Hopwood/University of Texas Affirmative Action Case
Contact: Myron Marlin 616-2765
Department of Justice

- The Supreme Court today decided not to hear the Hopwood case -- a case in which the 5th Circuit ruled that race cannot be considered at all in deciding whether to admit an applicant.

- By declining to hear case, the Court did not agree with or affirm the decision of the 5th Circuit. Declining to hear a case does not express any view on the merits of the case.

- In fact, Justice Ginsburg and Souter recognized the issues were important and needed to be addressed. But they said that this was not the appropriate case to resolve them -- because the program in question had already been abandoned by the University. "We must await final judgment on a program genuinely in controversy before addressing [this] important [issue]."

- The Court today did not say that race cannot be used in admissions. Nor did it overturn its own decision - in Bakke -- holding that race can be a plus factor in the admissions process.

MR. MCCURRY: They are. In fact, the Counsel's Office on all of those is making a review of each of the decisions the Court rendered. Today on the Hopewood case, involving the University of Texas, it's still not quite clear what the impact of that decision will be. Obviously, the opinions by Justices Ginsburg and Souter recognize the importance of the issue and don't rule out future consideration of the issue. But we understand now that, at least within the Fifth Circuit, there is going to be some level of uncertainty as they sort out the case law. And our counsel will be looking at that.

We were in that case, as you know, on an amicus brief. On the Penn Advertising case, we think that the ruling by the Court in no way jeopardizes the proposed rule that the Food and Drug Administration has promulgated. That rule, we have determined to the best of our opinion and legal review is fully consistent with the '44 liquor mart decision. And this case today is based on the same legal reasoning that applied in '44 liquor mart. So given that standard we believe that our own proposed rule would meet any First Amendment scrutiny that would be applied to it.

On the S&L case, that one is still being looked at because both the implications legally and also whatever it would mean in terms of federal expenditures -- I just don't have a thorough assessment yet of what the impact of that decision will be.

Q So you don't know who's going to foot the bill, especially in the S&L case, on up to $10 billion?

MR. MCCURRY: We don't know, and that's exactly the type of question we're looking at now.

Q Are you disappointed in the affirmative action ruling?

MR. MCCURRY: Not necessarily. I think they just ruled that that would not be the case to test some of the underlying legal propositions, in part -- according to our best understanding at this point of the opinion -- because the state had discontinued aspects of that program already. So I think that a court may have been searching for a better test case. That appears to be part of the reasoning, but we'll be looking a lot more closely at the decision itself.

[Boston Globe 7/2/96]

Justices uphold Texas ban on two-track admissions

■ COURT

Continued from Page 1

vote, the court said then that admissions may not be race-driven, but that schools can consider a student's race as a "plus factor."

The high court most likely backed away from deciding that issue now both because of uncertainty among the justices and a procedural flaw at the heart of the Texas case.

In Boston, attorney Michael McLaughlin, the father of Julia McLaughlin, a white student who is seeking admission to Boston Latin School, said the court's decision could have a major impact on his daughter's suit challenging the minority quota system established by US District Judge W. Arthur Garrity Jr. for admission to Boston Latin School.

McLaughlin said yesterday's decision "is about as important a development as we could hope for. It is right on point. The case is very clear on the use of quotas by governmental agencies. No consideration of race is allowed in admission."

In 1992, Cheryl Hopwood, who had earned a 3.8 grade average and an 83d percentile score on the Law School Admissions Test, was rejected at the Texas law school. After she and three other white students sued alleging reverse discrimination, her lawyers discovered that the school had used a two-track admissions process.

Applications were "color-coded" by race. White, Asian and some Latino students went through a screening process with one set of standards, while black and Mexican-American applicants were considered by a separate committee using more lenient standards.

Hopwood's grade and tests gave her a point total higher than all but one of the roughly 25 black students who were enrolled, and all but three of the 50 Mexican-American students who were admitted.

In the midst of the trial, the law school admitted that its two-track policy was illegal. Nonetheless, a federal judge in Austin ruled that the school did not violate Hopwood's rights.

On appeal, the 5th Circuit not only ruled for her, but declared broadly that colleges "may not use race as a factor" in admissions.

This sweeping opinion gained national attention because it declared that the Bakke ruling no longer stood as the law. If it had been affirmed by the high court, it would have ended race-conscious admissions policies at colleges nationwide, both private and public.

Cheryl Hopwood's grade and tests gave her a point total higher than all but one of the roughly 25 black students enrolled.

Because private colleges and universities receive federal funds, they have been obliged to follow antidiscrimination rules set by the federal courts.

But the justices put off such a decision yesterday.

Everyone agrees that two-track policy was "constitutionally flawed," noted Justices Ruth Bader Ginsburg and David H. Souter.

"Accordingly, we must await a final judgment on a program genuinely in controversy before addressing the important question of raced-based admissions," they said in their opinion in the case, Texas v. Hopwood, 95-1773.

But in California, the voters may decide the issue first. The University of California Board of Regents has voted to end race-based admissions.

PRESERVATION PHOTOCOPY

Recent affirmative action decisions

Following is a list of recent Supreme Court cases regarding affirmative action. Since the Bakke decision, the court has consistently struck down affirmative action programs that are not narrowly tailored to achieve a specific goal.

1978 – University of California v. Bakke

While the court ruled that Bakke had been discriminated against, it also ruled that race could be considered a factor in admissions when diversity in the student body is sought.

1986 – Wygant v. Jackson Board of Education

Racial classifications must be justified by a compelling state purpose, and the means to accomplish this purpose must be narrowly tailored.

1989 – City of Richmond v. Croson

The state must present compelling evidence of discrimination in evaluating minority set-aside contracting programs.

1990 – Metro Broadcasting Inc. v. FCC

Minority preferences were upheld in awarding broadcasting licenses.

1995 – Adarand Constructors Inc. v. Pena

The standard in the Croson case was applied to government mandated affirmative action programs.

1995 – Podberesky v. University of Maryland

The court let stand a lower court ruling that a scholarship program restricted to black students was a form of unconstitutional reverse discrimination.

1996 – Hopwood v. Texas

The court left in place a lower court ruling that struck down the affirmative action admissions program at the University of Texas Law School. The ruling applies only to Texas, Louisiana and Mississippi.

SOURCE: The United States Law Week, Lexis. Compiled by Michelle Gahee

GLOBE STAFF CHART

PRESERVATION PHOTOCOPY

The New York Times

DATE: 7-2-96

PAGE: A-12

Justices Decline Affirmative-Action Case

By LINDA GREENHOUSE

WASHINGTON, July 1 — Sidestepping a major controversy over affirmative action in higher education, the Supreme Court said today that it would not hear an appeal by the State of Texas from a ruling that barred public universities from taking race into account in selecting their students.

The Court left standing a ruling by the United States Court of Appeals for the Fifth Circuit, in New Orleans, that shook the academic world three months ago by invalidating a special admissions program aimed at increasing the number of black and Mexican-American students at the University of Texas Law School.

The appeals court took the highly unusual step of declaring that the Bakke case, the 1978 Supreme Court landmark that permitted race to be taken into account for the purpose of creating a diverse student body, was no longer a valid statement of the law of equal protection.

The Supreme Court today did not take its usual course of simply turning down an appeal without an explanation.

Instead, Justice Ruth Bader Ginsburg, in a one-paragraph opinion that was also signed by Justice David H. Souter, explained that the Court was denying review because the case did not actually present a live controversy: Texas no longer uses, and was not defending, a two-track admissions system, with separate admissions requirements and separate committees for white and nonwhite applicants, that the lower courts had declared unconstitutional. The law school now uses a single applicant pool, in which race is a factor to be considered among other factors, and no court has yet reviewed the school's current approach.

"We must await a final judgment on a program genuinely in controversy before addressing the important question raised in this petition," Justice Ginsburg said.

Justice Ginsburg appeared to be using her separate opinion as a way of advising the public not to interpret the Court's refusal to hear the case as an endorsement of the Fifth Circuit's analysis.

Nonetheless the action left educational institutions in Texas, Louisiana and Mississippi, the three states that make up the Fifth Circuit, in a difficult position, obliged to conform their practices to an appeals court ruling that may or may not ultimately prove to be a correct statement of the law. The Supreme Court is likely to resolve the ambiguity eventually, but that is little comfort to institutions that under the terms of the Fifth Circuit's ruling face punitive damages if they guess wrong about how to tailor their affirmative action programs.

Education officials throughout the region expressed consternation. Some, including Raymond Lamonica, vice chancellor of the Louisiana State University Law School, noted that his institution remained under a countervailing court order that required it to take race into account to increase the enrollment of black students. "We will follow the court order until steps are taken, if ever, to change it," he said.

Jim Ashlock, director of university relations at Texas A & M University, said, "What we really have to worry about is losing top-flight minority students to other states" outside the Fifth Circuit.

At the University of Texas, officials and lawyers met throughout the afternoon. Dr. William H. Cunningham, chancellor of the University of Texas system, issued a statement late in the day saying all components of the university would "honor all prior commitments regarding admissions, financial aid and other matters." He said the university and the Texas Attorney General's office would continue to review the "very complex legal questions" that now face the state.

The ruling in the U. of Texas case stands, at least for now.

The most urgent issue is whether Texas and other public universities in the Fifth Circuit can maintain their current affirmative action plans in the face of a ruling that held that the law school "may not use race as a factor" in admissions, "even for the wholesome purpose of correcting perceived racial imbalance in the student body." In its opinion, the Fifth Circuit pointedly said institutions that continued to use race in admissions faced punitive damages as a result of lawsuits from white applicants.

Theodore B. Olson, a Washington lawyer representing two of the four disappointed white applicants who sued the University of Texas Law School in 1992, said in an interview today that if he were a university administrator in the Fifth Circuit, "I definitely would not take the risk" of using race in admissions decisions outside the context of a program intended to remedy specific instances of past discrimination. "It would be hard to defend a lot of the programs I've read about," Mr. Olson said.

The current Texas program, which the law school put into effect when it lost the case at the Federal district court level in 1994, treats race in a much less rigid fashion, "as simply a factor in the individualized consideration and comparison of applicants to the Law School," as the brief filed in the Supreme Court on behalf of Texas told the Justices. Under the program that the lower courts invalidated, white and nonwhite applicants faced different minimum requirements on standardized tests and were evaluated in separate pools.

Neither the Texas appeal, Texas v. Hopwood, No. 95-1773, nor a brief the Clinton Administration filed on the state's behalf defended the old program, and the lower courts had not considered the new program. Prof. Laurence H. Tribe of Harvard Law School, who wrote the brief for the state, said the Court's action today reflected the Justices' "determination to await a case where the concrete details of a program considering race are fully before the Court."

Professor Tribe said it would be "certainly premature to extrapolate some kind of broad invitation to other institutions to dismantle affirmative action programs."

Ted Shaw, a lawyer for the NAACP Legal Defense and Educational Fund Inc., filed a separate appeal, also denied today, on behalf of black law students at Texas. Mr. Shaw said that "to the extent the other side was hoping this case would be the vehicle for overturning Bakke, that didn't happen." The Bakke case, he said, "is still the law of the land."

That case, a suit by a white applicant to a California state medical school, resulted in a ruling that

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barred the use of quotas in affirmative action plans but permitted universities to take race into account to serve the "compelling interest" of creating a diverse student body.

Martin Michaelson, an education law expert at the law firm of Hogan & Hartson here, said the Court's action today was "not an outcome that offers us peace." He said that while Justice Ginsburg's opinion performed a "public service" by making clear that the Court was not judging the case on the merits, the result of the Court's action was to "compound the uncertainty and invite further disputes."

The case had attracted so much attention that "all that energy will not dissipate," Mr. Michaelson said, adding: "The energy will find some other expression. We are entering a volatile period here."

The Washington Post

DATE: 07-02-96

PAGE: A-1

Justices Decline to Hear Campus Diversity Case

Ruling Against Race-Based Admissions Stands

By Joan Biskupic
Washington Post Staff Writer

The Supreme Court yesterday let stand a lower court ruling that public universities may not in most circumstances consider a student's race as a factor in admissions decisions. By refusing to hear the high-profile case, the justices passed up an opportunity to resolve the uncertainty and turmoil surrounding affirmative action on the nation's campuses.

With no recorded dissent, the justices turned down the University of Texas's appeal of a decision rejecting a law school affirmative action plan intended to build up enrollment of blacks and Mexican Americans.

Texas officials and the Clinton administration had urged the court to use the case to rule that public officials have a compelling interest in making sure state-run universities have a diverse student body. But yesterday's action produces no new clarity for affirmative action policies nationwide, and instead, college administrators said, it confounds the legal landscape.

The order casts doubt on all affirmative action programs in Texas, Louisiana and Mississippi—the three states covered by the 5th U.S. Circuit Court of Appeals, which last March said universities could not justify affirmative action policies based on the benefits of racial diversity. The appeals court said the Texas law school's policy of giving preference to minority applicants violated the Constitution's equal protection guarantee.

Two justices yesterday suggested that the court's refusal to review that ruling was based on procedural grounds and should not be interpreted as a sign of how the high court eventually would rule on whether it is constitutional for colleges nationwide to use race in deciding whom to admit.

"Whether it is constitutional for a public college or graduate school to use race or national origin as a factor in its admissions process is an issue of great national importance," Justice Ruth Bader Ginsburg wrote in a statement signed by Justice David H. Souter. ". . . [W]e must await a final judgment on a program genuinely in controversy before addressing the important question raised in this petition."

Ginsburg observed that the 1992 admissions policy challenged by a group of rejected white students had since been replaced. None of the other justices issued a public comment suggesting their reasons for refusing to review the case of *Texas v. Hopwood*.

While the high court in recent years has struck down race-based policies in government contracting and congressional voting districts, it has yet to revisit a landmark 1978 case standing for the proposition that universities have a compelling interest in educational diversity that justifies race preferences in admissions.

College administrators contacted yesterday said they believe they are still bound by the high court's 1978 decision, *Regents of the University of California v. Bakke*, endorsing racial diversity.

David Merkowitz, a spokesman for the American Council on Education, the nation's largest coalition of colleges and universities, said yesterday's action "creates another level of uncertainty" for colleges torn over affirmative action.

"We would hope that universities take this for what it is—a non-decision," Merkowitz said. "We're telling them to stay the course."

Yesterday's action marked the second time in two years that the justices had refused to review a lower court rejection of a college affirmative action policy. Last term, the justices let stand a 4th U.S. Court of Appeals ruling dismantling a University of Maryland scholarship program exclusively for blacks.

In the Texas case, the 5th Circuit said the high court's 1978 ruling allowing affirmative action based on the goal of racial diversity had been superseded by more recent high court decisions against race-based policies in other areas. The appeals court said an affirmative action plan would meet court standards only if it was narrowly drawn to remedy the present effects of past discrimination at a particular institution. That is a tough standard to meet.

"To believe that a person's race controls his point of view is to stereotype him" the 5th Circuit panel said, concluding, "the law school may not use race as a factor in law school admissions."

Yesterday the Supreme Court neither endorsed nor rejected that view. Ginsburg intimated that the 5th Circuit's statement that diversity never can justify using race in admissions was not squarely before the court and that the appeals court decision officially reflected only a judgment against a now-defunct policy.

Texas officials "challenge the *rationale* relied on by the Court of Appeals," Ginsburg said. "This court, however, reviews judgments, not opinions." She said the judgment of the lower court was that the particular admissions procedures used in 1992—evaluating white and minority applicants on two separate tracks and setting lower test score standards for minority applicants—were unconstitutional.

The law school has since replaced that program with a policy that considers race with several personal factors unique to a student. That policy has never been subject to challenge.

Theodore B. Olson, who represented Cheryl J. Hopwood and other white students who challenged the Texas policy, asserted yesterday that public colleges in Texas, Louisiana and Mississippi must abide by the appeals court ruling.

He said he considered the statement by Ginsburg, who has voted in the past for race-based remedies, "an effort to put a good face on things."

"What the 5th Circuit said is clear: If the law school continues to operate a disguised or overt program based on race, [school officials] will

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be subject to damages" to compensate students who were improperly turned down, Olson said.

Officials at Louisiana State University said the high court's order eventually could undercut affirmative action. But Raymond Lamonica, vice chancellor and professor at LSU law school, said yesterday the school would continue to use a policy of admitting some African American students with below-standard test scores, under the terms of a lower court order in a race-discrimination lawsuit against Louisiana's higher education system.

Texas Attorney General Dan Morales said in a statement that UT's law school would continue its new program that makes race one of many considerations in the application process. "Cultural, ethnic and racial diversity in an academic or any other environment benefits all," Morales said. "Our universities should strive for such diversity. However, as I have consistently indicated, it is simply wrong to give one applicant an automatic advantage over another applicant, based solely upon the color of one's skin."

Staff writer Rene Sanchez contributed to this report.

Los Angeles Times

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PAGE: A1

Court Lets Stand Ruling Against Race Preference

By DAVID G. SAVAGE
TIMES STAFF WRITER

WASHINGTON—In a surprise move, the Supreme Court on Monday let stand a ruling that struck down a University of Texas law school admissions policy on grounds that it preferred black and Mexican American applicants over better-qualified white students.

While the court's action marks another setback for affirmative action, it fails to resolve the central question of whether colleges can continue to use a student's race or ethnic background as one factor in admissions.

"This leaves a cloud of confusion," said Harvard law professor Laurence H. Tribe, who had urged the court to hear the appeal on behalf of Texas officials.

For now, it appears that colleges and universities in Texas, Louisiana and Mississippi must use a strict colorblind approach when admitting students. That was the standard announced in March by the U.S. 5th Circuit Court of Appeals, which sets the law in those three states. The high court let that decision stand.

However, the Supreme Court's refusal to hear an appeal does not convert the lower court decision into a binding national rule.

As a result, colleges and universities elsewhere may continue to rely on the high court's 1978 Bakke decision. By a 5-4 vote, the court said then that admissions may not be race-driven, but that schools can consider a student's race as a "plus factor."

The high court most likely backed away from deciding that issue now both because of uncertainty among the justices and a procedural flaw at the heart of the Texas case.

In 1992, Cheryl Hopwood, who had earned a 3.8 grade-point average and an 83rd percentile score on the Law School Admissions Test, was rejected at the Texas law school. After she and three other white students sued alleging reverse discrimination, her lawyers discovered that the school had used a two-track admissions process.

Applications were "color-coded" by race. White, Asian and some Latino students went through a screening process with one set of standards, while black and Mexican American applicants were considered by a separate panel using more lenient rules.

Hopwood's grade and tests gave her a point total that was higher than all but one of the roughly 25 black students who were enrolled, and all but three of the 50 Mexican American students who were admitted.

In the midst of the trial, the law school admitted that its two-track policy was illegal. Nonetheless, a federal judge in Austin ruled that the school did not violate Hopwood's rights.

On appeal, the 5th Circuit not only ruled in her favor, but declared broadly that colleges "may not use race as a factor" in admissions.

This sweeping opinion gained national attention because it declared that the Bakke ruling no longer stood as the law. If it had been affirmed by the high court, it would have ended race-conscious admissions policies at colleges nationwide, both private and public.

For now, it appears that colleges and universities in Texas, Louisiana and Mississippi must use a strict colorblind approach when admitting students.

Because private colleges and universities receive federal funds, they have been obliged to follow antidiscrimination rules set by the federal courts.

But the justices put off such a decision Monday.

Lest anyone think that the court had silently endorsed the 5th Circuit ruling, Justices Ruth Bader Ginsburg and David H. Souter issued a statement explaining that Texas officials had no basis for appealing since they had abandoned their two-track admissions policy.

Everyone agrees that two-track policy was "constitutionally flawed," they noted—even the Texas officials who were appealing. "Accordingly, we must await a final judgment on a program genuinely in controversy before addressing the important question" of race-based admissions, they said in their opinion in the case (Texas vs. Hopwood, 95-1773).

But in California, the voters may decide the issue first. The University of California Board of Regents has voted to end race-based admissions, and the proposed California Civil Rights Initiative, if approved by the voters in November, would mandate a colorblind approach in the state's public colleges.

For its part, the Supreme Court has repeatedly frowned on race-based decision-making by the government, but always stopped just short of outlawing the practice entirely.

Last year, a federal appeals court declared unconstitutional a University of Maryland scholarship program that was reserved for highly talented black students, and the justices refused to hear an appeal of that decision.

While Justice Sandra Day O'Connor has consistently joined the conservative majorities on the issue, she has refused to outlaw official affirmative action. As a result, neither the conservative nor liberal justices can be sure of mustering a five-member majority on the issue.

Nonetheless, a Washington lawyer who represented Hopwood said the court's series of decisions suggest differing standards based on race are in deep trouble.

"If I were an admissions officer, I would be very uncomfortable in keeping a policy that used race," said attorney Ted Olson. He noted that 5th Circuit judges threatened Texas university officials with punitive damages if they secretly maintained a race-based admissions policy.

But civil rights lawyers said the court was not signaling an end to affirmative action. "The broad rationale of the 5th Circuit decision has not been endorsed by the Supreme Court," said Elaine Jones, director of the NAACP Legal Defense Fund, "and Bakke remains the law of the land.

The Washington Times

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PAGE: A-1

Court upholds order banning race favoritism

By Frank J. Murray
THE WASHINGTON TIMES

The U.S. Supreme Court yesterday rejected Texas' appeal of a ban on using racial factors in law school admissions, ending any chance the high court will overturn a ruling widely seen as a nail in the coffin of affirmative action.

Theodore B. Olson, the attorney for two of the students who sought the ban, said the end is near for denying qualified white children opportunities to make room for other races, but Theodore Shaw, director of the NAACP Legal Defense Fund, said, "That's wishful thinking right now."

The action came despite U.S. Solicitor General Drew S. Days III's warning that it would eliminate affirmative-action admissions at 240 colleges and universities in Louisiana, Texas and Mississippi and create "substantial confusion and upheaval" nationwide.

In May 1995 the high court left standing a similar ruling that a University of Maryland scholarship program reserved for blacks was unconstitutional, causing consternation in Maryland, Virginia and the other three states of the U.S. Court of Appeals' 4th Circuit.

Mr. Shaw stressed that the court's action leaving the broad ban on affirmative action in place does not endorse "the appeals court's radical view."

"Affirmative action, while still under siege, is alive," he said.

"If it doesn't come out the way you want, your instant reaction is to say that," Mr. Olson responded, saying that the four unsuccessful white applicants who brought the original case now may seek damages and an order admitting them to the University of Texas Law School.

Asked if the action unfairly denies opportunities to nonwhites who need breaks, Mr. Olson said: "Not if it means a kid whose skin color is white is denied an opportunity because of that. Hopefully this means that racial discrimination is coming to an end in this country."

He said one of his clients, Cheryl Hopwood, is now a Maryland accountant, while the other, Douglas W. Carvell, is a law student at Southern Methodist University. The other two denied admission to the University of Texas Law School in 1992 are Kenneth R. Elliott and David A. Rogers.

The school had considered race with other factors to meet a goal of law classes that were 10 percent Mexican-American and 5 percent black.

"The use of ethnic diversity simply to achieve racial heterogeneity, even as part of a number of factors, is unconstitutional. . . . The use of race per se is proscribed," says the 5th U.S. Circuit Court of Appeals decision that the high court refused to review. "The law school may not use race as a factor in law school admissions."

Mr. Shaw found solace in a brief opinion by two justices suggesting why the court did not take the case of Texas vs. Hopwood.

"We must await a final judgment on a program genuinely in controversy before addressing the important question raised in this petition," Justice Ruth Bader Ginsburg wrote in an opinion joined by Justice David H. Souter.

She said Texas did not attack the 5th Circuit's judgment, but only questioned its rationale for throwing out a plan that "has long since been discontinued and will not be reinstated" and for saying the groundbreaking 1978 Bakke decision, which allowed the use of race as one factor in college admissions, no longer applied.

The main petition in the case, written for Texas by Harvard constitutional lawyer Laurence H. Tribe, said, "The national significance of the decision is obvious."

He called it urgent for the high court to "correct the court of appeals' misperception that Bakke is no longer the law" and its ruling that race may not be considered in any manner for school admissions.

Mr. Shaw, whose organization filed a parallel appeal separate from Mr. Tribe's that also was turned down yesterday, sought to minimize the decision's impact by saying it is the opponents of affirmative action who seek a supportive Supreme Court ruling.

Mr. Shaw said he knows of no pending cases that deal with the issue, "but I have no doubt that opponents of affirmative action are going to try with all haste to get something before the Supreme Court again."

Mr. Days underscored the issue's importance by saying it applied to private schools receiving federal support as well as state institutions.

Maryland Attorney General J. Joseph Curran Jr. filed a friend-of-the-court brief supporting the appeal to uphold affirmative action,

The New York Times

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PAGE: A-1

HIGH COURT FINDS RULE SHIFT BY U.S. DID HARM TO S.& L'S

BIG DAMAGE AWARDS SEEN

7-2 Decision Says Government Broke Its Word by Change in Bailout Accounting

By LINDA GREENHOUSE

WASHINGTON, July 1 — In a case that could cost the Federal Government billions of dollars in breach-of-contract damages to the savings and loan industry, the Supreme Court ruled today that the Government knowingly went back on its word through accounting changes that plunged three savings and loans into insolvency.

The lending institutions were trapped during the savings and loan bailout of the 1980's after regulators had induced them to assume huge liabilities to salvage other savings and loans.

While the case involved only three savings and loans — only one of which, Glendale Federal Bank of Glendale, Calif., is still in operation — the 7-to-2 ruling applies to more than 90 others that have similar breach-of-contract cases pending against the Government. The actual amount of damages will be decided in the lower courts. In January, the Government used the figure of $10 billion when it persuaded the Court to hear its appeal of a Federal appeals court ruling that found it liable for breach of contract.

After years of on-again, off-again rulings in the case, fleet-footed investors in savings and loans enjoyed a windfall on Wall Street in their most profitable day of the decade. [Page D8.]

The decision was the final ruling of the Court's 1995-96 term. The 75 cases the Justices decided since they convened last Oct. 2 made this the lightest term since 1953-54, although it was the first term in seven years to go into July.

The three savings and loans took over failed institutions at the Government's behest and in return were given favorable accounting treatment. The decision today interpreted the three contracts as promising that the Government rather than the savings and loans would assume the financial risk of any regulatory changes that might deprive the savings and loans of those advantages.

Congress eventually made such changes in 1989 when it passed the Financial Institutions Reform, Recovery and Enforcement Act, which authorized what turned out to be a $120 billion taxpayer bailout of the industry. Today's decision will add to the ultimate cost of that fiasco.

The 1989 law, among other things, converted paper assets into liabilities, leaving many of the savings and loans without the ability to meet minimum capital requirements.

Two of the three savings and loans in the case today failed, as did many others. Glendale Federal, which had been thriving before it accepted the Government's invitation to take over the First Federal Savings and Loan Association of Broward County, Fla., was able to raise enough cash to stay afloat. It now seeks more than $1.5 billion in damages.

The Government's interpretation of the contracts as not providing insurance against a legislative change was "fundamentally implausible," Justice David H. Souter said in a plurality opinion. He said "it would, indeed, have been madness" for the savings and loans to have entered into contracts without that guarantee, "for the very existence of their institutions would then have been in jeopardy from the moment their agreements were signed."

Three other Justices — John Paul Stevens, Stephen G. Breyer and Sandra Day O'Connor — joined Justice Souter's opinion, while Justices Antonin Scalia, Anthony M. Kennedy and Clarence Thomas concurred separately in an opinion by Justice Scalia. The dissenters were Chief Justice William H. Rehnquist and Justice Ruth Bader Ginsburg.

The Court ruled that the principles of ordinary contract law should apply to the contracts, and not the special doctrines that the Government invoked to try to shield it from liability. In fact, the bulk of Justice Souter's 72-page opinion was a detailed dismantling of the Government's arguments, which he said would actually have been "at odds with the Government's own long-run interest as a reliable contracting partner" had the Court accepted them.

The case, United States v. Winstar Corp., No. 95-865, stemmed from a period during the early 1980's when the health of the nation's savings and loans was deteriorating rapidly and the obligations of the Federal Savings and Loan Insurance Corporation to pay the depositors of failing institutions far exceeded the insurance fund's assets.

To postpone the cost, Federal regulators persuaded healthy savings and loans to acquire failing ones under an accounting method permitting the liabilities to be carried on the books as "good will," an asset that could be amortized over 35 or 40 years. Such deals were attractive because the paper asset allowed the acquiring savings and loans to make more loans than otherwise would have been permitted.

The 1989 law removed intangible assets, including good will, from those that could be counted toward a savings and loan's minimum capital requirements. As Justice Souter's opinion noted, the consequences of that change were "swift and severe," as many savings and loans fell out of compliance.

Many savings institutions sued the Government in the Court of Federal Claims here. The two other plaintiffs in the case today were the Statesman Savings Holding Corporation, based in Iowa, which had acquired failed institutions in Florida and Iowa, and an investment partnership known as the Winstar Corporation that was formed in 1984 to acquire a Minnesota institution, Windom Federal Savings and Loan. Their cases, along with Glendale Federal's, were successful in the claims court in 1992 and, last year, in the United States Court of Appeals for the Federal Circuit here, a specialized court that hears Government financial claims.

The Government argued that its contracts should never be interpreted to bind it to a promise to exercise regulatory authority in a particular way unless such a promise was unmistakable on the face of the contract. But Justice Souter said today that this argument was inapplicable. He said the savings and loans had never argued against Congress's right to change the law, but rather that the Government had assumed the risk of paying damages for any financial injury the savings institutions might suffer from any changes that took place.

The Court also rejected another of the Government's defenses, a rule known as the "sovereign acts defense" under which a "public and general" law can never be regarded as causing a breach of a particular

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Government contract.

The 1989 law was not a "public and general" act, Justice Souter said. Instead, it was "tainted by a governmental object of self-relief," he said.

In his dissenting opinion, Chief Justice Rehnquist objected that the Court had drastically reduced the Government's available defenses in contract cases. The decision "limits the sovereign acts doctrine so that it will have virtually no future application," he said.

Stephen Trafton, the chairman and chief executive of Glendale Federal, said in a telephone interview today that the Government had "shown only arrogance" in rejecting two recent settlement proposals. "It's a tragedy for the taxpayers," he added, "because they didn't breach these contracts, the Government did."

THE WALL STREET JOURNAL

DATE: 07-02-96

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High Court Backs S&Ls on Accounting, Declines to Hear Affirmative-Action Case

Decision in Thrift Lawsuit Could Add $10 Billion To Federal Cleanup Tab

By PAUL M. BARRETT
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON – Savings-and-loan cleanup costs could jump by $10 billion or more as a result of the Supreme Court's ruling that the federal government violated contracts with certain thrifts by changing accounting rules.

In a separate action yesterday, the high court surprised many educators by declining to review a federal appeals-court decision that could doom most affirmative action in public-university admissions programs in three Southern states. The appeals-court decision, involving the University of Texas Law School, already has prompted state schools around the country to reconsider their race-related policies. It is one of several recent court decisions that have raised doubts about affirmative action in employment and contracting as well as education.

Business Decisions

In its latest term, the Supreme Court handed down decisions that generally were favorable toward business, whether concerning liquor ads or punitive damages. Article on page B1.

The justices finished their 1995-96 term with yesterday's actions and are expected to stand in recess until the first Monday in October.

In the closely watched S&L case, the high court ruled 7-2 that when Congress changed industry accounting rules in 1989, it snatched back accounting advantages the government had used to induce healthy thrifts to take over failing S&Ls. "It would, indeed, have been madness" for the healthy institutions to get involved in these deals if the government could, whenever it chose, cancel the accounting "gimmicks," concluded Justice David Souter in the high court's main opinion.

The immediate victors were **Glendale Federal Bank** of California and two companies that are former owners of now-defunct S&Ls: Winstar Corp. and American Life Group Inc. The Supreme Court didn't calculate what the damages would be for these three, sending the case back to a lower court to determine those amounts. A larger group of some 120 thrifts and former thrift owners have cases pending against the government and will also benefit from yesterday's ruling.

The Clinton administration had estimated the potential damages from a government loss at $10 billion, but industry lawyers said yesterday that they will be seeking closer to $18 billion.

There was some uncertainty yesterday about where the money would come from, however much it turns out to be. But a senior Clinton administration official said that any damage awards would be paid from a permanent judgment fund maintained by the Treasury Department, meaning that, ultimately, taxpayers would foot the bill. The thrift debacle of the 1980s has already cost an estimated $200 billion.

Beyond the banking world, yesterday's ruling was "very good news for federal contractors generally," said an elated Jerry Stouck, lead attorney for Glendale Federal. A government-contract expert, Mr. Stouck said that among his clients, utilities and defense manufacturers have gotten into comparable contract fights with Washington and that the Supreme Court's decision will make it harder for the government to change signals on its business partners.

The justices couldn't agree on a majority opinion in yesterday's ruling. Joining all or most of the Souter opinion were Justices John Paul Stevens, Sandra Day O'Connor and Stephen Breyer. Concurring with the bottom line but not the reasoning were Justices Antonin Scalia, Anthony Kennedy and Clarence Thomas.

Chief Justice William Rehnquist wrote in dissent that the Souter opinion misinterpreted high-court precedent and "drastically" reduced the government's defenses in contract disputes. He was joined in large part by Justice Ruth Bader Ginsburg.

The case arose from bank regulators' efforts in the 1980s to ease the government's burden for the S&L cleanup by allowing strong thrifts to play an accounting trick when they acquired failed institutions. The trick was counting the insolvent thrifts' liabilities as an intangible asset, known as "supervisory goodwill."

Accountants define a company's good-

Cont'd

will as the difference between its purchase price and the value of its tangible assets. This difference was often large in the S&L deals encouraged by the government. Unlike in the ordinary acquisition context, where goodwill may reflect a business's intangible reputation with customers and other "going-concern" value, the goodwill of the defunct S&Ls was merely an accounting device. Regulators allowed the healthy S&Ls to count the goodwill of the insolvent thrifts as an asset that would help the acquirers meet their capital reserve requirements.

The government also let the healthy thrifts write down the diminishing value of this goodwill over very long periods of time – as long as 40 years. In addition, the government permitted some of the acquirers to double-count as "capital credit" the cash Washington put into the deals. Without these advantages, many of the acquisitions would have resulted in merged thrifts that would have been insolvent from the start, according to industry lawyers.

In 1989, with the thrift crisis continuing, Congress tightened accounting practices and eliminated the rules that greased the way for the earlier takeovers. This badly hurt the acquiring thrifts, helping to put some into insolvency. Each of the companies in the Supreme Court case, or their subsidiaries, had acquired one or more failing thrifts in the 1980s. Glendale Federal, for example, got more than $700 million of goodwill as a result of buying – at the government's request – a failing Florida thrift in 1981. Glendale Federal barely survived by privately raising $500 million in new capital, according to its chairman, Stephen Trafton.

A large group of acquiring thrifts sued the government in a special federal court in Washington, claiming the government had violated its contractual promise to allow them to take advantage of goodwill and other favorable accounting methods. Glendale claims it suffered $1.5 billion in damages related to, among other things, heavy losses it took on assets it had to sell to raise capital.

Although his opinion sprawled across 72 pages, Justice Souter's view boiled down to this: In its contracts with the S&Ls, the government agreed to bear the risk that Congress would change the accounting rules; when those rules were changed, the government became responsible for the damages. As to the existence of enforceable contracts, he said that the high court was "in no better position" than the lower federal court to evaluate the various documents in question.

Justice Souter methodically rejected the government's argument that these weren't ordinary contracts between private parties. For example, Justice Department lawyers had told the high court that the government can't surrender its right to change the law in the future unless it is done in "unmistakable" terms. Justice Souter said that the unmistakability doctrine didn't apply, because the government – specifically, Congress – remained free to change the law; but that didn't relieve the government of its duty to compensate those whose contracts were broken in the process. Justice Souter used broad language on this and related discussions of the government's defenses, implying that the ruling would apply to other public contracting cases.

The Justice Department declined to comment. The Office of Thrift Supervision, which regulates the S&L industry, said the 1989 rule changes helped to restore the thrift industry to financial health. *(U.S. vs. Winstar)*

USA TODAY

DATE: 7-2-96

PAGE: 3-A

Court's action unclear to many

Legal experts struggle for understanding

By Tony Mauro
and Desda Moss
USA TODAY

To David Rogers of Arlington, Texas, the impact of the Supreme Court's action Monday on affirmative action was clear.

Rogers, who is white, says the decision will allow him to re-apply to the University of Texas Law School, which rejected him four years ago, he says, because of his race. "I love the law," he said Monday.

But to many others, the Supreme Court action was difficult to interpret. The court had been widely expected to review a lower court ruling that struck down UT's affirmative action program.

When it did not, the Texas affirmative action program remained dead, but legal experts scrambled for explanation of what it meant. It wasn't exactly a repudiation of affirmative action, but it wasn't an endorsement, either.

"It does prolong the national confusion about the current status of the law," said Harvard law professor Laurence Tribe, who supported the Texas program.

But because the court action left in place a lower court ruling that was virulently anti-affirmative action, it did appear to be another milestone in its steady retreat from affirmative action programs. Affirmative action programs proliferated in the 1960s and 1970s to remedy bias in college admissions and the workplace.

At first the court embraced these programs. But in recent years it viewed them as just another form of racial discrimination, no matter how benign the purpose.

Justice Clarence Thomas, the court's only black justice, has spurred this trend with persistent opposition to affirmative action.

Affirmative action policies are under siege at public colleges and universities nationwide. Many universities are preparing for a post-affirmative action era in which they find new ways to promote diversity in their student body without looking strictly at race.

In California, the nation's largest public university system, new rules that take effect in 1998 will bar consideration of race and gender in undergraduate admissions decisions.

Georgia's 34 state universities also are reviewing affirmative action programs.

University of Texas President Robert Berdahl said diversity is "a very high priority and will continue to be." "But I want to stress, at no time have we admitted students who were not qualified," he said.

Also Monday, the court:

▶ Revived a free-speech challenge to Baltimore's prohibition on billboard ads for cigarettes. The justices ordered a lower court to restudy the issue in light of a recent Supreme Court ruling that struck down a Rhode Island ban on liquor price advertising.

▶ Made it easier for police to search cars without obtaining search warrants first. The court overturned a Pennsylvania Supreme Court ruling that warrants are needed except in an emergency.

▶ Let stand a ruling that struck down a Missouri law that limits how much money individuals can contribute to the campaigns of candidates for state and local political offices.

The Washington Post

DATE: 07-02-96

PAGE: A-1

High Court Ruling May Add Billions to S&L Cleanup Cost

By Jerry Knight and Joan Biskupic
Washington Post Staff Writers

In a decision that could add as much as $20 billion to the cost of cleaning up failed savings and loans, the Supreme Court ruled yesterday that Congress acted illegally in 1989 when it tightened S&L accounting rules, throwing hundreds of thrifts into financial distress that caused many to go under.

The court said Congress violated contracts with savings and loans in changing the rules for S&Ls that took over failing thrifts at the government's behest and that the government now must pay damages to the owners of the S&Ls hurt by the rule change.

The 7-2 decision ordered the Court of Federal Claims to decide how much money the government owes to the three thrifts that brought the lawsuit, Glendale Federal Bank of California, Winstar Corp. of Minnesota and Statesman Savings Holding Group of Iowa. About 120 other thrifts have sued over the issue.

Glendale, which is now California's largest thrift, is seeking $1.5 billion in damages. The owners of the Minnesota and Iowa thrifts, which were forced out of business by the rule change, have not asked for a specific amount, but their claims for damages are expected to run into the tens of millions of dollars.

The lawsuits grew out of the 1989 savings and loan rescue bill, which tightened many S&L regulations and provided funds for what became the $145 billion thrift cleanup, the most costly government rescue ever.

Clamping down on risky S&L practices, Congress ordered thrifts to stop using an accounting technique called "supervisory goodwill." Critics called this an accounting gimmick that hid the true seriousness of the S&L crisis, because the technique allowed some S&Ls to appear healthy, even if they were not.

Federal regulators and banking experts estimate the total damages in goodwill cases could range from $10 billion to $20 billion—making the decision one of the most costly lawsuits the government has ever lost. The Senate Budget Committee has allocated $9 billion from the Treasury to cover potential damages in the lawsuits.

Wall Street investors are counting on cashing in on the decision and for months have been buying the stocks of S&LS involved in the cases. Stock in failed S&Ls is usually worthless, but shares of some defunct thrifts are selling for $2 to $4 a share because investors think they stand to benefit from the cases. One thrift, California Federal Bank, has sold a special security to investors who will get 25 percent of any damages it wins in the case.

The decision written by Justice David H. Souter, issued on the final day of the Supreme Court's 1995-96 term, upheld an earlier ruling by the U.S. Court of Appeals for the Federal Circuit.

Joining Souter in the opinion were Justices John Paul Stevens, Stephen G. Breyer and, in most part, Sandra Day O'Connor. Justices Antonin Scalia, Anthony M. Kennedy and Clarence Thomas joined Souter in his judgment that the government was liable, but they differed in their reasoning. Dissenting were Chief Justice William H. Rehnquist and Justice Ruth Bader Ginsburg.

When the new S&L accounting rules took effect, hundreds of thrifts were declared insolvent and had to be taken over by the government. Many others were forced to raise new capital or revamp their operations to comply with the law.

Government regulators came up with "goodwill" accounting as a way to persuade healthy thrifts to take over failing ones in the early 1980s when the government was running out of money to pay depositors in failed thrifts.

When Congress later decided to ban the accounting practice, the healthy thrifts protested that they had been double-crossed. They said they never would have agreed to take on failed institutions if they knew Congress could change the accounting rules.

Cont'd

U.S. Department of Justice

Civil Rights Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

TELEFACSIMILE COVER SHEET

DATE: 7/1/96 **TIME:**

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COMMENTS:

NUMBER OF PAGES TRANSMITTED (INCLUDING THIS SHEET) 2
(max. 30 pages)

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SUPREME COURT OF THE UNITED STATES

TEXAS ET AL. *v.* CHERYL J. HOPWOOD ET AL.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 95-1773. Decided July 1, 1996

The petition for a writ of certiorari is denied.

Opinion of JUSTICE GINSBURG, with whom JUSTICE SOUTER joins, respecting the denial of the petition for a writ of certiorari.

Whether it is constitutional for a public college or graduate school to use race or national origin as a factor in its admissions process is an issue of great national importance. The petition before us, however, does not challenge the lower courts' *judgments* that the particular admissions procedure used by the University of Texas Law School in 1992 was unconstitutional. Acknowledging that the 1992 admissions program "has long since been discontinued and will not be reinstated," Pet. for Cert. 28, the petitioners do not defend that program in this Court, see Reply to Brief in Opposition 1, 3; see also Brief for United States as *Amicus Curiae* 14, n. 13 ("We agree that the 1992 [admissions] policy was constitutionally flawed . . . ."). Instead, petitioners challenge the *rationale* relied on by the Court of Appeals. "[T]his Court," however, "reviews judgments, not opinions." *Chevron U. S. A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U. S. 837, 842 (1984) (footnote omitted). Accordingly, we must await a final judgment on a program genuinely in controversy before addressing the important question raised in this petition. See Reply to Brief in Opposition 2 ("[A]ll concede this record is inadequate to assess definitively" the constitutionality of the law school's current consideration of race in its admissions process.).

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE GENERAL COUNSEL

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FACSIMILE TRANSMISSION COVER SHEET

DATE: 7-2-96

TO: Steve Warnath
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FAX NO: 456-7028

FROM: Karl Lahring 401-6006

NUMBER OF PAGES INCLUDING COVER SHEET: 3

COMMENT: Norma Cantu asked me to send you (1) DOJ's talking points & (2) ED's statement to be used when press calls.

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ED

OFFICE OF THE GENERAL COUNSEL STATEMENT: TEXAS v. HOPWOOD

"Although the United States Government, through the Justice Department, had encouraged the Supreme Court to accept Texas' appeal of the decision by the Fifth Circuit Court of Appeals in Texas v. Hopwood, to resolve uncertainties and confusion caused by the decision, the Supreme Court has decided to deny Texas' petition. In denying the petition, the Supreme Court neither affirmed nor reversed the Fifth Circuit's decision. Moreover, the action of the Supreme Court today leaves standing its own decision in the Bakke case, holding that race can be a plus factor in the admissions process. We intend to provide further guidance to colleges and universities after a closer review of the case in light of the Supreme Court's denial of certiorari and consideration of its implications."

Hopwood/University of Texas Affirmative Action Case
Contact: Myron Marlin 616-2765
Department of Justice

- The Supreme Court today decided not to hear the Hopwood case -- a case in which the 5th Circuit ruled that race cannot be considered at all in deciding whether to admit an applicant.

- By declining to hear case, the Court did not agree with or affirm the decision of the 5th Circuit. Declining to hear a case does not express any view on the merits of the case.

- In fact, Justice Ginsburg and Souter recognized the issues were important and needed to be addressed. But they said that this was not the appropriate case to resolve them -- because the program in question had already been abandoned by the University. "We must await final judgment on a program genuinely in controversy before addressing [this] important [issue]."

- The Court today did not say that race cannot be used in admissions. Nor did it overturn its own decision - in Bakke -- holding that race can be a plus factor in the admissions process.

E X E C U T I V E O F F I C E O F T H E P R E S I D E

02-Jul-1996 01:38pm

TO: Angus S. King

FROM: Richard Hayes
Office of Public Liaison

SUBJECT: Affirmative action question/answer

Race-Base Scholarships (7/2/966 update)

Recently, the Fifth Circuit panel held in Hopwood that diversity can never constitute the basis for any consideration of race in university admissions. This flatly contracts the Supreme Court's 1978 ruling in the Bakke case, which held that racial diversity in higher education is a constitutional permissible predicate for affirmative action in university admissions.

That is why I instructed the Justice Department to file a brief in support of the State of Texas's petition to the Supreme Court to overturn this decision and uphold the University of Texas Law School's interest in promoting the racial diversity of its student body through legally permissible means. Unfortunately, the Supreme Court decided not to hear the University's appeal.

By declining to hear the case, the Court did not agree with or affirm the decision of the 5th Circuit. In fact, Justice Ginsburg and Souter recognized the issues were important and needed to be addressed. But they said that this was not the appropriate case to resolve them -- because the program in question had already been abandoned by the University.

While it would have been better if the Court had of overturned the decision of the 5th Circuit, the Court did not say that race cannot be used in admissions. Nor did it overturn its own decision -- in Bakke -- holding that race can be a plus factor in the adminissions process.

Justice Powell had it absolutely right in his controlling opinion for the Supreme Court in Bakke: greater diversity among the student body at a university brings a wider range of perspectives to the campus, and in turn, contributes to a more robust exchange of ideas -- which is the central mission of higher education in the first place, and in keeping with time-honored First Amendment values. By drawing on America's diversity, affirmative

action in education enriches the academic experience of all students, and rebounds to the benefits of the nation.

Hayward

(1) Push out next week policy guidance memo
to say school that Bakke is the law except
to 5th Cir.
Track the brief in support of cert.
facts in TX state applies to system that
school DA even still use

Send a signal that school
race as considerat

to federal funding recipient

Separate guidance memo for the 3 states

Lisa Bowen in OLC
along w/ Dept Ed pick Norm

Maybe memo
A.G. to Cities
& A.G. to Admin

Dept's set on Monday
Meeting Monday

Did Counsel's Office attend

Roll-out

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