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THE PRESIDENT HAS SEEN  
9-26-95

THE WHITE HOUSE  
WASHINGTON  
September 7, 1995

95 SEP 11 P4:39

MEMORANDUM TO THE PRESIDENT

FROM: ABNER J. MIKVA *ajm*  
Counsel to the President 

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Associate Counsel to the President

SUBJECT: SAVINGS AND LOAN CASE

On August 30, the U.S. Court of Appeals for the Federal Circuit, sitting en banc, issued a ruling that could add significantly to the cost of cleaning up the savings and loan crisis. The Court held, by a vote of 9-2, that a provision of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which restricted the ability of banks to use "supervisory goodwill" to meet minimum capital requirements, breached contracts between the government and the three thrifts that filed the suit. About 90 other thrifts have similar, but not identical, claims pending in the Federal Circuit. If the Supreme Court does not reverse the Federal Circuit's decision and the pending claims also succeed, the eventual pricetag of the ruling, though still very uncertain, would run in the billions.

The case has its beginnings in the efforts of the Federal Savings and Loan Insurance Corporation (FSLIC), in the early 1980s, to encourage mergers between healthy thrifts and failing ones. As part of this effort, FSLIC allowed merged thrifts to count supervisory goodwill -- the difference between the failing thrift's liabilities and assets -- toward capital requirements. FIRREA expressly repudiated this practice: it greatly restricted the continued use of supervisory goodwill to satisfy capital standards. As a result, many thrifts (including the three that brought this suit) suddenly found themselves in violation of capital requirements and subject to seizure by the government.

The thrifts have argued that FIRREA's restriction on the use of supervisory goodwill breached contracts between the thrifts and the government, entered into at the time of the mergers. The government has defended on the grounds that (1) the government never entered into contracts with the thrifts allowing the use of supervisory goodwill to meet capital standards; and (2) assuming such contracts exist, the government is not liable for any breach of the contracts effected by a general statute such as FIRREA.

Although no official decision has yet been made, the Solicitor General intends to request the Supreme Court to hear the case. The Supreme Court almost certainly will grant this request, both because of the importance of the case to the government and because of an arguable conflict between the

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decision of the Federal Circuit and decisions of other Courts of Appeals. Under the most likely schedule, the Court would take the case in January, hear argument in April, and issue a decision in late June or early July. It is possible, however, that the argument would be deferred until October 1996, with the decision occurring some months after that. In the meantime, proceedings in the 90 other pending cases, as well as the determination of damages in this case, almost certainly would be stayed.

Those knowledgeable about the case within the Justice Department have a wide variety of views as to the chances for success in the Supreme Court. The only thing that can safely be said is that this is no easy case for the government: it is very possible that the Court will uphold the Federal Circuit's ruling.

Although newspapers have estimated the potential price tag of all of these cases (including the 90 pending cases) as up to \$20 billion, the actual cost is very uncertain. Some of the pending claims involve sufficiently different facts so that even if the Federal Circuit's decision stands, the claims might be dismissed. Moreover, the determination of damages in the cases will involve many tricky questions. In some cases, the government credibly can argue that there are no damages because the thrifts would have failed anyway. Still, if the Federal Circuit's decision stands, the damages likely will run into the billions and may, in an absolute worst-case scenario, total between \$10 and \$20 billion. OMB is currently exploring this matter further.