

## The View from the Land of Steady Habits Trust the Government?

No one seems to trust Uncle Sam these days. Bankers, business executives, and investors have all expressed concerns about accepting assistance from the U.S. Treasury or entering into partnerships with the Feds for fear that the terms of the deals will be onerous—if not now, then some time in the future. A contract is a contract, but business people and investors are concerned that their fates will be tied up with an unpredictable and, dare we say, less than completely rational political process. Terms and conditions might be altered. Congress or the Administration might change the rules of the game. Is Wall Street right to harbor such suspicions of Washington? Are the Feds really that untrustworthy?

If the future will be anything like the past, the sad answer is that the concerns are well founded. Uncle Sam can't be trusted, and it's a fool's bargain to take help from Washington.

In September 1989, nearly twenty years ago, I testified at a Washington hearing before the Office of Thrift Supervision (OTS) regarding new regulations the OTS proposed to issue to implement the then-recently passed Financial Institutions Reform Recovery and Enforcement Act, generally known as the Thrift Bailout Bill. At the time, I was an executive with a large regional thrift that had been formed in 1982 in order to assist the government in rescuing three failing savings and loan associations. The resulting entity was the first truly multi-state banking organization in the United States. Under the terms of the 1982 agreements with the Federal Home Loan Bank Board, my bank (a healthy state-chartered mutual savings bank) changed its charter, converted from a mutual to a public company to raise capital, relocated its headquarters to another state, and acquired the three S&Ls at no direct cost to the taxpayer. Uncle Sam contributed \$25 million of equity, loaned the bank \$50, and gave us written assurances that we would not be penalized for the large amount of goodwill (approximately \$300 million) we acquired in the process because we had to take on the institutions at market value and not book value. For the blessedly naïve, good will is the excess of the value of liabilities assumed over the value of assets acquired. Because rates were high at the time, the S&L's mortgages were worth less than 100 cents on the dollar while the deposits were worth full face value. The difference was the goodwill.

The deal went according to plan for seven years. The depositors at the three S&Ls suffered no losses, and my bank continued to be profitable. But then the terms of the Thrift Bailout Bill changed the rules of the game. Congress said goodwill had to be written off against capital. At the time we had more than \$210 million remaining on our books. Overnight, we went from being well-capitalized to being out of capital compliance. Why? Because we had been foolish enough to do a deal with the United States to help alleviate a financial crisis. At that September hearing, we announced that we intended to sue the United States for breach of contract and for a violation of the Constitution's Fifth Amendment for a taking of private property without just

compensation. In December, 1989, on the day the new regulations became effective, we sued the United States.

What happened? We scrambled to come into capital compliance in order to prevent the company from being seized and the shareholders being wiped out. We filed a capital plan, sold assets, reduced operations, and downsized the company from over \$8 billion to \$3 billion in assets. Within eighteen months we had returned to capital compliance. In the mean time our lawsuit was put on hold as the courts decided the merits of a representative case, *Winstar versus the United States*. If the government lost the *Winstar* case, it faced potentially billions of dollars of damages.

The *Winstar* case went all the way to the Supreme Court, upon appeal by the United States when it lost at the lower court levels. In July 1996, the Supreme Court held that Congress could not abrogate the terms of the agreements that the government had entered into with various banking organizations in order to assist it in resolving the S&L crisis of the early 80s. The decision by the Court read, in part:

The issue in this case is the enforceability of contracts between the Government and participants in a regulated industry, to accord them particular regulatory treatment in exchange for their assumption of liabilities that threatened to produce claims against the Government as insurer. Although Congress subsequently changed the relevant law, and thereby barred the Government from specifically honoring its agreements, we hold that the terms assigning the risk of regulatory change to the Government are enforceable, and that the Government is therefore liable in damages for breach.

So truth and justice prevailed in the end. But did they?

The decision in the *Winstar* case created a huge liability for the United States. Since the United States pays no interest on damage awards until the time damages are awarded, and then, only from that point forward, it appeared to be in the government's interest to stall further decisions as long as possible. Accordingly, to diminish its liability, the United States Justice Department proceeded to argue each *Winstar* case individually. The merits of my bank's case were not decided until January 2005, nearly sixteen years later, when the Federal Court of Claims rejected the Government's motion for a denial of liability.

But the case was still not resolved. The government proceeded to argue in the Court of Claims that although it was liable for damages, the actual damages incurred were zero! Congress—in breaching the terms of our contract with the Federal Government—had saved us from losses, and therefore our claim was worth nothing. The very steps we took to prevent the shareholders from being wiped out were used as evidence against our argument that but for the government's breach we would have been a larger and more profitable company.

Where do things stand today? Nearly twenty years after my testimony in Washington, the case is still not resolved. The damage claims are under consideration by the Court of Federal Claims. The Chairman of the Bank has died. The organization has been

acquired three times through successive acquisitions by larger and larger banking organizations. The stockholders of 1989 who suffered the loss in value are almost certainly not in a position today to benefit from any damage award today, presuming they are still alive. How does the saying go? Justice delayed is justice denied?

Are bankers, investors, and CEO's right to distrust the government? Absolutely. We have but little power against the full power of the Federal Government. And even when our claims are just, our recourse is weak against an uncooperative Uncle Sam.