. 494 U.S. 1, 20 (1990) (O'Connor, J., concurring) ("[S]tate law creates and defines the scope of the reversionary or other real property interests affected by the ICC's actions pursuant to § 208 of the National Trails System Act Amendments of 1983. . . . In determining whether a taking has occurred, 'we are mindful of the basic axiom that "[p]roperty interests . . . are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law.'"") (quoting *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001 (1984) (quoting *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 161 (1980))).

503. 480 U.S. 470, 518-19 (1987) (Rehnquist, C.J., dissenting) (quoting, *inter alia*, *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 161 (1980), *see supra* note 502).

504. *See* 494 U.S. 1, 11-13 (1990).

505. 467 U.S. 986, 1001 (1984) (quoted at *supra* note 502).

506. 475 U.S. 211, 227 (1986) ("It was also plain enough that the purpose of imposing withdrawal liability was to ensure that employees would receive the benefits promised them.

Ass'n,⁵⁰⁷ *Keystone Bituminous Coal*,⁵⁰⁸ and *Monsanto*⁵⁰⁹ imply this; however, *Preseault*⁵¹⁰ may be in conflict with this point, as may *Nollan*⁵¹¹ and *Dolan*⁵¹² (all of which involve realty). Timing may matter. Under *Monsanto*, that is, a sharp change in regulation may be a taking,⁵¹³ but, as *Connolly* and *Concrete Pipe & Products* suggest, the private party may be subject to an expectation that it adjust after some period of notice.⁵¹⁴ Reliance and, more particularly, capital investment matter under *Kaiser Aetna*,⁵¹⁵ *Monsanto*,⁵¹⁶ and even *Penn Central*.⁵¹⁷ Given *Kaiser Aetna*⁵¹⁸ and *Monsanto*,⁵¹⁹ too, there is little point in pretending that the magnitude of a prior investment matters.

Finally, and most problematically, the nature of the public interests involved *do* matter and *are* subject to some scrutiny. *Kaiser Aetna* stands for the proposition that the magnitude of the public interest will be measured, at least in land cases;⁵²⁰ *Nollan* and *Dolan* stand for the proposition that the

When it became evident that ERISA fell short of achieving this end, Congress adopted the 1980 amendments. Prudent employers then had more than sufficient notice not only that pension plans were currently regulated, but also that withdrawal itself might trigger additional financial obligations.")

507. See 452 U.S. 264, 296-97 & nn.37-38 (1981).

508. See 480 U.S. 470, 499-500 (1987).

509. 467 U.S. 986, 1008-09 (1984) ("In an industry that long has been the focus of great public concern and significant government regulation, the possibility was substantial that the Federal Government, which had thus far taken no position on disclosure of health, safety, and environmental data concerning pesticides, upon focusing on the issue would find disclosure to be in the public interest.").

510. 494 U.S. 1, 13 ("[A] Tucker Act remedy exists unless there are unambiguous indications to the contrary.").

511. See 483 U.S. 825, 840-42 (1987).

512. See 114 S. Ct. 2309, 2316-17, 2317-18 (1994).

513. See 467 U.S. 986, 1010-11 (1984).

514. See *Connolly*, 475 U.S. 211, 227 (1986), quoted *supra* note 506; *Concrete Pipe & Products*, 113 S. Ct. 2264, 2287-88 (1993).

515. 444 U.S. 164, 178 (1993) ("We think, however, that when the Government makes the naked assertion it does here, that assertion collides with not merely an 'economic advantage' but an 'economic disadvantage' that has the law back of it to such an extent that courts may 'compel others to forbear from interfering with [it] or to compensate for [its] invasion.'"); *id.* at 180 ("This is not a case where the Government is exercising its regulatory power in a manner that will cause an insubstantial devaluation of petitioners' private property. . . .").

516. See 467 U.S. 986, 1007 & n.11, 1011 & n.15 (1984).

517. See 438 U.S. 104, 129 & n.26 (1978).

518. See *supra* note 515.

519. See *supra* note 516.

520. 444 U.S. 164, 178 (1979) ("[T]he Government's attempt to create a public right of

scrutiny will not be relaxed terribly, at least in local land cases;⁵²¹ and *Lucas* and *Loretto* stand for the proposition that no public interest will suffice to justify some incursions on land.⁵²² It is Justice O'Connor's opinions, consistent throughout, however, that clearly indicate a demand for some showing of the presence of a general regulatory purpose in specific context, notwithstanding the demonstrable facial validity of a given regulatory scheme. All of Justice O'Connor's opinions are concurrences, with which the majority opinions express no discomfort.

Additionally, the conceptions in *Pennsylvania Coal* of "reciprocity of advantage" and of public schemes benefiting predominantly private parties or of regulation going "too far" are important. These ideas touch on the "extraordinariness" problem in *Hodel v. Irving* and *Kaiser Aetna* (and possibly *Dolan* and *Lucas*),⁵²³ but implicate in particular some inquiry into the relative roles of private and definably public interests in the regulation in question. *Pennsylvania Coal* bears this implication,⁵²⁴ and even the majority in *Keystone Bituminous Coal* is not contrary to it;⁵²⁵ Justice Rehnquist's

access to the improved pond goes so far beyond ordinary regulation or improvement for navigation as to amount to a taking. . . .").

521. See *Nollan*, 483 U.S. 825, 841 (1987) ("That is simply an expression of the Commission's belief that the public interest will be served by a continuous strip of publicly accessible beach along the coast. The Commission may well be right that it is a good idea, but that does not establish that the Nollans (and other coastal residents) alone can be compelled to contribute to its realization.").

522. *Loretto*, 458 U.S. 419, 434-35 (1982), quoted *supra* note 412; *Lucas*, 112 S. Ct. 2886, 2893 (1992), quoted *supra* note 414.

523. See *Kaiser Aetna*, 444 U.S. 164, 178 (1979), quoted *supra* note 520; *Irving*, 481 U.S. 704, 716 (1987) ("But the character of the Government regulation here is extraordinary. In *Kaiser Aetna v. United States*, 444 U.S. at 176, we emphasized that the regulation destroyed 'one of the most essential sticks in the bundle of rights that are commonly characterized as property — the right to exclude others.' Similarly, the regulation here amounts to virtually the abrogation of the right to pass on a certain type of property — the small undivided interest — to one's heirs. In one form or another, the right to pass on property — to one's family in particular — has been part of the Anglo-American system since feudal times.").

524. 260 U.S. 393, 413 (1922) ("As long recognized, some values are enjoyed under an implied limitation and must yield to the police power. But obviously the implied limitation must have its limits, or the contract and due process clauses are gone. One fact for consideration in determining such limits is the extent of the diminution. When it reaches a certain magnitude, in most if not in all cases there must be an exercise of eminent domain and compensation to sustain the act.").

525. 480 U.S. 470, 491 (1987) ("The Court's hesitance to find a taking when the State merely restrains uses of property that are tantamount to public nuisances is consistent with the notion of 'reciprocity of advantage' that Justice Holmes referred to in *Pennsylvania Coal*. Under our system of government, one of the State's primary ways of preserving the public

dissent reinforces the point, as do his opinions in *Kaiser Aetna* and *Dolan*,⁵²⁶ as well as Justice Scalia's opinion in *Nollan* (if not *Lucas*).⁵²⁷ The inquiry into private interests and reciprocity of advantage has pointed, suggestive, and potentially far-reaching implications if one perceives economic and social trends that produce a Rhenification of the national economic structure and if one stresses the role of constitutional tradition in modulating or channeling any such process.

Three different strands in the cases — the examination of the impact of the regulatory scheme on investment-backed expectations; the examination of the rational basis for the presence of statutory purpose in as-applied analysis; and the examination of private interests and reciprocity of advantage within a regulatory scheme — all implicate considering the details of a regulatory scheme in response to a claim of regulatory taking. Consideration of the scheme is in fact rather different under each of these separate inquiries, and there may be tensions between the governing ideas. However, together these inquiries provide a basis for evaluating the nature and content of state activity in relation to private rights that are defined to have a basis exogenous to the scheme. From them can be seen the shadows, if not the outlines, of a theory of property rights in relation to a theory of the state. Moreover, the emerging picture is one that is ideologically more ambiguous — more value ambiguous⁵²⁸ — than is characteristically assumed by the academic (or political) commentary that decries decisional law rediscovering the role of property rights, particularly in relation to an evolving, if not swiftly changing, economic order.

This theory fits into the three-factor approach inherited from *Penn Central Transportation* and *Monsanto*. It is useful to apply the three-factor standard to the supervisory goodwill cases, under which a substantial argument can be made for compensation. That argument implicates the considerations that define a state-property rights interface, suggested above, in ways applicable to other areas of the banking law and potentially to a broader range of regulatory issues as well.

weal is restricting the uses individuals can make of their property. While each of us is burdened somewhat by such restrictions, we, in turn, benefit greatly from the restrictions that are placed on others." (citations omitted).

526. *Id.* at 511 (Rehnquist, C.J., dissenting) ("The nature of these purposes may be relevant, for we have recognized that a taking does not occur where the government exercises its unquestioned authority to prevent a property owner from using his property to injure others without having to compensate the value of the forbidden use.").

527. *Nollan*, 483 U.S. 825, 841 (1987), quoted *supra* note 521.

528. See *supra* notes 24-28 and accompanying text and paragraph following note 43.

First, the nature of the governmental action is extraordinary. As the discussion in Part II details, the forbearance program was part of a legitimate, though peculiar, government effort that had widespread political support. The program reflected the initiatives pursued under the regulators' bill that were incorporated in Garn-St Germain. The objective of the regulators' bill was to minimize the cost of the "first" thrift crisis without appropriation of substantial public funds, by combining troubled thrifts with healthy ones. The belief was that time would tide the thrifts through the period of very high interest rates in the early 1980s. The regulatory accounting practices were not pure gimmicks; at least at the time they were adopted, substantial grounds existed for regarding them as proper accounting. The view of the "right" method of accounting shifted throughout the thrift crisis. However, those shifts were motivated more by political concerns — the effort to "buy time" in the early 1980s, in the expectation that time would heal the problem, and the effort to enact a bailout quickly in 1989, to move the entire issue from public consciousness at as safe a distance from an election as possible — than by objective accounting theory.

The second factor, the impact of the government action, may vary from case to case. However, this factor clearly seems to weigh in the thrifts' favor in those cases in which the abrogation of the goodwill agreements resulted in the insolvency of the institution and where the forbearance had been extended in connection with an acquisition transaction, as opposed to a conversion. For these institutions, the consequence of the government action has not only been the loss of the troubled institutions that they acquired at a price determined by the expectation that they would receive a regulatory forbearance — it has resulted in the loss of their investment in what had been a healthy institution prior to their agreeing to actions that benefited the government. In many takings contexts, the Court analyzes the "impact" factor by reference to a reciprocity of advantage implicit in the regulatory scheme. The concept, which derives from Justice Holmes's opinion in *Pennsylvania Coal*,⁵²⁹ is important in the cases that uphold general zoning ordinances against Takings Clause challenge.⁵³⁰ The reciprocity idea is important in the multiemployer plan withdrawal cases as well. In the banking context, such a principle would uphold, for instance, a requirement that institutions have deposit insurance or exit or entrance fees imposed upon conversions. However, it is difficult to understand what reciprocal advantage an institution gains from the abrogation of the capital standards, particularly when the change in capital standards renders the institution insolvent.

529. 260 U.S. 393, 415 (1922).

530. See *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926).

The final factor, reasonable investment-backed expectations, is ordinarily the critical factor in the regulatory takings cases. The argument, descended from *Monsanto*, *Connolly*, and *Concrete Pipe & Products*, is that one who is engaged voluntarily in a heavily regulated industry has no expectation that the regulations will not be changed. In the context of the supervisory goodwill cases, however, there are reasons this view should not block recovery. At a minimum, the Supreme Court decisions hold that the inquiry should be made on a case-by-case basis, and there should be defined circumstances in which recovery is allowed. Justice O'Connor suggests in *Monsanto* that the question of expectations is a factual one.⁵³¹ In *Connolly*, she explicitly conditions the constitutionality of withdrawal liability on some connection between the employer's conduct and an expectation that it would be responsible for the employee's benefits.⁵³² In the supervisory goodwill cases, by analogy, the constitutionality of the retroactive abrogation of the supervisory goodwill agreements should be conditioned on some basis in the thrifts' conduct that would make it rational to hold them accountable for the "poison" regulatory goodwill allegedly injected into the regulatory system. Such a basis might be shown by reckless conduct on the part of thrift insiders, actual knowledge on their part or on the part of the regulators that the forbearances were inappropriate in the circumstances and masked a condition of true insolvency, or some other similar inappropriate conduct. It is unlikely this showing will be possible in many cases, particularly with courts appearing in recent months to take a more tolerant view of the conduct of bank officers, directors, and representatives.

An outcome to the supervisory goodwill litigation that imposes substantial monetary liability on the government is an unpleasant one and would be the culmination of a series of what, at least in retrospect, look like poor choices on the part of Congress. However, the Claims Court in a recent case in another context has held that "Congress may not remedy the problems now confronting the federal banking system by placing the financial burden on the backs of innocents,"⁵³³ and the Supreme Court's takings cases recognize that the "Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice should be borne by the public as a whole."⁵³⁴ In

531. 467 U.S. 986, 1024 (1984) (O'Connor, J., concurring in part and dissenting in part).

532. 475 U.S. 211, 229 (1986) (O'Connor, J., concurring).

533. Branch *ex rel.* Maine Nat'l Bank v. United States, 31 Cl. Ct. 626, 637 (1994), *rev'd*, 69 F.3d 1571 (Fed. Cir. 1995).

534. *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

light of such principles, an outcome in the supervisory goodwill litigation that imposes compensation liability on the government would be a just one. Those principles also should influence consideration of other aspects of FIRREA that singled out parties on the basis of convenience to contribute to the rescue of the savings and loan industry.

V. Conclusion

The Supreme Court in the *Winstar* case faces a challenge to a far-reaching encroachment, effected by FIRREA, on the rights of private interests in the banking industry. Although the case was decided in the lower courts on contract grounds, the decision raises questions concerning the status as property of rights in contracts with the federal government or government bodies, the abrogation of which may constitute a taking of property requiring compensation under the Fifth Amendment. The Supreme Court should consider the case seriously as a takings case and should employ it to formulate a new doctrine: Even in a heavily regulated industry, government actions having extraordinary consequences for private rights that serve complex government programs in which benefits and burdens among private groups are distributed in a deliberately uneven manner can constitute a taking requiring compensation. Ample precedent for such a result reposes particularly in the Court's decisions in *Kaiser Aetna* and *Hodel v. Irving*, and in the line of regulatory takings cases descended from *Monsanto*.