**IN THE UNITED STATES COURT OF FEDERAL CLAIMS**

| | |
|---|---|
| **FRANK P. SLATTERY, JR.,** ***et al.*****,**<br><br>**Plaintiffs,**<br><br>**v.**<br><br>**THE UNITED STATES,**<br><br>**Defendant.** | **Civil Action No. 93-280 C**<br>**(Chief Judge Smith)** |

# PLAINTIFFS' POST-TRIAL REPLY MEMORANDUM


Thomas M. Buchanan
Winston & Strawn
1400 L Street, N.W.
Washington, DC 20005
(202) 371-5787

Attorneys for Plaintiffs

Of Counsel:
Eric W. Bloom
Peter Kryn Dykema
Charles B. Klein
Winston & Strawn
1400 L Street, N.W.
Washington, DC 20005
(202) 371-5700


May 24, 2000

Table of Contents

Page


I. The Trial Record Fails To Support The Government's Theories of the Case ..................4

A. Every Witness Who Participated In The Negotiation of the 1982 Agreement Affirmed That Goodwill Was to be Treated as a Regulatory Capital Asset for All Regulatory Purposes, Without Qualification ......................5

B. The Facts and Circumstances Underlying the Western Merger Do Not Give Rise To Any Inference that the Parties' 1982 Agreement was Intended to be Narrowly Construed ......................................................................8

C. Plaintiffs Interpretation of the 1982 MOU, Which is Supported By All of the Witnesses Who Participated in the Negotiation of that Agreement, Did Not Eviscerate The Regulators' Ability to Regulate the Bank ...........................10

D. The Bank Objected Frequently To FDIC's Breaches ........................................14

II. The Government's Claim That the 1988 MOU and 1991 Written Agreement Were Executed on a "Consensual" Basis Is Ludicrous ...........................................................18

III. Neither the 1988 MOU Nor the 1991 Written Agreement Terminated or Modified the 1982 MOU ..........................................................................................................22

IV. Defendant breached the 1982 Agreement by Imposing the 1988 MOU on Meritor ......26

V. The 1988 Breach Claim Is Not Time-Barred.................................................................34

A. The Amended Complaint "Relates Back" to the Original Complaint ................34

1. The government cannot show prejudice .................................................34

2. Plaintiffs' original complaint provided adequate notice.........................37

B. Successive Stays Sought by the Government and Granted by this Court Tolled the Statute of Limitations .........................................................................41

C. The Continuing Claim Doctrine Preserves Plaintiffs' 1988 Claim ....................43

VI. The Notion That Meritor Was Not Damaged By FDIC's Capital Demands Is Both Absurd And Contrary To The Overwhelming Weight Of Record Evidence..................46

A. The Branch Sale Was Driven Completely By The Demand -- Backed Up By Threat Of Legal Action -- That Meritor Raise $200 Million Immediately ....47

1. The Branch Sale Was Designed Only To Satisfy The 1988 MOU's Demands, And Did Just That. ....47

2. Every Single Witness On The Subject Affirmed That The ONLY Reason Meritor Sold The 54 Branches Was To Avoid The More Severe Regulatory Sanctions That FDIC Regularly Threatened ....49

3. It Was Not Possible for Meritor to Satisfy the Capital Dictates of the 1988 MOU By Selling Stock ....51

B. The Harmful Consequences Of The Branch Sale Were Affirmed By Every Single Fact Witness In This Case ....55

1. Loss of Low-Cost Funding ....55

2. Loss of Asset Generating Ability....55

3. Loss of Higher Quality Assets ....56

4. Immediate Losses Caused By the Transaction Itself ....56

5. Proportional Increase in Nonperforming Assets....57

6. Increased Operating Expenses ....58

7. Summary ....59

C. The Argument That Meritor Was Not Harmed By The 1988 MOU Is Categorically Refuted By The Testimony Of Plaintiffs' Experts, and Is Disproved By the Model Prepared By Dr. Goldstein ....60

1. Dr. Steven Goldstein....60

2. The Purpose of the Model....61

3. Statistical And Strategic Inputs....61

4. The "Baseline" Strategic Assumptions in the Goldstein Model ....62

5. Assumed Variables ....64

6. Dr. Goldstein's Conclusions....65

VII. The Idea That FDIC's Purpose In Demanding High Capital Ratios In The Written Agreement Was To Improve Meritor's Earnings And Asset Quality Is Refuted By Economic And Regulatory Reality And By The Entire Evidentiary Record ................66

VIII. The Seizure And Sale Of Meritor Was Fdic's Doing, Was A Breach Of The 1982 Agreement, And Obviously Caused Injury To The Bank And Its Shareholders............69

A. In 1992, As At All Earlier Times, The State Of Pennsylvania Followed FDIC's Lead In Seizing The Bank .....................................................................69

B. Meritor's Alleged Noncompliance With The Ratio Requirements of The 1991 Written Agreement Cannot Excuse FDIC's 1992 Breaches of the 1982 Goodwill Agreement.....................................................................................72

C. While More Relevant To The Damages Phase Of This Case, The Argument That Seizure Of The Bank Caused No Injury Must Be Rejected Now Because It Was Disproved By Expert And Factual Testimony ................75

1. Mr. Hillas and Mr. High Testified and Believed That Meritor, if left alone by FDIC, would survive and prosper after 1992..........................76

2. Dr. Finnerty's Unrebutted Expert Testimony Establishes That Meritor Was Viable In December, 1992..............................................................78

(a) Comparables Analysis .................................................................78

(b) The Liquidity "Problem"...............................................................81

(c) Projections.....................................................................................83

(d) Solvency Analysis..........................................................................85

D. The Government's Failure Even To Address The Evidence Showing That FDIC's Actions In 1992 Were Driven By Tangible Capital Considerations, And Were Thus In Breach Of The 1982 Agreement, Concedes The Issue ........87

1. The Presumption Of Good Faith By Government Employees Is Irrelevant To This Case............................................................................87

2. The Evidence Of Breach In 1992 Is Overwhelming And Largely Conceded ..............................................................................................90

3. Dr. Brumbaugh's Unrebutted Testimony Establishes The Government's Liability..................................................................................................91

**TABLE OF AUTHORITIES**

**CASES**

*In re A.H. Robins Co.*, 828 F.2d 1023 (4th Cir. 1987) ....................42

*Ariadne Fin. Serv. v. United States*, 133 F.3d 874 (Fed. Cl.), *cert. denied*, 525 U.S. 823 (1998) 44

*Attwood v. Mendocino Coast Dist. Hospital*, 886 F.2d 241 (9th Cir. 1989) ....................42

*Byelick v. Vivadelli*, 79 F. Supp. 2d 610 (E.D. Va. 1999) ....................54

*California Federal Bank v. United States*, 39 Fed. Cl. 753 (1997) ....................14

*The Cherokee Nation of Okla. v. United States*, 26 Cl. Ct. 798 (1992) ....................43,44

*Clipper Express v. Rocky Mountain Motor Tariff Bureau, Inc.*, 690 F.2d 1240 (9th Cir. 1980) .36

*Colorado River Water Conservation District v. United States*, 424 U.S. 800 (1976) ...........42, 43

*Direct Media/DMI, Inc. v. Rubin*, 654 N.Y.S.2d 986 (N.Y. Sup. Ct. 1997) ....................54

*FDIC v. Bennet*, 898 F.2d 477 (5th Cir. 1990) ....................39

*FDIC. v. Conner*, 20 F.3d 1376 (5th Cir. 1994) ....................41

*Haley v. Department of the Treasury*, 543 F.2d 1298 (Fed. Cir. 1992) ....................88

*Hunter v. Allis-Chalmers Corp.*, 797 F.2d 1417 (7th Cir. 1996) ....................20

*Maguire v. Osborne*, 130 A.2d 157 (Pa. 1957) ....................54

*Masachusetts Bay Transp. Auth. v. United States*, 21 Cl. Ct. 252 (1990....................45

*Menzel v. Metrolina Anesthesia Assocs., P.A.*, 310 S.E.2d 400 (N.C. Ct. App. 1984) ....................72

*Miami Nation of Indians of Indiana, Inc. v. Lujan*, 832 F. Supp. 253 (N.D. Ind. 1993) ....................44

*Mt. Hood Stages, Inc. v. The Greyhound Corp.*, 616 F.2d 394 (9th Cir.),
*cert. denied*, 449 U.S. 831 (1980) ....................43

*Nager Elec. Co. v. United States*, 177 Ct. Cl. 234 (1966) ....................45

*National Surety Corp. v. United States*, 31 Fed. Cl. 565 (1994) ....................24

*Northwest Lumber Sales, Inc. v. Continental Forest Prods., Inc.*, 495 P.2d 744 (Or. 1972) .......72

*Plaintiffs in Winstar-Related Cases v. United States*, 37 Fed. Cl. 174 (1997), *aff'd. sub nom. Ariadne Fin. Serv. v. United States*, 133 F.3d 874 (Fed. Cl.), *cert. denied*, 525 U.S. 823 (1998) .................... *passim*

*San Carlos Irrigation and Drainage Dist. v. United States*, 877 F.2d 957 (Fed. Cir. 1989) ........88

*Selph v. Nelson, Reabe and Snyder, Inc.*, 966 F.2d 411 (8th Cir. 1992) ....................42

*Smith v. O'Mara Enters., Inc.*, 100 B.R. 330, 336 (S.D. Ohio 1989) ....................72

*Snoqualmie Tribe of Indians v. United States*, 178 Ct. Cl. 570, 372 F.2d 951 (1967) ...........39, 40

*Stephenson v. United States*, 37 Fed. Cl. 396 (Fed. Cl. 1997) ....................34

*Swaner v. Union Mortgage Co.*, 105 P.2d 342 (Utah 1940) ....................72

*T & M Distribs., Inc. v. United States*, 185 F.3d 1279 (Fed. Cir. 1999) ....................88

*Union Pacific Railroad Co. v. Nevada Power Co.*, 950 F.2d 1429 (9th Cir. 1991) ...............39, 40

*United States v. Thompson*, 293 F. Supp. 1307 (E.D. Ark. 1967) ....................88

*United States v. Winstar Corp.*, 518 U.S. 839 (1996) .................... passim

*United States v. Zermeno*, 66 F.3d 1058 (9th Cir. 1995) ....................20

*Wenzel v. Mathies*, 542 N.W.2d 634 (Minn. Ct. App. 1996) ....................54

*White Mountain Apache Tribe v. United States*, 8 Cl. Ct. 677 (1985) ....................39

*Williams v. Agribank*, 972 F.2d 962 (8th Cir. 1992) ....................72

*Woods v. Indiana University*, 996 F.2d 880 (7th Cir. 1993) ....................34, 40

**MISCELLANEOUS**

Annotation, *Breach Of One Contract As Ground For Recission Of Another*, 27 A.L.R. 1157, 1157 (1923) ....................72

13 *Williston On Contracts* § 39:2, at 512 (4th ed. 2000) ....................72

## Introduction

Like the Wizard in the *Wizard of Oz*, the government has presented nothing more than smoke and mirrors as a defense to the plaintiffs' hard evidence. Through uncontested testimony and documents, the plaintiffs have "pulled back the curtain" on the government's case, revealing it as nothing more than pure obfuscation. Yet the government in its post-trial brief continues with the smoke and mirrors, asking this Court to pay no attention to the man behind the curtain, or in this case, the facts. Even Toto could distinguish between reality and fantasy.

The absurdities inherent in the government's brief are boundless. For example, the government argues that Meritor "voluntarily" executed the 1988 MOU and the 1991 Written Agreement, citing as support only a pre-discovery statement by counsel some six years ago. Not only does the government make its assertion in the absence of *any* supporting evidence, but it does so notwithstanding the testimony of at least six witnesses who have testified to the contrary. *See* Tr. 1206:6-10 & 1225:25-1226:6 (Slattery); Tr. 356:24-357:6 (Ryan); Tr. 406:6-9 (McCarron); Tr. 3232:11-3233:12 & 3234:2-6 (Lutz); Tr. 294:15-295:7 (Cooke); Tr. 836:14-837:9 (Albertson); Tr. 613:19-614:4 (Hillas); *see also* DX 1928 at 18-19. There is also the fundamental proposition that statements of counsel are not evidence, a concept familiar even to the first year law student.

The government also regurgitates its old argument that the 1991 Written Agreement terminates or modifies the 1982 MOU, even though, again, no witness ever so testified, and notwithstanding that nothing in the 1991 Written Agreement in anyway supports this theory. The evidence be damned, the government suggests.

Perhaps the strangest piece of government advocacy is its use of Chairman Isaac's testimony. Simply, there is no imaginable, intellectually honest manner in which his testimony

can be read to support the government's arguments in this case. Chairman Isaac repeatedly found FDIC documents to reflect a decision-making process that is fundamentally inconsistent with the 1982 contract. No example of breach can be more striking than Chairman Isaac's testimony concerning PX 426. In this document, Mr. Ketcha articulates FDIC's official position that the FDIC (and Pennsylvania) were free to disregard Meritor's goodwill for any and all purposes other than calculating the ratios described in the 1991 Written Agreement. The letter stated that "*the only required use of primary capital* [as opposed to capital ratios from which goodwill is excluded] *is to determine whether or not Meritor is in numerical compliance with the capital maintenance requirements of the Written Agreement. It is not required to be used on an ongoing basis in determining the overall condition of the bank*." James Hand, the author of PX 426 (Tr. 3536:13-16), confirmed that the quoted language expressed the "official policy" of the agency. Tr. 3550:6-13. *Chairman Isaac further testified that this official FDIC policy -- followed by FDIC officials and examiners -- is inconsistent with the 1982 Agreement he engineered.* Tr. 1567:1-1568:2.[1] That is the whole case, in a nutshell. If the government wishes, plaintiffs will readily agree to stipulate that judgment should be determined upon the testimony of Chairman Isaac.

[1] Chairman Isaac also testified that the 1982 Agreement would not permit FDIC to reject Meritor's request to repurchase its stock in 1984 based on Meritor's tangible capital levels, Tr. 1547:3-25, yet the evidence is undisputed that FDIC nonetheless denied the request on precisely those grounds. *See* PX 51. Isaac further testified that he was "troubled" by FDIC Report of Examination as of 9/30/86, Confidential Supervisory Section (PX 88), and concluded that it, too, was "*not consistent with the agreement we entered into*" because it purports to regulate the Bank on a tangible rather than total capital basis. Tr. 1562:17-1563:2 (emphasis added). Isaac further found FDIC's Offsite Review/Visitation Report (6/30/88) (PX 164) to be inconsistent with the 1982 agreement in that FDIC deducted the Bank's goodwill in assessing the Bank's "capital adequacy." Tr. 1565:15-20. He also testified at trial that the language of FDIC Report of Examination as of 6/30/85 (PX 68) was "bizarre" and "*totally ignores that we entered into a contract to agree to count the goodwill at face value. . . .*" Tr. 1553:2-7 (emphasis added). Not even the most optimistic of government optimists should find comfort in Chairman Isaac's testimony .

The government also resorts to the extraordinary and desperate accusation that nearly every plaintiffs' witness lied at trial. According to the government, both Slattery and Nocella fabricated their respective discussions with Mr. Lutz because Mr. Lutz does not remember them. Gov't Br. at 31-33. Never mind that Mr. Nocella prepared a contemporaneous memorandum to the file in 1987 regarding Mr. Lutz's statement that there would be a mental deduction of the Bank's goodwill from his calculation of the Bank's capital. PX 110. And never mind that Mr. Lutz testified that he would have freely shared many of the thoughts reflected in the testimony of these gentlemen with them. Pl. Trial Br. at 52-56. The government similarly suggests, incredibly, that Messrs. High, Slattery, Hillas and McCarron all fabricated their testimony that Meritor sold two-thirds of its branch network to Mellon to comply with the 1988 MOU. Instead, the government argues, Meritor would have sold its best branches and its strongest asset-generators even if it did not have to satisfy the 1988 MOU, Gov't Br. at 34-35, notwithstanding that *not one witness offered testimony supporting this theory*.

The government makes its arguments in the face of dozens of documents that make clear that FDIC was supervising and regulating the Bank in a manner that rendered hollow the government's promise in 1982 that Meritor could treat the Western goodwill as regulatory capital for all purposes. For example, Regional Director Ketcha states, by memorandum, in February 1991: "Our concerns regarding the viability of Meritor center upon the possibility that new legislation may force a charge-off of regulatory goodwill." PX 298. And, of course, Mr. Fitzgerald announced in the weeks just before Meritor's seizure: "*The problem is we're running out of tangible net worth*" (PX 443 at CSL031 0193); "*The problem is tangible net worth*" (PX 443 at CSL031 0195); and "*bottom line is, we're running out of tangible [net] worth.*" (PX 444A at CSL018 0304); Tr. 1824:12-1826:7; Tr. 1830:17-1831:1 (Fitzgerald). The nail in the

coffin on this point is that the government has been unable to identify a single institution that was seized pre-FDICIA that had over 1 percent capital, much less the 8 percent capital that Meritor had, in the eight years since the question was posed to them in discovery.

Finally, unable to confront a record which clearly proves that the government engaged in a nearly 10-year pattern of breaches and that FDIC itself was insolvent and would reap a benefit of nearly $1 billion by seizing Meritor, *see* Tr. 5508:4-5509:1; Tr. 5525:13-5526:7 (Brumbaugh), the government falls back on the simple theme which it has used in so many of these S&L cases: no foul, no harm, because Meritor was going to fail anyway. Aside from being wrong, the fact of the matter is that if losing money and having loans go bad during one of the worst economic downturns in the nation's history were the standard for closing banks, there would be none. To the contrary, the government's argument is itself a breach because it ignores the fact that with supervisory goodwill counting as fully qualifying capital, Meritor not only had more than enough capital to weather the storm, *see generally* PX 530 (Finnerty Report), it had one of the highest capital ratios of any bank in the country and was in compliance with the capital ratios required under the 1991 Agreement. Tr. 2393:15-2395:19 (Finnerty); PX 530 at Exh. 8. Indeed, history – and the experience of, among others, the nearby Wilmington Savings Fund Society – have proven the government's "the-sky-was-falling" theory wrong. PX 530 at Exh. 26.

Either the plaintiffs and the government attended different trials, or the government is viewing the trial through Alice's looking glass. In either event, the government's arguments are without merit and should be soundly rejected.

## I. THE TRIAL RECORD FAILS TO SUPPORT THE GOVERNMENT'S THEORIES OF THE CASE

While the government purports to argue the record, it offers nothing more than a few snippets taken completely out of context, at the same time ignoring the overwhelming evidence against its positions.

### A. Every Witness Who Participated In The Negotiation of the 1982 Agreement Affirmed That Goodwill Was to be Treated as a Regulatory Capital Asset for All Regulatory Purposes, Without Qualification

The government asserts:

> Plaintiffs' witnesses have established beyond doubt that the only agreement here was to treat the goodwill as an amortizing, nonearning asset. . . . They also testified that there was no agreement to treat the goodwill as if it were cash, an earning asset, or tangible capital.

Gov't Br. at 12 (citations omitted). Plaintiffs have already quoted generously from both plaintiffs' and defendant's witnesses who participated in the negotiation of the 1982 contract, s*ee* Pl. Trial Br. at 10-26, and plaintiffs will not recite all of the same evidence again. Suffice it to say, however, that the government's conclusions should be accorded no weight because the government has ignored the record. Even the snippets relied on by the government cannot, particularly *in context*, be read to support the government's position.

For example, while the government relies on PFOF 52 in support of its position, that proposed finding in no way supports the assertion that the 1982 agreement required the government to treat the goodwill as a regulatory capital asset for regulatory capital minima purposes *only*. The government's Proposed Finding of Fact 52 states, in relevant part:

> Mr. Ryan [PSFS's outside legal counsel] testified that although he had relatively little contact with the FDIC before this deal, he wanted to get an agreement in writing to treat the goodwill as a "solid asset" because the goodwill was obviously not cash, the equivalent of cash, or the same as a government bond. Tr. 338-39. He testified that
>
> > the whole reason for that clause in the MOU is because of the apprehension that the FDIC might view the goodwill as something other than a good asset, and would not give it credence in capital. And the whole function of it was to do that, yes, and that was, I think, perfectly clearly understood by the people at the time, that that goodwill was supposed to be treated as an asset. [Tr. 341-42].

Mr. Ryan clearly recognized, as everyone recognized, that goodwill was not *in fact* cash or a government bond. However, he did testify, as did numerous others, that the government was nonetheless agreeing to treat it as if it were. *See also* Tr. 333:16-21 (Ryan) ("Nobody in their right mind is going to enter into a transaction where the regulator says you can put [it] in your capital ratios, but remember, two months from now, they can come down and say, you know, I don't like the goodwill in your capital assets, so I'm going to start treating you as though you don't have enough capital."); *Cf.* Tr. 304:17-23 (Cooke) ("[F]or our purposes and the purposes of the agreement, [the supervisory goodwill] was as good as cash."). In other words, while no one is suggesting that the government had to wear blinders or was prohibited from ever uttering the words "nonearning asset," there was at the same time a recognition that the Bank would not be penalized on the basis that goodwill is not cash and does not have the same attributes as cash. This only makes good sense because the Bank took on the goodwill because FDIC could no longer afford more substantial assistance packages. *Cf.* Tr. 1525:1-1526:9 (Isaac) (goodwill was alternative to cash because FDIC could not afford cash). Why, then, would PSFS agree to anything less than what other banks received?

Chairman Isaac made the same point as Mr. Ryan -- that while the Bank's goodwill was in fact amortizing over time, and would disappear altogether within 15 years, the Bank would not be penalized for the noncash attributes of goodwill so long as the Bank had goodwill on its books. Consequently, he would expect an examiner to compare the Bank to its peers in a manner that essentially ignored goodwill amortization.

> In looking at the earnings of the institution, let's say that the typical savings bank was at that time was – was earning – of this size, would have earned a hundred million dollars, to pick a number. And this institution was earning $50 million after the goodwill charge. I would say that an examiner should, if they were carrying out what we intended, would look at that and say this

> institution is performing in accordance – in conformity with what its peers are doing, because it is earning a hundred million dollars pre the goodwill charge, and that's what the industry is doing, and so that's – therefore, we're satisfied.

Tr. 1546:7-18; *see also* Tr. 1538:22-23 ("It won't be marked down any faster than straight-line basis over a 15-year period"); Tr. 1530:21-23 ("We would look at [the goodwill] in terms of, this is real capital, it's part of the capital structure of the institution."); Tr. 1531:6-9 (agreeing that goodwill is a "better asset on the books than other assets" in that it would have no interest rate risk and no credit risk); Tr. 1567:25-1568:2 ("There is to be no distinction between goodwill capital and nongoodwill capital under the agreement.").

Perhaps Mr. Nocella put it best when he explained that the goodwill was to be treated as capital for all purposes, in part, because there was only one purpose in 1982:

> If goodwill is considered an asset for all purposes, just as any other asset, it would be included in capital for all purposes unless it stated that it should be deducted.
>
> * * * *
>
> It's to be deducted – I mean, you're back in 1982, there is no other regulations. Please don't use the words tangible net worth as a word, there is no such thing as risk-based capital. The basic concept was simply it was included in capital, and that's all there was. There wasn't any other terminology. So it was included in capital as any other asset was included in capital.

Tr. 122:13-24; *cf*. 2953:11-2954:4 (Fritts) (banks historically discarded intangibles); Tr. 2955:1-2956:6 (Fritts) (no such thing as tangible capital -- there was just capital); Tr. 908:12-16 (High) (FDIC did not distinguish between kinds of capital; "total capital" was the thing); Tr. 3522:16-20 (Hand) (no tangible capital requirements prior to FDICIA's enactment in 1991). The distinctions the government has sought to make at trial, and again in its post-trial brief, are distinctions that simply were not present in 1982. FDIC regulators, or perhaps its lawyers, may have conjured up these distinctions in later years. But what is abundantly clear is that none of the participants in

the underlying negotiations in 1982 drew the distinctions that the government now seeks to make.[2]

### B. The Facts and Circumstances Underlying the Western Merger Do Not Give Rise To Any Inference that the Parties' 1982 Agreement was Intended to be Narrowly Construed

In an effort to make sense of its tortured contract interpretation, the government argues that Meritor needed goodwill to count toward satisfying minimum capital requirements to avoid adverse regulatory action after consummation of the Western merger. *See* Gov't Br. at 10-11. According to the government, FDIC could have restricted the Bank's growth, the nature of its assets, and the deposit rates it offered if the Bank failed to satisfy a five percent capital ratio. *Id.* at 10. Furthermore, the government argues, FDIC would have resolved the Bank -- forced it to merge into another financial institution -- if its regulatory capital in the early 1980s were negative. From all of this, the government concludes, that "the concern at PSFS in 1982 was whether the FDIC would force the institution to write the goodwill off its books immediately after the transaction, not only placing it below the minimum five percent capital ratio required by the FDIC, but rendering it insolvent by any measure." Gov't Br. at 10.

The government's argument is wholly nonsensical as it suggests that the Bank would seek to protect its future by having goodwill counted as capital for purposes of satisfying

---

[2] The government also identifies certain innocuous statements as purported "admissions," when they are nothing of the kind. That Mr. Nocella believed that *not subtracting* goodwill from primary capital would be adequate to continue the parties' agreement is hardly an admission in that Mr. Nocella believed that capital ratios were the sole barometer of capital adequacy. And Mr. Ryan's statement that FDIC could increase ratios due to its financial condition likewise concedes nothing, because Mr. Ryan added that FDIC *may <u>not</u>* increase the capital levels on the basis of the Bank's *tangible capital* levels. Tr. 378:5-14 (Ryan) ("They were not consistent with the agreement to look at the bank and say I'm going to . . . give you a capital requirement of 6-1/2 or 7 percent or whatever, because you have goodwill on your books as a result of the Western transaction because that was not the deal."); Tr. 378:19-22 (Ryan) ("It depends [on] the reason for why they did that. If it is because they have inadequate [tangible] capital because of the Western transaction, it is a violation of the Western agreement.").

minimum regulatory requirements, but at the same time leave FDIC free to take adverse regulatory action against it due to the "type and quality" of this intangible asset. Mr. Ryan's legal analysis of the government's argument is on the mark: "We would have been idiots to have entered into [such a] transaction." Tr. 367:24-368:8. The government, of course, is unable to point to any testimony or document to support a finding that a government representative suggested during the 1982 negotiations that goodwill could be treated as an asset for some purposes but not others. It simply never happened. Indeed, had any government representative ever expressed that thought, PSFS representatives would have shut down the negotiations, because it would have been madness to do otherwise. Tr. 274:8-275:5 & 277:17-278:2 (Cooke); Tr. 86:1-9 (Nocella). Of course, this Court does not even need to decide what the government's silence meant in 1982 because Chairman Isaac, and indeed the government's own witness, Bob Gough, confirmed that the government fully intended to treat Meritor's goodwill as a regulatory capital asset for *all regulatory purposes*. *See* Pl. Trial Br. at 16-18 & 22-25.

In fact, this Court appears to have understood the essence of the government's contract argument as early as September 1994, and pointedly challenged its foundation. At a hearing on one of the government's many dispositive motions, this Court, responding to the same contract argument made by the government here, rhetorically inquired:

> But isn't that a little like saying, we're going to agree to sell you our car for $10,000 and then you – the person comes in and gives you the $10,000 to buy your car and you say, "Oh, forgot to tell you, we count your money at 70 percent, so you owe us another three thousand dollars to buy the car."

Sept. 16, 1994, Tr. at 43-44. Or, as this Court so aptly put it, the government's argument suggests that "the Plaintiffs had kind of a false agreement. You [the government] agreed on one hand to count it, but then you didn't say how much you'd count it." *Id.* at 44.

FDIC regulators treated the Western goodwill as something approximating 0 percent of tangible capital (as opposed to the Court's 70 percent figure), or, as Mr. Albertson testified, "like fluff." Tr. 824:9-19; Tr. 826:2-18 (Albertson). That, however, was never the view of those who negotiated the contract. Nor would such a reading of the contract comport with the underlying facts and circumstances giving rise to the agreement. Those who negotiated the 1982 agreement all concur, and have so testified, that the Western goodwill was part of the Bank's capital structure for *all regulatory capital purposes*.

### C. Plaintiffs Interpretation of the 1982 MOU, Which is Supported By All of the Witnesses Who Participated in the Negotiation of that Agreement, Did Not Eviscerate The Regulators' Ability to Regulate the Bank

The government attacks plaintiffs' case by completely misstating it. No rational regulator, the government argues, could have ever agreed to the supervisory goodwill agreement as interpreted by plaintiffs because it would have stripped the regulators of their ability to monitor the institution and fulfill their regulatory function. According to the government, plaintiffs' reading of the contract "would have had the effect of nullifying [the regulators'] 'day-to-day surveillance'" of the Bank, Gov't Br. at 19 (quoting *In re Seidman*, 37 F.3d 911, 927 (3d Cir. 1994)), and would "unjustifiably eviscerate the FDIC's extensive statutory and regulatory powers and responsibilities." Gov't Br. at 19. The government concludes that FDIC "would never give up its power to monitor Meritor's condition," *id*. at 20, or otherwise "limit[] its oversight of PSFS over a fifteen-year period." *Id*. at 18.

The problem with the government's straw man, of course, is that plaintiffs are saying no such thing. Over the years FDIC regulated virtually every aspect of Meritor's operation, and plaintiffs have nowhere suggested that the goodwill agreement prevented it from doing so. FDIC controlled branch openings and closings, *see, e.g.*, PX 173 at 2 (Memorandum from Gregory P. Wyka to the Files (Aug. 17, 1988) at 2); prohibited issuance of dividends, PX 172 at 93 (1988

MOU); regulated executive salaries and bonuses, *id.* at ¶ 10; set requirements for classified loans, *id*. at ¶ 9; caused the firing and replacement of the Bank's President, Tr. 1217:7-1219:13 (Slattery); mandated loan charge-offs, PX 172 at ¶ 9 (1988 MOU); ordered modifications to the Bank's D&O insurance, Tr. 1397:17-1398:19 (Fitzgerald); PX 449 at 24; ruled on the issuance or repurchase of securities, PX 51 (FDIC Board Order (July 23, 1984)); caused the downsizing of Meritor's Board, Tr**.** 1217:19-1219:3 (Slattery); ordered additions to the loan loss reserve, *see, e.g.*, PX 335 at 1-5 (FDIC Report of Examination as of November 18, 1991); and ordered reappraisals of collateral and "other real estate." *Id*. at 1-3. The 1982 agreement did not destroy FDIC's regulatory powers, and plaintiffs have never suggested as much.

The government's cited portion of Chairman Isaac's testimony, *in context*, firmly supports this position:

> THE WITNESS: As I understand it your question, if the institution had 8 percent capital, by whatever definition and assuming it was one that we considered, and included goodwill, or in this case, and it was performing miserably, losing lots of money, would we take any action, regulatorywise.
>
> And the answer to that is I would hope that the FDIC would have taken action. I certainly would have been pushing to take action. *I don't believe I would have been favoring seizing the institution, if it would have had 8 percent capital and I don't believe anybody on the staff, I hope, would have recommended it. Certainly I hope the lawyers wouldn't have recommended it.*
>
> *But I would hope that we would have brought an action against the officers and directors, ordering them to correct the problems or removing them from the institution, or levying fines or a number of other enforcement tools we had to straighten out the problems*.
>
> The fact that we entered into this agreement with Western Savings, in my opinion, was not carte blanche for them to do whatever they chose to do. We did set up a monitoring mechanism. We did not want this institution to get in trouble, and if it got in trouble, we wanted to be able to get it corrected promptly.

> But I think that the issue -- I mean, you said there are two different issues woven in here, and one is I don't believe that -- I believe we had an obligation to treat the goodwill as capital for all purposes in our analysis of the bank and consider that when we compare the bank to its peers based on capital or earnings, but that doesn't mean that the bank was free to do whatever it wanted otherwise.

Tr. 1582:11-1583:l7 (emphasis added). Chairman Isaac obviously had no problem harmonizing FDIC's promise to treat the Bank's goodwill as capital for all purposes with FDIC's responsibility to regulate the Bank. If the Bank had 8 percent *total capital* but otherwise faced significant problems, he would never expect anyone to suggest shutting the Bank down or taking action that may lead to its closure. Having said that, FDIC remained free to take action against the Bank's officers or directors, or otherwise to order the Bank to remedy whatever problems may be discovered, so long as it did not discount the Bank's goodwill or take action on the basis of its tangible capital.

The only constraint on FDIC's power to regulate is that FDIC committed to analyze the Bank's capital on a total capital basis, that is, *with goodwill*. However, as stated above, this restriction did not preclude FDIC from monitoring Meritor any way it found prudent, just as the goodwill contracts in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), did not prohibit Congress from passing legislation it found prudent. But just as surely as Congress was free to enact such legislation, in the form of FIRREA, it had the concomitant obligation to pay damages to the injured plaintiffs for breaching its contractual commitments. Likewise here, FDIC was always free to regulate Meritor consistently with its own good judgment, but it too has the concomitant obligation to pay damages to the extent its manner of regulation has breached a valid and binding contract.

When the government argued that the goodwill contracts in *Winstar* could not possibly tie Congress's hands, and then took the illogical leap (or plunge) therefrom that Congress could

thus enact, *with impunity*, legislation making government performance of its contract obligations impossible, the Supreme Court observed that one does not necessarily follow the other. That is, while the contracts could not and did not bind Congress (unless the contracts so provided in "unmistakable terms"), congressional freedom to act did not translate to the freedom to act with impunity. As the Supreme Court observed:

> The thrifts do not claim that the Bank Board and FSLIC purported to bind Congress to ossify the law in conformity to the contracts; they seek no injunction against application of FIRREA's new capital requirements to them and no exemption from FIRREA's terms. . . . The question, then, is not whether Congress could be constrained but whether the doctrine of unmistakability is applicable to any contract claim against the Government for breach occasioned by a subsequent act of Congress. The answer to this question is no.

*Winstar*, 518 U.S. at 871. Perhaps anticipating a case such as the instant one, the Supreme Court further intimated that goodwill contracts may not prohibit the regulators from exercising their regulatory functions as otherwise required by law:

> [Plaintiffs] seek no injunction against application of the law to them, . . . and they acknowledge that the Bank Board and FSLIC could not bind Congress *(and possibly could not even bind their future selves)* not to change regulatory policy.

*Id*. at 881 (emphasis added). While Congress was not bound to the preexisting regulatory scheme, any more than FDIC was bound to regulate in any specified manner, the United States is liable in either event for breach of contract damages when it acts contrary to its contractual obligations. And while the Defendant aptly notes in its Trial Brief that FDIC, pursuant to both the 1988 MOU and the 1991 Written Agreement, reserved unto itself its continuing *power* "to take further action against Meritor if needed," *see* Gov't Br. at 14, this reservation of rights is functionally no different than the "reserved powers" doctrine underlying the unmistakability doctrine. *Cf. Winstar*, 518 U.S. at 874. But, as in *Winstar*, the government's reserved *power*

does not magically negate every other material term of the contract, thereby contractually committing the government to nothing at all. It instead must be read *in harmony* with the contract's other terms. The Supreme Court so held in *Winstar*, and this Court has more recently applied the same principles in rejecting the identical argument urged here.[3] *See California Federal Bank v. United States*, 39 Fed.Cl. 753, 760 (1997) (citations and internal quotation marks omitted) ("[T]he government has provided no basis for reinterpreting those promises to render the promise regarding supervisory goodwill largely insignificant and useless. The proposition that a contract must be interpreted to give meaning to all of its provisions is a fundamental rule of contract interpretation").[4]

**D. The Bank Objected Frequently To FDIC's Breaches**

The government contends that Bank officials never objected to FDIC's complaints regarding the Bank's tangible capital levels, suggesting that the Bank somehow acquiesced in

---

[3] As Justice Breyer observed:

> To be sure, it might seem unlikely, in the abstract, that the Government would have intended to make a binding promise that would oblige it to hold the thrifts harmless from the effects of future regulation (or legislation) in such a high-risk, highly regulated context as the accounting practices of failing savings and loans. But, as the plurality's careful examination of the circumstances reveals, that is exactly what the Government did.

*Winstar*, 518 U.S. at 918 (Breyer, J., concurring).

[4] The government makes the silly argument that *Winstar* stands for the proposition that goodwill contracts required the government to treat the goodwill as regulatory capital *only* for purposes of satisfying minimum capital requirements. Just as the government sought to twist Chairman Isaac's testimony to fit its needs, so, too, the government twists the meaning of *Winstar* -- to the point of eviscerating its holding. The government in *Winstar* never argued that the goodwill could be treated as an asset for some purposes but not others, so the issue was never before the Supreme Court. However, the suggestion that a bank or thrift would agree to acquire a failing thrift with negative net worth in the hundreds of millions of dollars and receive the limited protection the government suggests here is absurd. *See also* Tr. 2077:7-2078:10 (Mancusi) (1982 MOU provides no benefit to Bank if FDIC is free to discard goodwill in determining the Bank's capital adequacy; 1982 agreement "was to provide time. And if you are (continued)

FDIC's narrow reading of the 1982 Agreement. *See* Gov't Br. at 21 (stating Mr. Cooke did not consider examiner comments regarding the Bank's tangible capital as breaches). Assuming this to be true, it is of no moment, because, to borrow from the old children's adage, words were never going to hurt Meritor, only regulatory action based on those words. Thus, there was no reason for Meritor to issue a call-to-arms every time some examiner trashed the goodwill in an exam or other regulatory report. However, as made clear by Mr. Cooke and other Bank representatives, whenever FDIC contemplated regulatory action predicated upon Meritor's tangible capital levels, the Bank challenged the action.

The first significant protest by the Bank came in 1984, at a time when the Bank representatives (Cooke, Nocella and Ryan) who negotiated the 1982 Agreement were all still associated with the Bank. By letter dated May 16, 1984, PSFS requested FDIC approval of its application "to retire up to 2 million shares of the bank's outstanding common stock." *See* PX 49. On July 27, 1984, FDIC's Board of Directors denied the request because "of the bank's already low tangible equity capital position." PX 51; *see* Tr. 1547:3-25 (Isaac) (FDIC's reliance on low tangible equity capital position inconsistent with 1982 Agreement). PSFS immediately dispatched a letter to FDIC seeking reconsideration of its petition. Far from acceding to FDIC's breach, PSFS, through its Chief Financial Officer, Anthony Nocella, forcefully reminded the agency of its contractual obligations:

> As part of the [1982] Memorandum of Understanding concerning the Western acquisition, goodwill was to be amortized for regulatory purposes. If we agree that the Memorandum of Understanding by the FDIC and PSFS is a binding agreement, then the goodwill established as part of the merger and the capital notes created as part of the assistance package should be treated in

---

not going to allow it in the assessment of the capital adequacy, then there was no benefit -- there was no benefit to Meritor, when they did this deal.")

> accordance with the Memorandum of Understanding. If this is not the case, then PSFS would have had a large amount of negative capital the day after it merged with Western, and I am sure, that this was not the case that anyone had considered. It seems that we are being punished by FDIC for the Western transaction with FDIC.

PX 54. Mr. Nocella and Mr. Ryan, the Bank's legal counsel, then traveled to the Regional Office and pressed their case. According to an FDIC internal memorandum, Messrs. Nocella and Ryan were "dismayed at the language of our Board's Order denying the proposed capital retirement, which cited the . . . 'adverse effect the proposed retirement of common stock would have on the bank's already low tangible equity capital position' as the basis for its action. . . . ."

PX 55. The FDIC internal memorandum continued:

> A Memorandum of Understanding executed concurrently with the 1982 merger Assistance Agreement provides, in pertinent part, that for RAP purposes PSFS may book goodwill arising out of the Western acquisition and amortize it over 15 years. Also, the MOU specifies that subordinated debt, totalling $290,961,000 at mid-year 1984 (including $216,250,000 purchased by FDIC pursuant to the Western merger) ". . . may be treated as capital." Messrs. Ryan and Nocella stated that it was obvious to all parties involved in the merger negotiations that PSFS would have a low tangible equity capital position the moment the transaction was consummated (adjusted tangible equity capital was *negative* 3.59% as of June 30, 1982) and that it is inequitable and logically inconsistent to now penalize the bank for the transaction. Additionally, based on the current stock price of $7, the proposed capital retirement would have a negligible impact on PSFS' capital structure.

PX 55 at 1. As a result of FDIC's backsliding, Messrs. Nocella and Ryan informed FDIC that they desired written "reaffirmation of the 1982 MOU" from the agency. *Id.* Two months later, after the submission of several additional, equally strong letters from Meritor regarding the issue, *see* PX 56 & PX 61, FDIC provided that reaffirmation:

> The FDIC Division of Bank Supervision confirms that it found PSFS' capital adequate at its last examination of the bank on November 30, 1983. The Division of Bank Supervision further

> confirms that the Memorandum of Understanding, dated April 3, 1982, executed in connection with PSFS' acquisition of Western Savings Fund Society remains unchanged and in place. . . . Furthermore, in accordance with the Memorandum, PSFS may continue to amortize the goodwill arising from the Western acquisition over the agreed-upon period. The Division believes that PSFS should not repurchase its stock at this time.

PX 62.[5] From the Bank's perspective, it got what it wanted. It mattered little that the Bank's request to repurchase stock was denied; FDIC no longer cited the Bank's low tangible equity position as the basis for that denial. *See* Tr. 280:4-9 (Cooke) ("the fact [our request] was denied, was really to us not particularly significant; but it was significant to us that the FDIC through this memo [PX51], appeared to be putting a new twist on our agreement, and they were not, in our judgment, living up to the contractual arrangement."); *see also generally id.* at 279:5-286:9 (Cooke). Both Mr. Cooke and Mr. Ryan expressed satisfaction with FDIC's letter confirming the vitality of the 1982 MOU. Tr. 286:6-9 (Cooke); Tr. 348:3-23 (Ryan). As Mr. Ryan testified:

> We were reasonably relaxed because it confirms capital adequacy at the last examination, which indicates they are giving credit to the goodwill because it's hard to see how that statement could be true if they weren't giving credit to the goodwill; and that is what triggered the whole thing.[6] If they had simply said we've looked it over and we don't think it's a hot idea to buy the 2 million shares back, I don't think anyone would have gotten into the issue with that -- you know, on that case.

---

[5] The record also reflects *internal* FDIC correspondence that suggests that the agency may have begun to parse, and reinterpret, the language contained in the 1982 Agreement at this time. The Regional Office, for example, expressed concern regarding the explicit commitment sought by the Bank that goodwill will not be deducted from capital calculations when assessing capital adequacy, and proposed instead language that would have confirmed FDIC's practice to "include the intangible assets derived from the Western Savings Bank acquisition in its *consideration* of capital adequacy." PX 58 (emphasis added); *see also* PX 56 & PX 61. FDIC, however, kept its concerns to itself, opting to draft a commitment letter that appears firm, but which, in hindsight, may have been drafted to accord the agency some wiggle room. Significantly, neither David Meadows nor Kenneth Walker, the two FDIC officials involved in the drafting of PX 62, were involved in negotiating the 1982 Agreement.

[6] At this time, more than 70 percent of the assets acquired from Western had already been sold. *See* PX 4 at 24.

Tr. 348:13-23. What is clear, and undisputed, is that the Bank's representatives did not accept the government's "twist" on the 1982 Agreement, but instead "protested" what it perceived as a breach of the parties' agreement. Tr. 114:8 (Nocella) ("We did write this [PX 51] as a protest").

Examples of Bank persistence abound. Tr. 3066:25-3067:8 (Fritts) (Nocella protested to Fritts that the goodwill counts toward capital adequacy); Tr. 873:1-14 (Albertson) (Nocella always very vocal that goodwill counts toward capital adequacy); Tr. 1180:4-1181:5 & Tr. 1604:6-15 (Fitzgerald) (Fitzgerald wrote that High was "reluctant to give up on the idea of the goodwill counting as capital" because he kept a copy of FDIC letter reaffirming 1982 MOU in his desk and "every time I saw Mike he would say 'we got the letter'"; "he brought it up every time we passed"); Tr. 664:1-9 & Tr. 711:22-712:18 (Hillas) (value of goodwill was a "constant item of discussion" during Hillas years); Tr. 912:23-913:23 (High) (High always complained to examiners about regulators' approach to goodwill, arguing that Meritor had a contract); Tr. 1191:8-1192:5 (Fitzgerald) (High and Hillas often raised the question of how goodwill would be treated under FDICIA, a matter of "pressing importance" to them); Tr. 1207:21-1208:16 (Slattery challenged Lutz regarding FDIC treatment of goodwill); Tr. 426:2-15 (McCarron).

## II. THE GOVERNMENT'S CLAIM THAT THE 1988 MOU AND 1991 WRITTEN AGREEMENT WERE EXECUTED ON A "CONSENSUAL" BASIS IS LUDICROUS

Again, ignoring the overwhelming and *undisputed* record to the contrary, the government makes the preposterous and unsupported claim that Meritor *voluntarily* entered into the 1988 and 1991 Written Agreement. Gov't Br. at 8 (agreements were "consensual"). The evidence is all to the contrary.

The absurdity of the government's argument that the 1988 MOU was executed voluntarily by the Bank is made clear by the alleged proof the government offers in support, which is limited to Mr. Slattery's comment that Mr. Lutz was "very

accommodating and very helpful" in the 1988 negotiations and flexible on the terms of the 1988 MOU. That, the government argues, is somehow evidence that the 1988 MOU was "consensual." Gov't Br. at 8 n.4. But the government ignores Mr. Slattery's *complete* testimony that, while Mr. Lutz was indeed accommodating and flexible *generally*, he was at the same time insistent that the *capital components* of the MOU be swallowed in their entirety:

> [Mr. Lutz] told me that the conditions of the MOU were flexible, and that he would work with us, *but that the capital requirement that he had in the MOU was not negotiable, or if it was negotiable, in very narrow grounds,* but that most other things in it could be negotiated.

Tr. 1206: 6-10 (emphasis added). And the government further closes its eyes to Mr. Slattery's testimony that Mr. Lutz threatened to take more severe regulatory action if the Bank did not sign the MOU:

> He said, Frank, that would be a breach of faith. We would – could go as far as taking the bank the way it stands. And I said, well, I know a little bit about capital now, we have six point something percent. He said, no, you have 1.5 percent. If we want to, we could take the bank now.

Tr. 1225:25-1226:5. And, as set forth in plaintiffs' trial brief, Mr. Lutz readily conceded that he may well have advised Mr. Slattery that failure to execute the MOU would have resulted in much more severe regulatory action against the Bank. Pl. Trial Br. at 56 (citing Tr. 3232:11-3233:9; Tr. 3234:2-8).

Not only is Mr. Slattery's testimony unequivocal on this point, and effectively conceded by Mr. Lutz, but *every witness who testified on the subject confirmed that the Bank signed the 1988 MOU with a proverbial gun to the head. See* Tr. 406:6-9 (McCarron) ("It was my understanding, based upon comments of people who were involved in the process of the MOU

with the FDIC, that the Bank was required to enter into that agreement."); Tr. 356:25–357:2 (Ryan) ("they wanted and insisted on a MOU, so you sort of took your chances if you didn't go along with the MOU"); Tr. 294:15–295:7 (Cooke) ("I don't think there was an alternative" to signing; Bank was "pressured by the FDIC to do it"); Tr. 836:14–837:9 (Albertson) ("I guess the alternative is if you don't want the MOU, we will give you a cease and desist"); *cf.* Tr. 613:19–614:4 (Hillas). *Indeed, the government does not -- because it cannot -- cite to testimony even from its own witnesses that the Bank executed the 1988 MOU willingly.*

The documentary record is equally compelling. *See, e.g.,* DX 939 at 2 (Mar. 28, 1988 Memorandum from Hand to Lutz) ("Aware of an impending MOU or Order, he [Connell] was seeking guidance as to how to mitigate or eliminate the aforesaid. He was told that the form of regulatory action taken is the RD's prerogative"); DX 1928 at 18-19 (emphasis in original) (Glancz memorandum) ("I have tried to indicate what is negotiable with the FDIC. What is *not* negotiable is the amount of capital . . . . I have also tried to indicate that there is *no room to go to war with the FDIC*, except on the trading account issue. If we cannot agree with the FDIC on the Memorandum of Understanding, the FDIC will issue a *formal order* against the Bank. That is *much worse* than an MOU.").[7]

[7] To the extent that the government relies on counsel's prediscovery statements for the proposition that the 1988 and 1991 agreements were consensual, *see* Gov't Opp. at 33, they are not evidence. *See United States v. Zermeno*, 66 F.3d 1058, 1062 (9th Cir. 1995) ("pleadings are not evidence"); *Hunter v. Allis-Chalmers Corp.*, 797 F.2d 1417, 1424 (7th Cir. 1996) ("Complaints are not evidence."). Nor is Plaintiffs' First Amended complaint evidence in this case. Indeed, to the extent any allegation is inconsistent with the evidence, the latter controls. In fact, post-trial amendment of the pleadings can occur even when the party desiring the amendment does not submit a motion to amend. *See* R.U.S.C.C. 15(b) (providing that amendment may occur "even after judgment; *but failure so to amend does not affect the result of the trial of these issues*") (emphasis added). Therefore, the trial court is to consider all issues actually litigated irrespective of the pleadings and whether or not a party files a motion to amend. *See id.* (providing that "[w]hen issues not raised by the pleadings are tried by express or implied consent of the parties, they *shall be treated in all respects* as if they had been raised in the pleadings") (emphasis added).

Nor does the government even bother to provide *any* support for its proposition that the 1991 Written Agreement was voluntarily executed by the Bank. Nor could it, since no such evidence exists. In fact, when the Written Agreement was first mentioned to Meritor, the alternative identified was a Cease and Desist Order. Tr. 432:21-433:6 (McCarron). At this and later meetings, the clear understanding was that if Meritor did not sign, FDIC would take even more severe action — a Cease and Desist Order at the minimum — against the Bank. *Id.*; Tr. 645:12-24 (Hillas); Tr. 968:16-969:7 & 1001:3-8 (High) (Ketcha threatened to revoke FDIC insurance). At one meeting Mr. Ketcha stated that, without an agreement, FDIC would cause Meritor's seizure. Tr. 1269:7-22 (Slattery). The Government questions whether such a statement was made, but the fact is that Mr. Ketcha himself acknowledged at deposition that, in the context of negotiating the Written Agreement, he communicated to Meritor management that its only alternatives to signing the agreement were either a Cease and Desist Order or a proceeding to terminate the Bank's insurance. JX 3 (Ketcha Dep.) at 464-65; *see also id.* at 160-61, 526.

The documents tell the same story. PX 274 at 1-4 (ROE as of Aug. 20, 1990) ("[Ketcha] emphasized that this Agreement was a necessity"); PX 249 at CSL005, 0629-30; PX 256 at 1-2; PX 276 at 1-2; PX 277 at 1-2; PX 279 at 1-2; PX 282 at /csk9979481-92; PX 287 at 1-2; PX 289 at CSL0030406-07 (drafts of Written Agreement); PX 307 at CSL0030146-47 (final version of Written Agreement) ("Whereas in order to induce the Federal Deposit Insurance Corporation ("FDIC") to defer initiating proceedings pursuant to Section 8(a) on Section 8(b) of the Federal Deposit Insurance Act . . . and to defer issuing a capital directive pursuant to Section 325.6 of the FDIC's Rules and Regulations . . . for as long as the Bank is in compliance with the provision of this Agreement").

Against this testimony and these admissions the government adduces no evidence of any kind. Instead, on the basis of unsupported assertions, the government effectively asks this Court to find that the officers and directors of Meritor were, each and every one of them, not only perjurers but also masochists. For some reason, the government suggests, these men actually wanted regulatory demands put upon them so that their lives would be even more miserable than they already had been. The argument is silly.

## III. NEITHER THE 1988 MOU NOR THE 1991 WRITTEN AGREEMENT TERMINATED OR MODIFIED THE 1982 MOU

The government also resuscitates its old argument that the 1988 MOU and the 1991 Written Agreement modified or terminated the 1982 MOU. This argument was rejected at the summary judgment stage, and the government cites to no new evidence to justify asserting this rejected argument anew.

That the government chooses to make this argument nonetheless is understandable, given the proverbial box its witnesses have put it in. The testimony of several FDIC examiners and officials, for example, that they only included the goodwill in calculating minimum ratios (and thus assessed capital adequacy on a tangible basis, and penalized Meritor for the effects of goodwill on earnings) amounts in the end to a voluminous admission of breach. It would seem, therefore, that the government has little choice but to argue that the 1982 agreement was in fact limited to counting ratios.[8]

A similar box is created by Regional Director Ketcha's official communiqué to Secretary Hargrove dated August 26, 1992. In that letter Mr. Ketcha articulated FDIC's official position that FDIC would disregard Meritor's goodwill for any and all purposes other than calculating the

[8] We note, again, that no one who was actually present when the 1982 agreement was negotiated espoused the government's interpretation.

ratios described in the 1991 Written Agreement. PX 426.[9] Under the policy stated in PX 426, FDIC would use capital measures that excluded goodwill for any purpose other than assessing compliance with the requirements of the Written Agreement. Tr. 3537:23-3547:15 (Hand). And this was no isolated statement. As we noted in our Trial Brief, when Stan Shull came into the Region to examine Meritor in 1991 he was given the impression that there was *NO* agreement regarding goodwill other than whatever might be found (and not scratched out from) the 1991 Written Agreement. Pl. Trial Br. at 95-96.

FDIC's official position, that it would disregard any promises made in 1982 that were not expressly reaffirmed in the 1991 Written Agreement, is an admission of breach unless, and only unless, the 1991 Written Agreement had in fact both the purpose and effect of superceding and extinguishing the 1982 goodwill agreement. It therefore makes some sense that the government would seek to find evidence to support a contention that the 1991 Written Agreement had that very purpose and effect.

But there is absolutely no such evidence.

Undeterred, the government argues the point anyway.

The argument proves specious, first, because not one witness, and not one document, in any way hints or suggests that any human being even remotely involved in the proposal, negotiation, or drafting of the 1988 MOU or the 1991 Written Agreement ever for one single

---

[9] The letter stated that "the only required use of primary capital [as opposed to capital ratios from which goodwill is excluded] is to determine whether or not Meritor is in numerical compliance with the capital maintenance requirements of the Written Agreement. It is not required to be used on an ongoing basis in determining the overall condition of the bank." *See also* JX 3 (Ketcha Dep.) at 673 (PX 426 expresses the view that FDIC was obligated to count the goodwill when calculating the ratios included in the 1991 Written Agreement, but was free to exclude goodwill in calculating any other ratios). James Hand, the author of PX 426, Tr. 3536:13-16 (Hand), confirmed that the quoted language expressed the official policy of FDIC. Tr. 3550:6-13 (Hand).

moment hinted, thought, believed, desired, or suggested that these regulatory "agreements" could or should supercede the 1982 goodwill agreement or any aspect thereof in any way whatsoever.[10] Like its assertion that the Bank was only too happy to execute the 1988 MOU and the 1991 Written Agreement, the assertion that these agreements modified or terminated the 1982 MOU is wholly unsupported by any evidence. If the parties had really sought to modify or terminate the 1982 MOU, one would have expected the government to have elicited testimony from at least one or more of its own witnesses that such was the intent in 1988 or 1991. Instead, the record is barren in support of the government's position. Mr. Lutz offered no testimony in support of the government's position that the 1988 MOU modified or terminated the 1982 MOU, nor did Mr. Ketcha offer any testimony that the 1991 Written Agreement modified or terminated the 1982 Agreement.

Neither the 1988 MOU nor the 1991 Written Agreement states that these respective agreements supplanted the 1982 MOU. In fact, the 1991 Written Agreement specifically provides that the 1988 MOU would thereinafter be terminated, but fails to make any similar representations about the 1982 MOU. Clearly, the parties knew how to terminate earlier agreements, and their failure to terminate the 1982 MOU in either of these later agreements is glaring. *Cf. National Surety Corp. v. United States*, 31 Fed.Cl. 565, 580 (1994) ("absent any evidence of intent in the [second] agreement to the contrary, the court refuses to find that the takeover agreement modifies or supersedes [the parties'] rights under the original agreement.").

---

[10] The only evidence relevant to the point is a memorandum by Assistant Regional Director Piracci. The memo discusses, among other things, Meritor's insistence that the Written Agreement specify that its remaining goodwill be counted towards the ratios required in the Written Agreement. Piracci's internal commentary on this issue was to the effect that the point is a given because the FDIC was already fully committed to count the goodwill. The memo thus reflects no intimation that the Written Agreement would extinguish the 1982 agreement; on the (continued)

Further, the government's argument that the 1982 MOU had no force in the later years contradicts government witnesses who claimed to have *honored* that same agreement after the so-called "modification" purportedly occurred. *See*, *e.g.*, Tr. 3163:2-16 (Lutz) ("My job was to see to it that that [1982] agreement was carried out as it was drafted. It was part of my responsibilities [as Regional Director]."); Tr. 4949:17-4950:2 (Ketcha) (his responsibility to learn about FDIC's commitments as set forth in the 1982 MOU and to assure "that that agreement was enforced by [his people]."). The government cannot plausibly assert that FDIC, on the one hand, was faithfully carrying out its responsibilities under the 1982 MOU while at the same time asserting that the 1988 and 1991 "agreements" had terminated the original agreement.

In fact, in the final memorandum from the Division of Resolutions to FDIC Board of Directors regarding the Bank's resolution, FDIC was very clear that the 1982 MOU was still in force:

> In 1982, Meritor merged with The Western Saving Fund Society of Philadelphia. The FDIC provided assistance to facilitate the merger which added approximately $2 billion in deposits to the Bank's balance sheet, but which also generated approximately $800 million of intangibles. As a result of normal amortization and various balance sheet restructurings, including the sale of assets and deposits to Mellon in December, 1989, the balance of this goodwill has been reduced to $60 million on a GAAP basis. *At the time of the merger, the FDIC entered into a Memorandum of Understanding with the Bank regarding its use of certain accounting methods. In that memorandum, the FDIC indicated that it "would not object" to the amortization of goodwill over a 15-year period. <u>As a result</u>, at June 30, 1992, Meritor reported approximately $60 million of GAAP goodwill and recorded $252.8 million of RAP goodwill.*

---

contrary, it assumes that the 1982 agreement not only survives the Written Agreement but governs its terms. PX 284.

PX 499 at 9 (emphasis added). *See also* PX 288 at 2 ("[T]his [1991] agreement will continue to give credit for existing goodwill *as we honor previous FDIC contracts*.").

Finally, and perhaps most fundamentally, the 1988 MOU and the 1991 Written Agreement themselves constitute breaches of the 1982 Agreement. Simply, if these "agreements" were not entered into voluntarily, but instead were forced on the Bank under threat of more severe regulatory action, as the evidence conclusively establishes, *see* discussion *supra* at Part II, then the 1988 and 1991 "agreements" themselves constitute independent breaches of the 1982 MOU and cannot, by definition, constitute mutually agreed upon modifications to the original Agreement. To be clear, the Bank "accepted" the terms thereof only to mitigate the effects of the breach, and efforts at mitigation cannot either eviscerate the underlying contract or excuse the underlying breach.

## IV. DEFENDANT BREACHED THE 1982 AGREEMENT BY IMPOSING THE 1988 MOU ON MERITOR

Fully aware that the evidence supports a finding that the 1988 MOU would not have been imposed but for FDIC's discarding or discounting of Meritor's goodwill, the government's first strike is to attempt to recast the nature of the 1982 agreement. As shown above, the evidence is overwhelmingly to the contrary. Then, in the alternative, the government recasts the question as it relates to breach. The government now contends that:

> The question is whether Meritor was regulated on the basis of its tangible capital ratio *alone* rather than on the basis of capital ratios that included the unamortized Western goodwill at some point during the period of 1982-92.

Gov't Br. at 26.

No one is contesting that FDIC analyzed the Bank on the basis of more than Meritor's tangible capital levels. Regulators viewed Meritor through the prism of a variety of factors, each one of which has an effect on the analysis of each other. But capital is always the key, because

without it, FDIC's insurance fund is exposed. Tr. 3515:13-16 (Hand) (agreeing that "FDIC does not want to be an insurer of an institution that has no capital cushion"); Tr. 3523:12-15 (Hand) ("depletion of tangible capital, and the elimination of the protection to the FDIC insurance fund was a significant concern"); Tr. 3512:19-3513:7 & Tr. 3514:22-3515:12 (Hand) ("the quantity of a bank's tangible capital is a significant component in assessing its financial condition" because tangible capital "represents a protection available to the creditors of the institution if the institution were to incur difficulties, and losses"); Tr. 4673:25-4674:4 (Hammer) ("I worked for the FDIC for two years. They had one thing in mind, in my view -- you have plenty of FDIC people here. They had to protect their insurance fund. That's number one on their list. That's number 1, 2, 3, then they worry about 4, 5, 6"); Tr. 3741:22-3742:9 & 3743:9-3746:4 (Francisco) (as a bank becomes more troubled, tangible capital becomes more important because intangibles have no liquidation value); Tr. 5512:14-5513:14 (Brumbaugh); Tr. 3641:23-3642:11 (Hand) (practice was to put banks on failing bank list if they were projected to become insolvent within eight quarters).

Thus, a bank with poor earnings can effectively offset this performance indicator in the eyes of the regulators with sufficiently high capital levels, and likewise, low capital levels may be offset by a strong earnings history. Tr. 3523:16-3525:8 (Hand) ("poor earnings can be offset by a high level of capital, because it takes longer for those -- for losses to eat away at that capital"); Tr. 3525:4-13 (Hand) (same); Tr. 2075:14-2077:2. Capital thus inevitably extends the lifeline of a troubled bank in that it affords the bank additional time to turn around its financial woes. Tr. 3525:4-9 (Hand) (agreeing that "the longer it takes to deplete" capital, "the more time an institution has . . . to turn itself around"); Tr. 4577:16-18 (Hammer) ("I thought we had the time. We had plenty of capital, you know, goodwill was there for, what, 15 years or

something."); Tr. 5512:14-5513:14 (Brumbaugh) (FDIC's practice is to determine viability by reference to tangible capital life); Tr. 2045:25-2046:12 & 2207:6-13 (Mancusi). The question, then, is *not* whether FDIC regulated Meritor "on the basis of its tangible capital ratio *alone*," but rather, whether FDIC's decision to discard the Bank's goodwill, and focus instead on Meritor's tangible capital, was a proximate cause of, or a substantial factor in, FDIC's decision to impose the 1988 MOU, the 1991 Written Agreement, and to initiate the 1992 8(a) action. To that question, the evidence is an unequivocal, "Yes." *See* Pl. Trial Br. at 28-61, 83-98, 101-126.

We take the government's specific arguments in turn.

First, the government returns to FDIC's denial of the Bank's request to repurchase its own stock in 1984. In defense of its action, FDIC lamely states that Chairman Isaac testified that FDIC would have disapproved of such a buy back "regardless of the rationale. . . ." *See* Gov't Br. at 26-27. But that, of course, ignores the real issue, which is *whether* FDIC disregarded the Bank's goodwill in the agency's decision-making process. That FDIC specifically relied upon the Bank's low tangible net worth as its basis to deny the request is itself powerful evidence that FDIC was discarding the Bank's goodwill as "real" or "legitimate" capital as early as 1984. Why would one expect FDIC to change its approach thereafter?

Second, the government argues that Meritor's growth is itself evidence that FDIC treated Meritor's goodwill as regulatory capital for purposes other than compliance with regulatory capital minima.[11] *See* Gov't Br. at 27. In fact, what Meritor's growth actually demonstrates is

---

[11] That the government should even suggest that Meritor received the benefit of the bargain because it sought to leverage goodwill is stunning given Mr. Lutz's statement in deposition that the Bank did not and could not leverage goodwill. *Compare* Tr. 3198:9-22 (Lutz) ("They didn't leverage supervisory goodwill. They leveraged their capital, equity capital. The way I look at the world, I'm not a smart guy, you probably know that by now, the supervisory goodwill is over here, the equity capital is over here, I don't leverage goodwill, I leverage capital") with Tr. 1559:20-22 (Isaac) (PSFS's supervisory goodwill "was part of their capital structure, and they

(continued)

that FDIC had little need to revisit the 1982 agreement while Meritor was profitable and while its tangible capital ratios provided a sufficient buffer so that the FDIC insurance fund was adequately protected. In times of difficulty, however, when Meritor began to suffer its first losses, and its tangible capital levels began to diminish and threaten FDIC's insurance fund, FDIC then acted to replace the goodwill with tangible capital so as to provide a sufficient buffer to protect its insurance fund. Tr. 2046:8-12 (Mancusi); *see generally* Tr. 2031:1-2061:17 (Mancusi). Those concerns first became apparent when FDIC drafted proposed MOU's in 1986 and 1987. *See* PX 78 & PX 91; *see also* Tr. 5487:13-5488:2 (Brumbaugh) (describing early drafts of the MOU as "pulling out a gun" for 1988 breach). Simply, there is no inconsistency between Meritor's growth in the early years and a finding that FDIC breached the 1982 agreement when it imposed higher capital requirements and required Meritor to shrink the Bank.[12]

Third, the government argues that the 1988 MOU's requirement that Meritor use its best efforts to reach 6.5 percent was not unusual, and indeed, reasonable in light of the circumstances. But that ignores that FDIC accorded Meritor just four months (an unprecedented *short* period of time) to achieve the 6.5 percent level, and did not follow its usual practice of according the Bank

can — it counts as any other capital does [under the 1982 MOU], which means you can leverage it.").

[12] And there should be no question that the 1988 MOU and the 1991 Written Agreement required Meritor to do just that. As plaintiffs set forth in their initial trial brief, the only mechanism available for Meritor to raise $200 million in 1988 or 1989 was to sell more than two-thirds of its franchise, shrinking drastically the size of the institution so as to satisfy the requirements of the 1988 MOU. Moreover, the highly inflated 1991 Written Agreement capital levels required Meritor to continue its self-liquidation simply to offset the amortization of goodwill. As everyone recognized, Meritor was not going to reach a break even point for at least another year. Consequently, even in the face of break-even earnings, Meritor would have to sell off assets sufficient to realize a $54 million gain each year to offset goodwill amortization in the same amount just to maintain its compliance with the 1991 Written Agreement. Pl. Trial Br. at 89.

an opportunity to develop a business plan first. Tr. 2032:17-2033:19; 2308:3-13; 2311:13-23 (Mancusi). Nor did FDIC follow its usual practice of according new management (Hillas had arrived at Meritor just weeks before the 1988 MOU was executed) an opportunity to develop its own plan prior to FDIC's enforcement of the 1988 commitments. *Id.* (Mancusi). In this case, FDIC's usual practices were nowhere to be found; it instead wanted tangible capital *immediately*.

More fundamentally, however, the government fails to address, at least in serious terms, FDIC's demand that Meritor raise $200 million (in just a matter of months) at a time when the capital markets were effectively closed. The government wholly ignores Mr. Mancusi's testimony that it is most unusual for a banking regulator to impose a requirement on any bank to raise a sum certain except in the narrow circumstances where the raising of such funds is necessary to offset a negative net worth created by the posting of reserves, a situation that just did not exist here. *See* Pl. Trial Br. at 59-60.

The government's only response is its assertion that FDIC was motivated, not because of Meritor's goodwill, but "as a direct replacement for the over $250 million in capital notes that had to be repaid in the spring of 1989, which would reduce Meritor's capital by around 25 percent." Gov't Br. at 28. But the only evidence of that is Mr. Lutz's testimony that the maturity of the notes was one of a number of factors he considered. Gov't Opp. at 28. But Lutz's credibility is seriously lacking in that he testified at deposition that he could recall no connection at all between the notes and the 1988 MOU, and indeed had no idea as to how the $200 million number was determined. Tr. 3249:16-24 (Lutz). Nor is there any documentary evidence specifically linking the $200 million requirement and the capital notes coming due. Significantly, Mr. Lutz also testified that "the amount of [the Bank's] supervisory goodwill versus tangible capital" was "taken into consideration, along with other factors," in arriving at

the 1988 MOU. Tr. 3248:24-3249:3 (Lutz). And even if Lutz's more recent testimony were accurate, and the maturity of the notes had been a factor, that is not to say that FDIC would have imposed the $200 million requirement had it counted Meritor's goodwill as real capital. The notes, Lutz testified, were only one of many factors he considered.

The government's subsequent reliance on Mr. Slattery's testimony and that of plaintiffs' experts is patently absurd. In both cases, the government has omitted substantial portions of the testimony that establishes the very opposite of that which the government now asserts. In the case of Mr. Slattery:

> Q. Did Mr. Lutz ever indicate to you that he was requesting an additional $200 million in equity capital to replace those notes?
>
> A. He might have. I can't remember a specific instance of that. Certainly we talked about that, whether it was Mr. Lutz raising it or my asking him whether that's what he was doing, I don't remember. I can't remember who brought it up.

Tr. 1238:21 – 1239:4. Mr. Slattery expanded on his answer later:

> [Lutz and I] had a variety of conversations, and I am relatively certain that I think you put it as a *quid pro quo* yesterday. I am relatively certain it was not a *quid pro quo*. There were discussions. And as I thought about it last night, *I remember very clearly that we had a discussion that there would have been a $425 million swing if we had to do that.* So I'm not at all sure that that's the way it came up.
>
> Q. And you testified yesterday that the 1988 MOU required that those capital notes not be included in capital, even though they weren't due until the next year?
>
> A. That is correct.

Tr. 1347:12-24. In fact, the suggestion that the $200 million figure was intended to replace the capital notes makes no sense in that, regardless of the 1988 MOU, the Bank had to replace the notes with tangible capital just to maintain compliance with whatever capital ratios were otherwise required. Put another way, if Meritor had to satisfy a 6.50 percent capital ratio, or any

other capital ratio, it would, by necessity, have to raise any capital lost dollar for dollar. Thus, it would have been unnecessary to inject into the 1988 MOU a provision specifically to require the raising of capital other than to set forth a specific ratio. Here, as Mr. Slattery testified, Meritor had to replace the capital notes, reach and maintain a 6.5 percent capital ratio (without the notes), and raise an additional $200 million. Thus, the 1988 MOU in fact required the "$425 million swing" alluded to by Mr. Slattery -- and that is what the Bank did. That is inevitably the reason why there is no contemporaneous FDIC document identifying the maturity of the notes as a basis to impose the $200 million requirement on the Bank.

Plaintiffs' experts likewise fail to support the government's conclusion. Mr. Mancusi's testimony was unequivocal:

> I mean, it seemed pretty clear to me that the $200 million request was to get tangible capital in the bank and raise the tangible capital levels of the institution.

Tr. 2354:17-19. *See also* Tr. 2311: 20-23 (Mancusi) ("So, I mean, I think there were a lot of factors at that time that suggest to me the $200 million request was for something other than replacing the notes that were being disallowed at that time."); Tr. 2356:5-2357:6 (Mancusi) (1988 MOU predictably forced sale of Bank's "crown jewels," which, in turn, predictably hurt asset quality and earnings; "[t]he only thing that it did accomplish was that it brought $200 million or more into the institution, at that point in time, as equity"; and describing "only advantage" of 1988 MOU and subsequent sale of branches is that it raised tangible capital); Tr. 2363:21-2364:8 (Mancusi) ("I believe the $200 million number was in there to raise the tangible level of capital in the institution."). Nor does Dr. Brumbaugh's testimony provide FDIC with any comfort. Tr. 5515:10-23 (Brumbaugh) (1988 MOU "counterproductive" to stated goals of improving asset quality and earning problems). In fact, all Dr. Brumbaugh states in the transcript

excerpt relied on by the government is that FDIC may have considered the notes coming due as "one of the things among many that regulators took into consideration." Tr. 5595:11-17.

To be weighed against Mr. Lutz's testimony is the well-established documentary record specifically linking the official 1988 action to Meritor's low tangible net worth. Pl. Trial Br. at 38-46. Moreover, Mr. Nocella and Mr. Slattery both testified regarding Mr. Lutz's acknowledged disdain for the Western goodwill, Lutz's statement that he would mentally deduct the goodwill when determining the Bank's capital adequacy, and Mr. Lutz's own admissions that he thought goodwill was worthless once the underlying (acquired) assets are sold. *See* Tr. 3264:20-3265:10 (Lutz). In other words, the question here is not whether FDIC can offer a *post hoc* economic rationale for its decision making in 1988. Rather, the exercise here is to determine what in fact motivated FDIC. Stray self-serving testimony aside, plaintiffs have more than satisfied their burden in establishing that Meritor's low tangible net worth, and the government's failure to treat the Bank's goodwill as real capital, proximately caused FDIC to impose the capital requirements.

The government's current dance to find a way around the documentary and testimonial record stands in sharp contrast to the government's ready acknowledgment in 1994 that the capital requirements contained in the 1988 MOU and the 1991 Written Agreement were due to the high level of intangibles carried on the Bank's books. Indeed, once upon a time, in this proceeding, government counsel so advised this Court:

> I mean, let's understand the best asset is money in the bank. That's Tier I core capital, and there are other kinds. The next best is probably something like a treasury note, and we go down from there. Goodwill, while it was allowed to be counted against the established ratios, did not determine what the minimum level would be. And as we see, the government has set different levels in 1988 and 1991, taking into account the overall risk to the institution. Particularly, when you're at a situation –

> The Court: So the minimum level you're arguing was affected by the percentage of the adjusted equity capital that was goodwill as opposed to land or money?
>
> Mr. Rice: Yes, Your Honor.

Sept. 16, 1994 Tr. at 39-40. The government was right in 1994 and is wrong now.

## V. THE 1988 BREACH CLAIM IS NOT TIME-BARRED

The government asks the Court to dismiss as time-barred Plaintiffs' claim that the contract was breached in 1988.[13] For the reasons articulated below, dismissal would be both inequitable and contrary to law.

### A. The Amended Complaint "Relates Back" to the Original Complaint

Whether an amended pleading relates back to the original complaint depends on *notice* and *prejudice,* which are interdependent factors. The question asked is whether the defendant has received adequate timely notice so as not to be prejudiced in the preparation of its case. *Stephenson v. United States*, 37 Fed. Cl. 396, 405 (Fed. Cl. 1997); *Woods v. Indiana University*, 996 F.2d 880, 888 (7th Cir. 1993). This Court has held that a defendant has been given "adequate notice of the new claim" if it has been reasonably alerted to the fact that "the type of evidence required for the new, amended claim should be preserved." *Stephenson*, 37 Fed. Cl. at 405. In the present action Defendant cannot reasonably deny adequate notice under RCFC 15(c), nor can it reasonably claim to have suffered any prejudice by reason of the delayed assertion of the 1988 breach.

#### 1. The government cannot show prejudice

The government's singular claim of prejudice is based on the unavailability of one witness, Maurice Henderson, a review examiner in the New York Region who died unexpectedly

[13] *See* Amended Complaint at ¶¶ 43-45, 72- 73.

in January 1997. *See* Gov't Br. at 42. However, the most the government can say about Mr. Henderson's involvement with the 1988 MOU is that he "probably" authored drafts of the agreement. *Id.* The government's assertion of prejudice should be rejected.

First, even if the government's hypothesis were correct that Mr. Henderson played some role in drafting the 1988 MOU, the government concedes that Mr. Henderson did not die until "four months *after* plaintiffs first raised their 1988 breach claim." *Id*. The government thus *did* have an opportunity to speak with Mr. Henderson, or preserve his testimony, but it apparently opted to do neither. Second, there is no reason to believe that the government would have in fact preserved his testimony even if the 1988 breach had been alleged in the original complaint. Notwithstanding medical-imposed restraints on the taking of Dennis Fitzgerald's deposition, it was still the plaintiffs that sought and insisted upon his deposition. The government did nothing to preserve his, or anyone else's, trial testimony, and there is simply no reason to believe that the government would have treated Mr. Henderson any differently, especially in the absence of any evidence that he was ill. If the government does not preserve the testimony of ill witnesses, why would it have preserved the testimony of a healthy witness? Of course, if the government cannot demonstrate that it would have preserved Mr. Henderson's testimony, there can be no prejudice because Henderson would have been unavailable for trial regardless of whether plaintiffs included the 1988 breach claim in the Original Complaint or later.

Third, the government's claim of prejudice is also defeated by the fact that the "new claim" was filed early in the discovery process. In fact, *all* of the depositions in this case — close to fifty of them — occurred well after the filing of plaintiffs' amended complaint. As a result, a full opportunity to explore issues relating to the 1988 breach claim has been afforded. And that opportunity has been seized. The parties have taken the depositions of: (1) the FDIC

examiner-in-charge in 1987 who drafted the examination report upon which the 1988 MOU was based and who personally recommended the imposition of the MOU (Albertson); (2) the number two FDIC examiner on the 1987 examination (Fitzgerald) (PX 120 at A-4): (3) the head of the Pennsylvania state examination team, which participated jointly with FDIC in the 1987 examination (Metzger); (4) the FDIC Assistant Regional Director responsible for the supervision of the Bank at the time of the 1988 MOU (Wyka): (5) the FDIC Regional Director who personally negotiated the terms of the 1988 MOU with the Bank (Lutz); (6) the FDIC Regional Director who enforced the 1988 MOU (Ketcha); and (7) the representative of the Bank who negotiated the terms of the 1988 MOU with FDIC (Slattery). In other contexts, where it serves the government's interests, the government has accurately characterized this wealth of deposition testimony as "exhaustive." *See* Defendant's Motion for a Stay of Proceedings (Jan. 13, 1999) at 6. The government claim of prejudice therefore fails. *See Clipper Express v. Rocky Mountain Motor Tariff Bureau, Inc.*, 690 F.2d 1240, 1259 n.29 (9th Cir. 1980) (Rule 15(c) is to be "liberally applied" especially where there is ample opportunity for discovery and other pretrial procedures: "In the absence of any evidence of prejudice to defendants caused by the late filing of the fraud claim, there is no reason to find it time-barred.").

Finally, and perhaps most significantly, there is no evidence that Mr. Henderson actually played a substantial role in the 1988 MOU. *See* Tr. 860:1-17 (Albertson) (Albertson wrote initial draft); Tr. 862:13-863:5 & 868:17-22 (Albertson) (Regional director has final authority regarding MOU; Albertson has "no specific knowledge as to what [Henderson] did or didn't do in that 1988 MOU" except for the fact that "he was involved in some of the drafting"); Tr. 3684:7-16 & 3735:8-3736:14 (Francisco) (no knowledge of what, if anything, Henderson did because the review examiner does not have authority to agree to transaction); Tr. 3218:18-3219:7 (Lutz) (not

certain what role Henderson played). Indeed, there is quite substantial, and uncontested, evidence that Mr. Henderson's role was insignificant. Tr. 3731:5-20 (Francisco) (review examiner's work subject to review by Assistant Regional Director ("ARD"), Deputy Regional Director ("DRD"), and Regional Director ("RD")); Tr. 3734:9-3735:14 (Francisco) (negotiations with banks regarding MOU would be handled by ARD, DRD and RD -- not by the review examiner); Tr. 1232:17-22 (Slattery) (Lutz is only person with whom Slattery negotiated); Tr. 1445:15-18 (Slattery) (does not recall Henderson being at any of Bank's meetings with Lutz).

The government's prejudice argument thus rests upon multiple layers of speculation. The government hypothesizes, without support, that Mr. Henderson played some critical role in proposing or negotiating the 1988 MOU; further speculates that the government would have had the insight to have spoken with him and realized prior to any depositions that it should preserve his testimony in the event of death, even though Mr. Henderson was not ill prior to his death; and then speculates that Mr. Henderson's testimony would have been advantageous to the government, that he -- as a review examiner with no decision-making authority -- would have offered something in testimony that no other government witness could offer; and that the testimony would be of such importance that it could alter the verdict in this case. The government, of course, has offered no evidence to support any of its hypotheses.

**2. Plaintiffs' original complaint provided adequate notice**

The government's argument that plaintiffs did not raise any issue with regard to the 1988 breach in its original complaint is self-defeating, because *the government itself* made an issue of the 1988 MOU as early as 1994. In its second supplement to its first motion for summary judgment, the government discussed the 1988 MOU at length: How the agreement reflected the intent and state of mind of the parties, the circumstances surrounding its execution, and its effect on plaintiffs' contentions. *See* Defendant's Motion for Leave to File a Supplement to

Defendant's Pending Motion, Defendant's Supplement, and Defendant's Reply (Sept. 7, 1994) at 7-13. The government attached a copy of the 1988 MOU to its pleading (but no affidavit from Mr. Henderson). *Id.* at 13.[14] The government's use of the 1988 MOU in support of its motion came as no surprise, since plaintiffs' original complaint had likewise put in issue FDIC's treatment of Meritor's goodwill as far back as 1983-84. *See* Complaint at ¶¶ 37-38, 41, 43-44. The government's ability to assess the actual significance of the 1988 MOU was of course far superior to plaintiffs' at the time, since the government was the only party that had access to the relevant documents. Nor is it surprising that the government's treatment of Meritor's goodwill in prior years, including 1988, should be within the ambit of the original action, since the parties' treatment of the goodwill may be construed as evidence of intent to contract or evidence as to the interpretation of a contract.

The fact that both the amended complaint and the original complaint focus on the same transaction — the government's treatment and use of Meritor's supervisory goodwill under the 1982 MOU from 1982 through 1992 — establishes that the original complaint put the government on notice to investigate this issue for the entire lifetime of the contract. The government's reliance upon the 1988 MOU in its 1994 pleading proves that it not only received, but acted upon, that notice. As the Court of Federal Claims and its predecessors have noted, RCFC 15(c) requires that "adequate notice [be] deemed to exist if the claims asserted in the

---

[14] The government noted in its September 7, 1994 brief:

> Because we believe that the Court should be free to consider the 1988 MOU in ruling upon our pending motion, we have filed a motion for leave to file a supplement to our motion and an appendix containing a copy of the 1988 MOU, rather than simply a reply to the shareholders' opposition.

*Id.*

amended pleading arose out of the same conduct, transaction, or occurrence set forth in the original pleading." *See White Mountain Apache Tribe v. United States*, 8 Cl. Ct. 677, 682 (1985); *Snoqualmie Tribe of Indians v. United States*, 178 Ct. Cl. 570, 372 F.2d 951, 961 (1967). Importantly, this standard is disjunctive. Thus, plaintiffs need only show that the 1988 claim involves the same conduct *or* the same occurrence *or* the same transaction, as that asserted in the original complaint. *See FDIC v. Bennet*, 898 F.2d 477, 479 (5th Cir. 1990). That standard is easily satisfied here.

In *Snoqualmie*, the government argued that the addition of a new party and new claims to a nine-year-old complaint alleging a violation of a treaty between the government and several Indian tribes did not relate back to the original complaint. The court rejected the government's argument, stating, in relevant part, that the treaty underlying the action was the "transaction" giving rise to both tribes' claims. *Id.* In addition, the court reasoned that, given the government's role as administrator of Indian Affairs, the government was on notice of the possibility of additional tribal plaintiffs and claims. *Id.* Similarly, in the present action, the 1982 MOU, like the treaty in *Snoqualmie*, is the transaction upon which all of plaintiffs' allegations are based. Additionally, as the receiver of Meritor, the government acted as Meritor's "administrator," especially since it seized, and thereafter had in its possession, all of Meritor's records at the time it was appointed receiver.

Nor does the "relation back" doctrine turn on whether the 1988 MOU was "mentioned" in the original complaint. In *Union Pacific Railroad Co. v. Nevada Power Co.*, 950 F.2d 1429, 1431 (9th Cir. 1991), the court of appeals affirmed the lower court's decision allowing Union Pacific to add an additional claim for the return of reparation payments four years after filing its original complaint, even though the specific tariff that formed the basis for the additional

reparation claim was not mentioned in the initial lawsuit. *Id.* In its original complaint, Union Pacific asserted a claim for the return of reparation payments made to Nevada Power when a determination of overcharges by the Interstate Commerce Commission was vacated. Its original complaint focused solely on payments made under Union Pacific's Tariff 6034, which set forth the rates to be charged for the transportation of Nevada Power's coal from Utah to Nevada. *Id.* at 1430. Four years later, it added another claim for the return of reparation payments made to Nevada Power; that claim centered around an entirely different tariff — Tariff 6020. *Id.* at 1431. The trial court, rejecting Nevada Power's statute of limitations defense to the addition of this claim, held that the new claim arose out of the same transaction as the original claim despite the fact that the new claim for repayment centered upon a different tariff. *Id.* The court stated in part:

> We differentiate between pleadings attempting to amend claims from those seeking to amend parties. Amendments seeking to add claims are to be granted more freely than amendments adding parties. . . . When a suit is filed in a federal court under the [Federal Rules of Civil Procedure], the defendant knows that the whole transaction described in it will be fully sifted, by amendment if need be, and that the form of the action or the relief prayed or the law relied on will not be confined to their first statement.

*Id.* (citations omitted) (emphasis added).[15]

Like the Defendants in *Snoqualmie* and *Union Pacific*, the government here was on notice that its treatment of Meritor's supervisory goodwill under the 1982 MOU was at issue. The "new" claim alleges the same kind of breach, of the same provision of the same contract, by the same party. The original complaint, moreover, specifically put in issue the government's

---

15 Notice is determined by more than what is contained in the pleadings. *See Woods*, 996 F.2d at 888 (citing Wright, Miller & Kane). Here, the government has always had possession of (continued)

treatment of the contract clause at issue throughout the contract's ten-year life.[16] Especially given the complete absence of prejudice, these facts bring plaintiffs' 1988 claim squarely within the provisions of RCFC 15(c). The 1988 claim is therefore not time-barred.

### B. Successive Stays Sought by the Government and Granted by this Court Tolled the Statute of Limitations

This Court stayed all proceedings in this action just one month after the original complaint was filed, and that stay was followed by successive stays. *In all, this case was stayed continuously for 33 months*.[17] And for much of the time, the stays were "stays of proceedings" that acted to prevent plaintiffs from taking discovery, filing any pleadings or amending the Complaint. Indeed, in 1994, the government was compelled to file a motion for leave to file its dispositive motions precisely because, absent relief, this Court's stay orders were absolute -- that

---

its own internal documents -- documents in which evidence of the 1988 breach is primarily located.

[16] In the original complaint, plaintiffs did not allege that FDIC's prior actions (in 1988 and 1991, for example) were taken in breach of the 1982 agreement. Plaintiffs in fact asserted that FDIC had honored the 1982 MOU until it seized Meritor to demonstrate FDIC's understanding of that agreement's terms. The government argues that this fact is dispositive on the issue of notice, and that the original complaint's averment that FDIC "honored" the 1982 MOU from 1982 to 1992 (*see* Gov't Br. at 41) somehow prejudiced the government in this action. The government's argument misses the point, however, because the issue under RCFC 15(c) is whether the complaint put the government on notice of the transaction to be litigated, and because in this case the original complaint not only alerted the government to the fact that its performance under a particular provision of a particular contract would be challenged, but also that its performance under that contract over its entire ten-year life would be at issue. *See FDIC. v. Conner*, 20 F.3d 1376, 1386 (5th Cir. 1994). In *Conner* the court of appeals allowed FDIC to amend its complaint to add claims for wrongfully approved loans that were not included in its original pleading despite the fact that FDIC had represented to defendants at an earlier time that the loans identified in the original complaint would be the only loans that FDIC would act upon. *Id.* The court reasoned that the damage allegedly caused by the loans to be included in the amendment arose out the same conduct as the damage caused by the loans included in the original complaint. *Id.* Further, the court held that FDIC's earlier representations about the loans did not negate the notice provided by the original complaint, nor did the earlier representations prejudice the defendants because over a year of discovery remained after the amended complaint was filed. *Id.*

[17] The government did not file its answer until May 2, 1996, some three years after the commencement of the suit.

is, they stayed all proceedings, not just discovery. *Cf.* Order (Jan 21. 1994) ("IT IS ORDERED that the stay of proceedings imposed in this case is modified to allow the parties to proceed with a dispositive motion to be filed by the defendant"). Even after the stay of proceedings came to an end, plaintiffs still were barred from taking discovery until the government's dispositive motions were resolved. *See* Transcript of July 29, 1994 Hearing at 12-14.[18]

Having continually objected to plaintiffs' requests to lift the earlier stays, the government cannot now complain in good faith that the plaintiffs' first amended complaint came too late or otherwise prejudiced the government in the preparation of its case. *See In re A.H. Robins Co.*, 828 F.2d 1023, 1026 (4th Cir. 1987) ("[B]y seeking the protection of the court under bankruptcy laws, Aetna implicitly waives its right to claim that this stay does not toll the state statute of limitations. Our system of law universally frowns on a party who would use the stay as both a sword and a shield.").

Where federal courts stay proceedings pending resolution of identical state court actions, the stay tolls all applicable statutes of limitations. *See Colorado River Water Conservation District v. United States*, 424 U.S. 800 (1976); *Attwood v. Mendocino Coast Dist. Hospital*, 886 F.2d 241, 244 (9th Cir. 1989); *Selph v. Nelson, Reabe and Snyder, Inc.*, 966 F.2d 411, 413 (8th Cir. 1992). Courts reason, first, that the stay and the corresponding tolling avoids judicial waste that may occur from duplicative litigation, and second, that the stay, unlike dismissal of the federal action, avoids the risk that the federal plaintiffs' claims will be time-barred if the state court fails to resolve all of the relevant issues in the case. *Id.*

---

[18] For a detailed history of this Court's successive stay orders, *see* Plaintiffs' Opposition to Defendant's Motion for Partial Summary Judgment (filed March 3, 1999) at 23-27, which Plaintiffs incorporate by reference herein.

This reasoning should apply with equal weight in the present action. This Court, over plaintiffs' repeated objections, stayed the present action in 1993 pending a final resolution of the related *Winstar* appeals. While the *Winstar* action did not involve the identical parties and issues as is often the case in so-called *Colorado River* actions, the concerns expressed by the government and this Court underlying the request for and imposition of stays in both situations are identical. *See* United States' Response to Plaintiffs' Memorandum (July 13, 1993); United States' Response to Plaintiffs' Memorandum (September 28, 1993); Defendant's Opposition to Plaintiffs' Motion to Modify Previous Orders Affecting Discovery (January 17, 1995); Defendant's Supplemental Brief Submitted Pursuant to this Court's September 5, 1995 Order, and Request for a Stay of Proceedings (Oct. 5, 1995); *see also Mt. Hood Stages, Inc. v. The Greyhound Corp.*, 616 F.2d 394, 399 (9th Cir.), *cert. denied*, 449 U.S. 831 (1980) (Prior proceeding tolls statute of limitations where subsequent action does not rest on identical cause of action if issues decided in prior lawsuit may dispose of claims in present suit and prior action "afford[s] adequate notice of the issues upon which a defense should be prepared.")

**C. The Continuing Claim Doctrine Preserves Plaintiffs' 1988 Claim**

Even if plaintiffs' 1988 breach claim does not "relate back" to the original complaint pursuant to Rule 15(c), and even if the successive stays issued in this action did not toll the limitations period, the 1988 claim would still survive under the "continuing claim" doctrine. The government's 1988 breach of the 1982 contract represents one in a series of government breaches of its continuing duty to treat the Bank's supervisory goodwill as regulatory capital. Plaintiffs are therefore spared the time-bar of six-years so long as one of the alleged breaches occurred within the limitations period.

Under the continuing claim doctrine, if the government owes a continuous duty to plaintiffs, a new cause of action arises each time the government breaches that duty. *The*

*Cherokee Nation of Okla. v. United States*, 26 Cl. Ct. 798, 803 (1992); *Plaintiffs in Winstar-Related Cases v. United States*, 37 Fed. Cl. 174, 189 (1997), *aff'd. sub nom. Ariadne Fin. Serv. v. United States*, 133 F.3d 874 (Fed. Cl.), *cert. denied*, 525 U.S. 823 (1998). The continuing claims doctrine permits a plaintiff to defer litigation until the termination of a continuous wrong, thus "spar[ing] plaintiff from having to pursue multiple actions." *Winstar-Related*, 37 Fed. Cl. at 189. The Claims Court explained the policy underlying the continuing claim doctrine:

> The continuing claim doctrine permits a plaintiff to defer litigious action until the termination of a continuing wrong, and thus spares plaintiff from having to pursue multiple actions. In this way *the continuing claim doctrine prevents the statute of limitations from protecting an offender in an ongoing wrong, and thereby avoids [sic] claims that would be unactionable simply because they commenced prior to the statutory period.*

*Cherokee Nation*, 26 Cl. Ct. at 803 (emphasis added) (citation *omitted*); *see also Miami Nation of Indians of Indiana, Inc. v. Lujan*, 832 F. Supp. 253, 256 (N.D. Ind. 1993).

In *Cherokee Nation*, the plaintiff asserted causes of action for multiple claims of trespass, only some of which occurred within the applicable six-year limitations period. The Claims Court, applying the continuing claim doctrine, held that the plaintiff could sustain its claims for *all* of the trespass allegations, even including claims that occurred at least seventy-nine years beyond the limitations period. *Cherokee Nation*, 26 Cl. Ct. at 804. The Court so held because it found that the government owed the plaintiff a continuing duty to recognize the tribe's sovereignty, and each of the government's repeated trespasses upon the tribe's land constituted breaches of that same duty.

The government here had a continuing duty under the 1982 MOU to permit the institution to amortize supervisory goodwill for a specific period of time. *See Ariadne Fin. Serv. v. United States*, 133 F.3d 874, 879 (Fed. Cir.), *cert. denied*, 525 U.S. 823 (1998) (The goodwill contract at issue in the case was a "contract that promised continuing performance into the future."). Under

the continuing claim doctrine, each breach of that duty by the government created a new cause of action. Plaintiffs allege three breaches in their amended complaint: (1) the decision to impose heightened capital requirements in the 1988 MOU; (2) the decision to impose heightened capital requirements in the 1991 Written Agreement; and (3) the decision to initiate insurance revocation proceedings against the Bank and cause the Pennsylvania Department of Banking ("PDB") to seize the Bank in December, 1992.

Plaintiffs filed this action well within six years from the date of this final (and most destructive) breach, and also within six years of the 1991 breach, thus avoiding both the risk of having to file successive actions concerning continuing breaches as well as the risk of facing potential *res judicata* hurdles. Therefore, in accordance with *Cherokee Nation* and the continuing claim doctrine, none of plaintiffs' causes of action for breach of contract is time-barred. *See Massachusetts Bay Transp. Auth. v. United States*, 21 Cl. Ct. 252, 265 (1990) (acknowledging the potential "piecemeal nature of the litigation" and expressing its desire "to keep this entire 'circus' under one tent"); *Nager Elec. Co. v. United States*, 177 Ct. Cl. 234, 245 (1966) (citation omitted) ("'it was not intended by Congress that . . . [the statute of limitations] should be interpreted to require a multiplicity of suits on various items of a claim arising under an entire contract,' but rather that 'all rights of the parties under the contract' are to 'be heard and determined at the same time and in one suit'").

This court acknowledged that courts apply the continuing claim doctrine in cases that involve "a series of distinct events, each causing harm to the plaintiff and each classifiable as a separate 'breach' of the defendant's 'continuing duty' to the plaintiff." *Plaintiffs in Winstar-Related Cases*, 37 Fed. Cl. at 189. This is the case here.[19]

## VI. THE NOTION THAT MERITOR WAS NOT DAMAGED BY FDIC'S CAPITAL DEMANDS IS BOTH ABSURD AND CONTRARY TO THE OVERWHELMING WEIGHT OF RECORD EVIDENCE

Nietzsche wrote that "there is no greater tragedy than to see a beautiful theory struck down by cold hard fact." The cold hard fact in this case is that FDIC destroyed the oldest savings bank in America by inducing it to pay off over $800 million in projected government debts and then -- far more concerned for protecting its pocketbook than for honoring its commitments -- disregarding the promises that formed the inducement. The theories offered by the government to avoid this fact are, however, anything but beautiful. They are tissue-thin abstractions that seek to distort or conceal altogether the sworn testimony and admissions of honest men. Meritor *wanted* to cut its heart out by selling two-thirds of its best assets and deposits, the government incredibly asserts. FDIC forced Meritor to cut its heart out *in order to make the bank healthy* -- an equally implausible notion. More implausible still, the government claims that the FDIC, the body with all financial responsibility for Meritor's deposits, didn't do *anything* -- it was Sally

[19] This Court and the Federal Circuit declined to apply the continuing claim doctrine to the claims of two *Winstar*-related plaintiffs, Ariadne and Shane. 37 Fed. Cl. at 189. The two plaintiffs had argued that their causes of action actually constituted a series of distinct breaches, thus postponing accrual until the government's final breach -- when OTS acted directly against the thrifts. 37 Fed. Cl. at 189. Both courts rejected this argument, finding instead that the thrifts suffered a single breach when their goodwill contracts were abrogated by the final promulgation of OTS regulations implementing FIRREA. All subsequent denials of the use of supervisory goodwill "flow[ed]" from this original repudiation. *Id.* at 190; 1998 WL 1942 at *5. In contrast, in the present action there was no "single event" -- like FIRREA -- which "made clear" the government's intent to breach the 1982 MOU, *see id.*; rather, there was a series of breaches of the 1982 MOU.

Hargrove in Harrisburg who decided that Meritor would be closed and simultaneously sold by the federal government to another bank at a net book gain to the federal government of $846 million. These and the other positions taken by the government on the events that followed the imposition of the 1988 MOU are utterly refuted by the evidence and by the law, by experience and by logic. If there is tragedy in this refutation, it exists in the fact that so much of the Court's and the plaintiffs' time and resources have been spent in building a record that the government does not meaningfully address.

### A. The Branch Sale Was Driven Completely By The Demand -- Backed Up By Threat Of Legal Action -- That Meritor Raise $200 Million Immediately

The government argues that FDIC had nothing to do with Meritor's selling two-thirds of its branch franchise, and its better assets, to Mellon. Part of the government's reasoning rests upon a mathematical exercise according to which FDIC's $200 million demand could have been satisfied with a mere $7 million. The government's arguments overlook the fact that there has been a trial on these issues, and that the evidence adduced at that trial proved the government's thesis unworkable.

#### 1. The Branch Sale Was Designed Only To Satisfy The 1988 MOU's Demands, And Did Just That.

Ignoring all record evidence on the subject, the government continues to argue that the branch sale must have been unrelated to the 1988 MOU because the sale generated "four times" the amount of tangible capital required by the 1988 MOU. This bogus arithmetic relies upon the fact that Meritor's August 1989 Capital Plan assumed the conversion of the ICC's issued by FSLIC to the Bank's subsidiary, Meritor FA, and the fact that the MOU provided that if these ICC's could be converted to stock a contribution to capital in their face amount ($118 million) would be recognized. Thus, it is argued, Meritor needed to raise only $82 million to satisfy the 1988 MOU. Govt. Br. at 50. Beyond this, the Government argues that because the MOU would

allow Meritor to apply $75 million of the money raised to restructuring costs (specifically, the retirement of interest rate hedges), "tangible capital needed to be raised only $7 million . . . to achieve compliance with the 1988 MOU . . . ." *Id.* at 49-50. But as Mr. High's testimony, and the documents themselves, proved, the branch sale to Mellon, with its projected $333 million premium, was the only possible way to raise the $200 million demanded by the 1988 MOU.

In the first place, the Government ignores the fact that consummating the sale to Mellon would require Meritor to absorb over $100 million in losses on assets to be transferred. PX 216 at 27. The Government also ignores the more than $70 million in one-time restructuring costs that the sale to Mellon would impose. *Id.* The 1989 Capital Plan shows that when these costs are accounted for, and with the assumed retirement of the $118 million in ICC'S, the tangible capital raised by the branch sale -- as anticipated in August 1989 -- amounted to only $208 million.

| Premium expected | $333,037 | **Net** |
|---|---|---|
| Less loss on sale of assets | -$165,382 | $167,655.00 |
| Less one-time restructuring costs | -$77,734 | $89,921.00 |
| Plus Retirement of ICC's | $118,000 | **$207,921.00** |

*Id.; See* Tr. 957:15-959:4, 5177:4-21, 5194:15-5196:20 (High). The government's assertion that the branch sale netted for Meritor "four times" the capital infusion required by the MOU (Govt. Br. at 49) is thus unsupported. As Mr. High testified, the deal was specifically structured to ensure that it would get Meritor over the $200 million hurdle. Tr. 958:18-959:4 (High). The magnitude of the sale, the numbers show, was driven in large part by the losses and expenses that the sale itself would impose upon Meritor (aggregating over $200 million). These were costs that the Bank would not have had to incur if not subjected to FDIC's capital dictates.

The Government's assertion also overlooks the fact that Meritor actually tried to propose a capital plan similar to that which the government now claims would have satisfied the 1988

MOU. In its February, 1989 plan Meritor proposed an immediate $145 million infusion, consisting of $20 million from the sale of the Bank's credit card operations and $125 million from the conversion of the ICC's to preferred stock. *See* PX 190 at 15; PX 191. The plan also included an additional $90 million capital infusion by year-end 1989 through additional subsidiary sales, which would have exceeded the $200 million required by the MOU, but not until several months after the 1988 MOU's March 31 deadline. PX 190 at 15. Regional Director Ketcha's response to this plan was a series of letters, and oral communications, plainly stating that the plan would not satisfy the 1988 MOU and if Meritor did not submit a plan to raise $200 million in tangible capital *immediately* the Regional Office would proceed with a Cease and Desist Order or the withdrawal of the Bank's insurance. *See* PX 191; PX 200; PX 212; *See also* Tr. 5199:20-5200:2 & 5204:23-5205:7 (High). The government's efforts to rewrite history and thereby to create a kinder, gentler, FDIC thus founder upon cold historical fact.

**2. Every Single Witness On The Subject Affirmed That The ONLY Reason Meritor Sold The 54 Branches Was To Avoid The More Severe Regulatory Sanctions That FDIC Regularly Threatened**

The government baldly asserts that "the fundamental purpose of selling the branches . . . was to accomplish restructuring of the Meritor balance sheet to extend the life of the institution." Govt. Br. at 49. The assertion is an insult to the intelligence of anyone who attended the trial. It ignores the unanimous testimony of every witness who spoke on the subject. It also suggests that Mr. Hillas's annual letter to shareholders lied when it attributed the branch sale to "the heightened need to increase regulatory capital." PX 9 at 2; s*ee* i*d.* at 16 ("As part of Meritor's plan to improve regulatory capital ratios, the size of the organization was reduced through the sale of 54 branch offices and their associated deposits which was funded through the sale of assets.")

Mr. Hammer testified that he never contemplated such a sale, and that when he heard about it later he concluded that the Bank was "beginning to eat [its] stomach." Tr. 4677:25-4678:1. All witnesses agreed that, but for FDIC's insistence upon an immediate infusion of $200 million in tangible capital, Meritor never would have even contemplated the sale to Mellon. Tr. 412:10-18 & Tr. 575:16-20 (McCarron); Tr. 951:2-13 (High); Tr. 719:8-721:13 & Tr. 728:22-729:9 (Hillas). No member of Meritor's senior management ever even proposed a branch sale of such magnitude. Tr. 951:15-25 (High). There was one and only one reason for the sale -- to satisfy FDIC. Tr. 415:2-4, Tr. 416:4-7 & Tr. 523:24-524:7 (McCarron); Tr. 1082:14-1083:21 & Tr. 938:11-939:5 (High); Tr. 5170:3-4 (High); Tr. 2153:17-22 & Tr. 717:21-718:8 (Hillas); Tr. 1251:8-11 (Slattery). *See also* Tr. 837:19-22 (Albertson); PX 9 at 2.

Neither Meritor nor Bankers Trust believed there was any other way to raise the $200 million, and they believed that if the $200 million were not raised a Cease and Desist Order (or worse) would be the result. Tr. 954:25-955:11 & Tr. 5179:5-8 (High) ("In my view, that was the only thing that we could determine that we would do to come into compliance with the MOU. It was clearly as a result of the MOU, we entered into this transaction."). In Mr. Hillas' view, the sale to Mellon cost Meritor its "crown jewels," which would never have happened but for FDIC's demands. Tr. 630:9-631:7 & Tr. 636:4-10 (Hillas); DX 244.

When Meritor and Bankers Trust concluded that the branch sale was the only possible way to satisfy the MOU, Mr. Slattery met with Regional Director Ketcha in New York specifically to call upon Mr. Lutz's promise to be flexible in enforcing the MOU. Selling the branches would be "a mother eating her young," Mr. Slattery insisted, and would do the Bank

great damage. Tr. 1248:11-1250:15 (Slattery).[20] *See also* Tr. 2142:18-2143:24 (Hillas). The government's revisionist history thus ignores virtually all pertinent record evidence.

### 3. It Was Not Possible for Meritor to Satisfy the Capital Dictates of the 1988 MOU By Selling Stock

The 1988 MOU gave Meritor *four months* to achieve a 6.5 percent primary capital ratio. It is probably no coincidence that doing so, by capital infusion, would have required approximately $200 million.[21] Failing this, the MOU required that a plan be established for reaching 6.5 percent, and that, in addition, $200 million in tangible capital be raised *within three months.* Ignoring most of the record evidence on the point, the government argues that Meritor could have satisfied these requirements by selling stock, but opted against that expedient because the Bank's directors, presumably out of selfish greed, were unwilling to dilute the value of existing shares. There is no question that any and all possible avenues for raising capital externally were in fact explored, and there is substantial evidence that the dilutive effects of such measures were in fact discussed -- as they must be by any responsible manager of a publicly traded corporation. But the suggestion that satisfying the MOU through a stock sale was even possible is contrary to all evidence of record.

First, achieving a 6.5 percent primary capital ratio by December, 1988 (four months away) by means of a stock issuance would be an extraordinary accomplishment under the best of economic conditions. But conditions could not have been worse. Even by late 1987, according

[20] Mr. Ketcha did not deny that Mr. Slattery asked him to honor Mr. Lutz's promise (Tr. 4983:19-4984:8 (Ketcha)), and an internal FDIC memorandum records a conversation in which Mr. Ketcha declined Mr. Slattery's request that the Bank be given more time to satisfy the demands of the 1988 MOU (PX 207), although Mr. Ketcha denied any recollection of the meeting. Tr. 4998:9-4999:19 (Ketcha).

[21] In FDIC's 12/31/87 Exam Report primary capital, and adjusted total Part 325 assets, are calculated as $ 1,059,496,000 and $ 19,642,225,000, yielding a Primary Capital Ratio of 5.39

(continued)

to then Chairman Frederick Hammer, the "hostility in the marketplace" to thrifts generally (Tr. 4627:19 (Hammer)) meant that the financial markets were simply closed to Meritor. Tr. 4685:5-13 (Hammer). By 1988, the picture was even uglier.

> The big thing was that the industry was in disarray. We were in much better shape than most. The whole northeast, one by one, the great savings banks of the northeast were toppling. So you just couldn't get -- I mean, there was nobody interested in investing in a thrift at that point. I mean, all the financial press, all these sophisticated journalists that really didn't know what they were talking about said well, there's going to be no more thrift industry. The fact is, they were probably right in the long run, but that was enough to scare potential investors. You're not going to get good reception.

4638:3-13 (Hammer). Meritor's financial advisors in 1987-88, First Boston, had solicited private investments from 40 targeted interests, with no success. Tr. 1243:24-1245:19 (Slattery). In late 1988, and heading into 1989, the situation only got worse. Tr. 1243:24-1245:19 (Slattery); Tr. 4686:16-20 (Hammer).

In our Trial Brief, we reviewed the unanimous testimony of Meritor's managers that the 1988 MOU could not have been satisfied through a stock sale. *See, e.g.*, Tr. 740:21-741:2, 624:1-21 & 707:11-21 (Hillas); Tr. 936:16-19 (High); Tr. 409:7-22 (McCarron). Meritor's managers, financial advisors, and Board of Directors all concluded so. Tr. 1243:24-1245:19 & Tr. 1245:20-1246:16 (Slattery); Tr. 625:12-627:17 (Hillas). The FDIC witnesses who were closest to Meritor agreed. *See* Tr. 2909:15-2910:21 (Valinote) (stock sale not feasible); Tr. 816:7-9 (Albertson) (markets at the time would not permit a stock sale).

The experts also agreed. Dr. Brumbaugh testified, without contradiction by any witness, that "there was no possibility that the institution could raise capital by an acquisition, a merger,

---

percent. PX 119 at CSL 00 1 1 1 14 FF. Adding $ 232,351,471 to both the numerator and denominator would produce a ratio of 6.5 percent.

or raising capital in the capital markets given the condition of the thrift institution and the banking industry in general at that time." Tr. 5494:24-5495:3 (Brumbaugh). Beyond this, Dr. Brumbaugh testified that the impossibility of satisfying the MOU through a stock issuance would have been perfectly obvious to the regulators at the time the MOU was imposed.

> [T]he capital markets were essentially shut to these institutions. What this meant was that if an institution like Meritor was to meet the demands [of the 1988 MOU], it was going to have to sell assets and liabilities, and I think that that was perfectly perceivable and understandable by everybody who was involved in this transaction, the regulators as well as the directors and officers of Meritor.

Tr. 5495:21-5496:3 (Brumbaugh). Dr. Goldstein agreed. For banks that needed to increase their capital ratios at this time:

> There are two basic choices: one is to sell new stock, sell equities or sub debt, and the market for equities during '89, '90, '91 for banks, for thrifts, savings institutions in particular, was basically nonexistent. There were almost no offerings done in that period. So that left plan B, and plan B was to reduce the -- shrink the bank into its capital footprint.

Tr. 5758:7-13 (Goldstein). Regional Director Lutz would not dispute this, as he admitted that he made no effort to analyze whether it would be possible for Meritor to satisfy the MOU through a stock sale. Tr. 3260:6-3261:1 (Lutz).

The government nonetheless asserts, in the face of this evidence, that Meritor could have sold stock but chose not to out of concern for dilution. Govt. Br. at 47. The government's only support consists of observations made by Mr. High and Mr. Hammer, long after the fact, that at least some members of the Board of Directors were disinclined to issue stock if doing so would trash the interests of existing shareholders. Because Mr. High was not a member of the Board, his knowledge of this issue is limited (Tr. 1070:17-1071:16 (High)), and in all events he too saw a stock issuance as impossible. Tr. 935:11-936:7, 937:5-18 & 938:18-939:9 (High) (The markets were adverse, and the very existence of the 1988 MOU was an impediment to Meritor's

accessing those markets.) As for Mr. Hammer, he clearly testified that by the time the MOU was in place the dilution issue was moot. *See* Tr. 4685:5-13 (Hammer) (By the time Mr. Roth -- who was most vocal in his concerns about dilution -- joined the Board in early 1988, it would have been impossible to sell stock). Mr. High's and Mr. Hammer's testimony provides no support for the government's dilution theory.

While there no doubt was some discussion of dilutive effects, the managers at Meritor all testified that dilution was simply not a significant factor. *See* Tr. 936:20-937:18 (High); Tr. 627:18-628:5 (Hillas); 1246:17-22 (Slattery). Some discussion of the issue would hardly be surprising or improper. If indeed an offering had been possible, but would have trashed the value of the existing stock, no Board of Directors could ignore that fact without seriously breaching its duties to the company's owners. *See* Tr. 1070:17-1071:16 (High) (The likely effect on existing values *has* to be assessed any time a stock issuance is under consideration).[22] But since all involved concluded that a stock sale was impossible, the issue could not have arisen in any meaningful sense. Finally, Meritor's total market capitalization at the end of 1988 was

---

[22] Meritor's officers and directors were in fact legally bound to consider an issuance's dilutive effect on the current shareholders' interests. *See Maguire v. Osborne*, 130 A.2d 157, 159 (Pa. 1957) (noting that "[i]t is hornbook law that officers and directors owe a duty to stockholders to act in the utmost good faith and that they must act for the common interest of all the stockholders"). Several courts have recognized a cause of action by shareholders against corporate managers who failed properly to consider dilutive consequences. *See, e.g., Byelick v. Vivadelli*, 79 F. Supp.2d 610, 625-26 (E.D. Va. 1999) (shareholder could assert a breach of fiduciary duty claim against an officer who approved a new stock issuance that diluted shareholder's interest); *Wenzel v. Mathies*, 542 N.W.2d 634, 640-41 (Minn. Ct. App. 1996) (pledgees of a bank holding company's stock had standing to assert a breach of fiduciary duty claim against the bank's officers and directors for issuing additional shares of bank stock that diluted the holding company's interest in the bank); *Direct Media/DMI, Inc. v. Rubin*, 654 N.Y.S.2d 986, 988-89 (N.Y. Sup. Ct. 1997) (minority shareholder could assert a breach of fiduciary duty claim against the corporation's directors and majority shareholders who voted to issue new shares of stock, diluting minority shareholder's interest).

approximately $160 million. 1988 Annual Report (PX 8) at 1 & 27. Given that fact, given the loss Meritor posted in 1987, and given the prevailing economic conditions, the suggestion that Meritor could have satisfied the MOU through an equity offering is almost ludicrous. It is, in all events, completely without evidentiary support.[23]

### B. The Harmful Consequences Of The Branch Sale Were Affirmed By Every Single Fact Witness In This Case

Ignoring the unanimous testimony of its own witnesses just as much as that of the Plaintiffs' witnesses, the government announces that "[i]njury due to the 1988 MOU, as opposed to the negative economic conditions that prevailed in the early 1990s, has not been demonstrated." Govt. Br. at 50. This is nonsense. The branch sale, which was compelled by the MOU, caused considerable "injury."

#### 1. Loss of Low-Cost Funding

The sale sacrificed a large portion of Meritor's low cost funding franchise and thereby sacrificed future earnings. Tr. 950:25, Tr. 959:22-960:8 & Tr. 1013:9-21 (High); Tr. 3575:11-3578:7 (Hand); Tr. 2862:10-21 (Valinote) (the branch sale "seriously impaired the recovery of the institution" because it sacrificed much of the Bank's core franchise.); Tr. 2866:18-2867:6 (Valinote) ("a good portion of the low-cost funding [was] . . . lost"); s*ee also* PX 407 at A-1.

#### 2. Loss of Asset Generating Ability

Predictably, Mellon took the more lucrative pool of deposits in the suburban areas which, due to growth there, was the superior asset generator. Tr. 412:20-413:12, Tr. 415:11-18 &

---

[23]We also note that, had it been possible to issue stock at a substantial loss to existing shareholders, the government's breach would be the same, only the damages case would change, because the forced dilution would effectuate a compelled capital contribution by all existing shareholders.

Tr. 439:15-18 (McCarron); Tr. 952:8-13 (High). Asset generating limitations had already been an issue at the Bank.

### 3. Loss of Higher Quality Assets

To make the offer attractive to Mellon, Meritor had to allow Mellon to select assets to match the deposit liabilities. Tr. 424:15-18 (McCarron); Tr. 952:17-23 (High). The sacrifice of better earning, higher quality assets, quite apart from the loss of its deposit franchise, would compromise the Bank's earning capacity in the future. Tr. 442:3-19 & Tr. 575:9-15 (McCarron); Tr. 950:23-25 (High); Tr. 1170:14-17 (Fitzgerald) ("[O]ccasioned as it was by the sale of better earning assets, [Meritor's downsizing] . . . compromised the Bank's earning capability.")

### 4. Immediate Losses Caused By the Transaction Itself

The sale to Mellon required Meritor to absorb enormous costs and expenses. As laid out in the 1989 Capital Plan, this burden would be as follows.

| | |
|---|---:|
| Loss taken on assets transferred | $165,382,000 |
| Severance payments to furloughed staff | $7,360,000 |
| Losses projected on disposal of office space | $50,374,000 |
| Cost of obtaining release from Data processing contract | $20,000,000 |
| TOTAL | **$243,116,000.00** |

PX 216 at 27; s*ee* Tr. 957:15-959:4, 5177:4-21 & 5194:15-5196:20 (High). On a GAAP basis, the transaction would also compel a write-off of goodwill in the total amount of $159 million, for total sale-related costs of $382 million. PX 216 at 27.

When the sale was eventually consummated interest rates had come down, so the loss taken on assets sold was moderated to $115 million -- highlighting the fact that if Meritor had not been compelled to make the sale none of these losses would have been incurred, because the securities involved all would have returned to or above book value by year-end 1992. As finally implemented, the deal imposed immediate costs as follows.

| | |
|---|---|
| Loss taken on assets transferred | $115,100,000 |
| Transaction costs | $16,100,000 |
| Losses projected on disposal of office space | $53,700,000 |
| Cost of obtaining release from Data processing contract | $20,000,000 |
| Goodwill write down (GAAP) | $171,900,000 |
| TOTAL | **$376,800,000.00** |

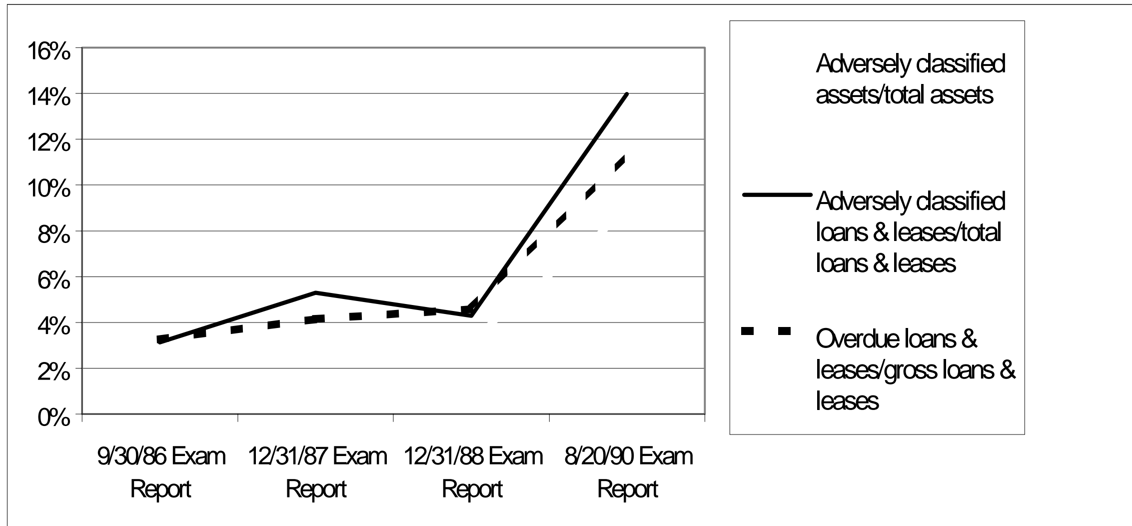
PX 9 at 14. As the government and its "experts" are so very fond of pointing out, Meritor posted a net loss for 1990 of $209 million. *Id.* at 1. Small wonder.

**5. Proportional Increase in Nonperforming Assets**

Because Mellon was of necessity allowed to pick and choose assets to match deposit liabilities, Meritor's nonperforming and nonaccrual loans constituted a much higher proportion of its total loan portfolio as a result of the sale. Tr. 631:22-632:7, Tr. 633:22-34:10 & Tr. 647:18-25 (Hillas); Tr. 440:2-9 (McCarron); Tr. 959:14-21 (High); Tr. 1400:20-1401:4 & Tr. 1170:1-13 (Fitzgerald); Tr. 3769:3-3771:3 (Francisco); Tr. 3311:13-21 (Shull); PX 335 at 2-1, 2-2; Tr. 2866:18-2867:6 (Valinote) (As a result of the sale "the ratios of adversely classified assets would, to a degree, skyrocket . . . ."); PX 274 (1990 Exam Report) at CSL 001 0342 F ("Percentagewise, classified assets have risen dramatically due to the downsizing and restructuring efforts which have taken place.") The comparisons in the 1990 Exam Report tell the tale.

| **Classified Asset Ratio** | 9/30/86 Exam Report | 12/31/87 Exam Report | 12/31/88 Exam Report | 8/20/90 Exam Report |
|---|---|---|---|---|
| Adversely classified assets/total assets | **3.38** | **3.81%** | **3.11%** | **8.98%** |
| Adversely classified loans & leases/total loans & leases | **3.13** | **5.30%** | **4.39%** | **13.98%** |
| Overdue loans & leases/gross loans & leases | **3.25** | **4.15%** | **4.59%** | **11.38%** |

PX 274 at CSL 001 0347 F. Viewed graphically, it appears that the Bank was making improvements on asset quality issues in 1988, but the branch sale overwhelmed its efforts.




In their *post-hoc* efforts to justify the imposition of the 1991 Written Agreement and the seizure of the Bank in 1992, FDIC witnesses (and government counsel) never weary of harping upon Meritor's asset portfolio problems. FDIC created the bulk of those problems.

### 6. Increased Operating Expenses

The increased concentration of nonperforming assets predictably caused Meritor's operating expenses to balloon. *See* Tr. 1170:18-22 (Fitzgerald) ("Q. [The downsizing] also increased in a relative way the bank's operating expenses because the management of troubled loans is costly; Correct? A. That's correct. The overhead expense on administering bad loans increases geometrically.") *See also* Tr. 1614:22-1615:8 (Fitzgerald). The branch sale also saddled the Bank with an enormous amount of vacant office space which, in the midst of the New England real estate recession, would prove difficult to sublet or sell. Tr. 946:4-948:1 (High).

### 7. Summary

Regional Director Ketcha frequently commented on the damage done by the branch sale, and in fact used that damage as his primary justification for imposing still more onerous capital demands in the 1991 Written Agreement. *See* PX 241; PX 300; PX 473; Tr. 5014-5017, Tr. 5029-5030 (Ketcha). In the Confidential/Supervisory section of his 1992 Exam Report, Dennis Fitzgerald was even more dramatic: "*The 1990 sale of two-thirds of the branches, especially those outside the immediate downtown area, and the PSFS trade name to Mellon Bank, may have effectively doomed the institution.*" Tr. 1178:20-1179:11 (Fitzgerald); PX 407 at A-1.[24] Meritor's consummation of the branch sale to Mellon, like the majority of its desperate efforts to satisfy FDIC's unending demands for more capital, is best understood as an attempt to mitigate the effect of the government's continuing breach. The record leaves no room for dispute, however, that this particular act of mitigation, to which Meritor was given no alternative, was costly.[25]

---

[24] As noted in our Trial Brief, the Regional Office, remarkably, instructed Mr. Fitzgerald to delete this observation from the Confidential section of his exam report. Tr. 1178:20-1179:9 (Fitzgerald); Tr. 5029:8-15 (Ketcha); *compare* PX 408 with PX 407 (at A-1).

[25] The government argues that the 1991 Written Agreement also did Meritor no harm, noting in particular that Meritor had been trying to sell the Florida subsidiary for some time. Govt. Br. at 50. The fact is, however, that from the beginning Meritor's efforts to sell Meritor FA were inspired at least in part by the Government's unceasing demand that capital ratios be improved. *See* PX 216. And the ultimate sale of Meritor FA in December, 1992 was unquestionably driven by the 1991 Written Agreement. All witnesses acknowledged that the sale of FA was an assumption underlying the ratio projections upon which the Written Agreement was based. *See* Tr. 978:24-979:6, Tr. 968:5-15 (High); Tr. 479:24-480:18 (McCarron); Tr. 745:6-10, 722:15-21 (Hillas); PX 249. FDIC knew that selling FA was integral to Meritor's complying with the ratio requirements of the Written Agreement. Tr. 1296:9-19 (Slattery). It is also uncontested that it was the FDIC itself that made the sale of Florida difficult by causing the rejection of Meritor's proposal to convert FA's ICC's for stock and the demand for in excess of $40 million. *See* PX 10 at 38; PX 578; Tr. 3823:6-3824:7 (Francisco); Tr. 964:10-15 (High).

### C. The Argument That Meritor Was Not Harmed By The 1988 MOU Is Categorically Refuted By The Testimony Of Plaintiffs' Experts, and Is Disproved By the Model Prepared By Dr. Goldstein

The experts did not agree with Mr. Fitzgerald that the branch sale "effectively doomed the institution," but they all agreed that the MOU drove Meritor to it and that the sale did serious damage. Mike Mancusi concluded that the MOU predictably compelled Meritor to sell its "crown jewels" and, with them, its "future earnings." Tr. 2039:6-22 (Mancusi). The record evidence on these points is uncontested. As Dr. Brumbaugh put it: "By all accounts in the record, without, I believe, any contradiction by anyone, regulator, member of the supervisory staff of the institution or anyone else really, this represented the sale of some of the best, if not the best assets of the institution, and the most stable, lowest cost deposits." Tr. 5496:7-12 (Brumbaugh).

#### 1. Dr. Steven Goldstein

Dr. Goldstein has spent his entire career in the management, analysis, and regulation of financial institutions. He has taught finance at both graduate and undergraduate levels. Tr. 1642:16-1646:25 (Goldstein). From 1985 to 1997 Dr. Goldstein worked as an industry analyst and consultant to financial institutions, extensively using computer models to evaluate and project bank performance. Tr. 1647:1-1650:23 (Goldstein). Since February, 1997, Dr. Goldstein has served as Chief Financial Officer of Centura Bank in North Carolina. Tr. 1650:22-1652:25 (Goldstein). At Centura he has been responsible for, among other things, the evaluation of over 40 potential bank acquisitions, and he has consummated four acquisitions. *Id.* Dr. Goldstein has published extensively on finance and financial institutions generally. Tr. 1651:20-1653:16 (Goldstein).

Dr. Goldstein was recognized as an expert by the Court in the fields of econometrics, bank management, bank finance, and in the computer modeling of financial institution

performance. Tr. 1657:3-7; Tr. 1664:14-18. His testimony was essentially unrebutted at trial, because the government witness primarily relied upon for rebuttal possessed expertise in none of these fields.

As Deputy Director of Policy in the Office of Policy and Economic Research at the Bank Board in Washington, Dr. Goldstein developed computer models to be used by FSLIC, including a model that evaluated failing institutions and the cost of alternative bids for them (known at FSLIC as the "viability model.") Tr. 1642:16-1646:25 (Goldstein). The financial models that Dr. Goldstein has used throughout his career are relied upon by bankers, bank analysts, bank consultants, bank regulators, and investors. Tr. 1647:1-1650:23 & Tr. 1654:16-1657:2 (Goldstein). As CFO of Centura, Dr. Goldstein has used computer *pro forma* modeling to evaluate potential mergers, and experience has shown that his models are extremely accurate. Tr. 1650:22-1652:25 (Goldstein).

**2. The Purpose of the Model**

The purpose of Dr. Goldstein's analysis in this case was to determine, upon a conservative set of strategic and environmental assumptions, whether Meritor's condition in 1992 would have been better -- and if so, how much better -- had the Bank not been compelled to satisfy the capital demands imposed in the 1988 MOU and the 1991 Written Agreement.

**3. Statistical And Strategic Inputs**

Dr. Goldstein derived the data for his model from Meritor's Call Reports, and conferred with CFO Michael High and Chairman Roger Hillas to confirm that the strategies implicit in the model were consistent with those that Meritor management would have adopted had the 1988 MOU and 1991 Written Agreement not been imposed. Tr. 1673:22-1674:14 (Goldstein). Both Mr. High and Mr. Hillas indicated in conversations with Dr. Goldstein that "the baseline strategy reflected in the model is, indeed, an approach they would have taken if the government had left

them free to do so." Tr. 1770:1-6 (Goldstein). Chairman Hillas was given the opportunity to review the finalized model, to confirm that the strategies implicit in the model were consistent with Mr. Hillas's plans for Meritor. Tr. 1708:22-1709:17 (Goldstein).

In several respects the model inputs represented actual data, which also contributes to the model's reliability. For example, because the model starts with Meritor's actual 1988 balance sheet, in which the principal economic variables are fixed, the "projection of cash flows on assets and liabilities" is particularly accurate and dependable. Tr. 1674:15-1675:7 (Goldstein). Similarly, Dr. Goldstein was able to use Meritor's actual asset quality experience (including charge-offs and ORE) through 1991. Tr. 1675:8-17 (Goldstein). Of equal if not greater importance, actual prevailing interest rates were used in the model throughout its entire study period.

> The interest rate environment, which is what normally gives rise to modeling error, is known with certainty in this case since we are looking back at real data. So generally, the terms of the variables used here are either known with sort of a mathematical precision or [] are based on actual data, are relatively stable parameters.

Tr. 1675:18-22 & Tr. 1684:22-1685:3 (Goldstein).

#### 4. The "Baseline" Strategic Assumptions in the Goldstein Model

The primary strategic constraint on Meritor was the need to stay within its "capital footprint," which would have required some shrinkage even in the absence of the MOU (although nothing like the drastic shrinkage that actually occurred). The driver in the Goldstein model is the simple economic fact that by lowering interest rates on deposits the Bank would have driven away what Dr. Goldstein referred to as "the low profit customers." Tr. 1677:24-1678:3 (Goldstein). This would have shrunk the size of the Bank (and thus stay within capital constraints), but allowed it to retain most of the more profitable (because less rate-sensitive)

customer base. Tr. 1677:9-23 (Goldstein). Vastly less long-term harm is done to the institution by this method, as opposed to the sale of branches, because, by definition, the more rate-sensitive customers who are driven away when deposit rates are lowered are likely to return when, in other economic conditions, interest paid on deposits can be increased again. Tr. 1678:22-1679:23 (Goldstein). Dr. Goldstein's model thus reasonably assumes that unless compelled to do so, Meritor would seek to avoid selling core branches, because the sale of branches entails the sacrifice of customer relationships that are very difficult to reestablish. Tr. 1677:2-8 (Goldstein).

Importantly, as Dr. Goldstein explained, the core strategy that drives his model is absolutely fundamental and very common.

> Q. Is this strategy that's reflected in your model of shrinking both the asset and liability side of the balance sheet . . . by lowering interest rates, is that an unusual or exceptional strategy?
>
> A. No, . . . it was a fairly common strategy. I believe . . . you will find that Glendale followed something quite similar to this, to downsize the bank . . . to shrink to its capital footprint. It's a matter of selling assets - or reducing assets, using the cash generated to fund the outflows.
>
> Q. Does the implementation of this strategy require a bank to do anything that it doesn't ordinarily do?
>
> A. These are basic fundamental principles of banking and how banks actually control the balance sheet. You increase deposits or decrease deposits, you increase investments, decrease investments.

Tr. 1681:1-17 (Goldstein).

Dr. Goldstein's model also, conservatively, assumes no sales of subsidiaries or substantial restructuring, for two reasons:

> [O]ne is that we really don't have . . . enough information to assess which subsidiaries could be sold and at what prices. And second, more importantly, the assumptions that underlie the model, are based on variables within the control of management. Management set deposit pricing. Management can control all the variables used in this model, or directly controlled by management.

> The ability to sell an asset is outside their control. It depends on if you find a willing buyer at a price. And I choose not to speculate.

Tr. 1683:18-1684:5 (Goldstein). The effect of this conservative assumption will "tend to understate the financial performance. Real bank management are opportunistic, and to the extent that opportunities would arise that would improve the financial performance of the firm beyond this very conservative strategy or narrow strategy presented here, certainly . . . they would be able to generate superior returns." Tr. 1684:6-15 (Goldstein).

**5. Assumed Variables**

Dr. Goldstein's loan growth assumption, 4.5 percent, is very conservative compared with the actual 9.5 percent growth rate experienced by all insured financial institutions (except credit unions) in Pennsylvania. Tr. 1685:9-16 & Tr. 1737:8-16. (Goldstein). The deposit growth assumption is also conservative: "Deposits are only assumed to grow at about 2 percent rate, while the actual growth rate was closer to 7.5." Tr. 1685:17-22 (Goldstein). In Dr. Goldstein's expert opinion the growth rates for loans and deposits assumed in the model "are nominal, at best. . . . Indeed very low." Tr. 1688:20-24 (Goldstein).

Dr. Goldstein's assumptions for operating expenses as a percentage of assets were also conservative. They were based on Meritor's actual numbers in 1987 and 1988 -- a time when the Bank's operating expenses were unusually high, as a result of the recent dramatic growth. The 2.5 percent operating expense figure is substantially higher than average for thrifts. Tr. 1690:17-1691:8 (Goldstein). After several years the model assumes that the operating expense ratio will fall to 2.3 percent -- still substantially higher than most thrift institutions. *Id.* And as Dr. Goldstein explained, operating expenses is one of the variables over which management has a high degree of control. Tr. 1691:11-1693:20 (Goldstein). At the same time, operating costs at banks and thrifts generally have fallen over the period modeled by Dr. Goldstein, as a result of

improved technology and changing consumer patterns. Tr. 1693:21-1695:14 (Goldstein). Meritor's ratio of operating expenses to total assets is projected to run substantially higher than the thrift average. Tr. 5718:22-5719:8 (Goldstein).

The Government contends that the assumptions Dr. Goldstein incorporated in his model were overly favorable. Several of the government's specific criticisms are dealt with in our response to defendant's Proposed Findings of Fact. In general, however, we note that the unrebutted record evidence establishes that Dr. Goldstein's assumptions were, generally, conservative. Tr. 5715-5716 (Goldstein).

### 6. Dr. Goldstein's Conclusions

The model shows that, after significant but orderly shrinkage to stay within the Bank's capital footprint, Meritor would have returned to profitability in 1992 and thereafter due in part to the "very friendly rate environment" that arose for thrifts. Tr. 1696:1-1697:8 (Goldstein). Dr. Goldstein's analysis led to his expert opinion that "under reasonable sets of assumptions and strategies, Meritor would have been able to maintain capital compliance through the decade of the 90s, or at least through 1997, absent the [written] agreement and the MOU." Tr. 1642:11-15 (Goldstein).

Given the conservative assumptions of the model, and the conscious decision to exclude any significant restructuring opportunities, Dr. Goldstein concluded that, if he were in charge of Meritor during the model period, he would expect to do at least as well as the model projects.

> I would certainly expect to be able to do at least this well. As I think we characterized it earlier, this is a baseline forecast. This is a naive, limited strategy that says the only things that management can control are strategic variables or policy variables.
>
> There are no opportunities, there is nothing exogenous to the bank that can be capitalized on. So I would view this as a sort of a - again, we use the term "baseline." That's a good way to

> characterize it. Certainly, I would hope to be able to do considerably better.

Tr. 1698:17-1699:2 (Goldstein). Accordingly, Dr. Goldstein concluded that, to a reasonable degree of certainty, "had Meritor Management pursued the strategy embodied in the model, that the bank would have achieved results at least as good as reflected in the model." Tr. 1769:17-21 (Goldstein). Dr. Brumbaugh concurred in Dr. Goldstein's overall conclusions. Tr. 5679:4-8 (Brumbaugh).

In light of this evidence, it is clear that great damage was done to the Bank by FDIC. Indeed, the problems experienced by the Bank in 1992, which the government recites (and exaggerates tirelessly) are all, in this light, evidence of damage caused by FDIC's breaches.

## VII. THE IDEA THAT FDIC'S PURPOSE IN DEMANDING HIGH CAPITAL RATIOS IN THE WRITTEN AGREEMENT WAS TO IMPROVE MERITOR'S EARNINGS AND ASSET QUALITY IS REFUTED BY ECONOMIC AND REGULATORY REALITY AND BY THE ENTIRE EVIDENTIARY RECORD

In our Trial Brief (at 106-115) we reviewed the uncontested and extensive testimonial and documentary evidence that the one and only reason the FDIC imposed the Written Agreement upon Meritor was to enhance the buffer for the FDIC insurance fund. Virtually every relevant document so indicates, and almost every FDIC witness who testified has admitted as much. We need not revisit that evidence here, in part, because the government does not offer probative contrary evidence.

Instead, the government reiterates *ad nauseam* Meritor's earnings and asset problems. PFOF 241-270. Putting aside for the moment the fact that those problems were in significant part a result of FDIC's prior breaches, the government's endless earnings and asset refrain is little more than a distraction because it misses the central point. By 1991, there is no question that Meritor was a troubled bank. But the uncontested testimony by the regulators and regulatory experts in this case establishes that FDIC's primary concern in dealing with a troubled institution

was the adequacy of the buffer that the institution's capital account provided for the FDIC insurance fund. Tr. 3679:19-21 (Francisco); Tr. 1569:24-1571:14 (Isaac); Tr. 5535:5-19 (Brumbaugh); Tr. 5533:14-5534:5 (Brumbaugh); PX 12A (FDIC's 1991 Annual Report) at 22; Tr. 4978:9-4979:3 (Ketcha); Tr. 3641:23-3642:2 (Hand); Tr. 4673:25-4674:7 (Hammer). The relevance of Meritor's earnings and asset problems therefore lay in the fact that it was these problems that focused FDIC's attention on Meritor's capital. The action the FDIC took -- namely, the ratcheting up of Meritor's ratio requirements -- served only to supplement the protection for the FDIC fund, at the expense of Meritor's earnings and assets. To suggest that the imposition of these ratio requirements was intended to help the Bank address its earnings and asset problems is therefore cruelly ironic.

The government's favorite refrain on this subject is the idea that forcing Meritor to increase its tangible capital would improve its earnings. But the premise is simply false. First, a Bank's capital contributes only marginally to its earnings.

> Q Tangible capital, aside from its relevance to solvency, is looked at by regulators for other reasons; isn't that right? For example, the more tangible capital an institution has on hand, the more earnings it can generate? Would you agree with that?
>
> A Not in its entirety. I mean, capital was a very small percentage of the liabilities of an institution. An institution earns money on its liabilities, and the deployment of its liabilities, as assets, whether it's loans, investments or other forms of assets.
>
> The capital component of an institution, you know, whether you want to use the minimum requirements of 5.5 or something higher than that, 10 or 11 percent, is still a small component of the liabilities that are available to deploy into earning assets.
>
> So tangible capital would have some contribution, but it's not -- it's nowhere near the major reason banks earn money. Capital is used to leverage. I mean, an institution leverages off its capital, which means it grows off its capital and -- and liabilities -- they produce more liabilities and liabilities [produce] more earning assets.

> Q One of the functions of tangible capital is to help generate earnings?
>
> A No. One of the functions of tangible capital is to allow the bank to leverage itself so that it does earn the money. As I said before, I mean, capital is a very small percentage of the liabilities that are available to produce earning assets.
>
> I did say, and that's correct, that capital -- you will earn some money off of capital, but it is certainly not the significant generator of earnings for banks.

Tr. 2293:20-2294:25 (Mancusi). It is by *leveraging* capital that banks make money, and the effect of FDIC's capital demands was to *limit* Meritor's ability to leverage, and thus to *restrict* its earnings. Tr. 5513:15-5515:23 (Brumbaugh).

The bottom line on this issue was written by Dennis Fitzgerald, the examiner-in-charge of the 1992 Meritor examination. In the confidential section of this examination report, Mr. Fitzgerald diagnosed the root cause of Meritor's problems: "An overemphasis on reaching capital goals *at the expense of profitability*." Tr. 1171:12-1172:3 (Fitzgerald); PX 407 at A-1. The 1988 MOU and 1991 Written Agreement were imposed at the expense of, not for the sake of, earnings.[26]

---

[26] The government relies on plaintiffs' purported failure to address a government argument during the summary judgment stage as a basis to prevail on Count II (breach of the 1991 agreement). Gov't Br. at 5 n.3. Of course, the government's motion for summary judgment was denied and has no relevance here. Notwithstanding the government's wishes, this Court has the discretion, indeed the obligation, to consider the entirety of the *trial record*, and the governing authority, in rendering a fair and just verdict.

The government also asserts that the Federal Circuit's holding in *First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279 (Fed. Cir. 1999), renders plaintiffs' rescission count "no longer tenable." Gov't Br. at 5 n.3. In *First Hartford*, the Court of Appeals dismissed a count in First Hartford's complaint on the ground that "[t]he federal government was not a party to the contracts by which First Hartford and other investors purchased shares in [the bank]." *Id.* at 1296. To be clear, *First Hartford* is relevant only to Count VII, concerning the rescission of the shareholders' investment. The holding is irrelevant to Count VI of plaintiffs' complaint, concerning the rescission of the Western acquisition, because the federal government (continued)

## VIII. THE SEIZURE AND SALE OF MERITOR WAS FDIC'S DOING, WAS A BREACH OF THE 1982 AGREEMENT, AND OBVIOUSLY CAUSED INJURY TO THE BANK AND ITS SHAREHOLDERS

In light of the overwhelming evidence that Meritor's lack of tangible capital motivated FDIC's actions in 1992, it is not surprising that the government virtually concedes the point. Instead, the government seeks to avoid liability by a combination of strained legalisms and evidentiary obfuscation. Contrary to all of the evidence, the government argues that the State of Pennsylvania took the lead in seizing Meritor. Contrary to all of the evidence, the government argues that the 1991 Written Agreement somehow superceded the 1992 goodwill agreement -- a point we have addressed above. Contrary to all of the evidence, the government argues that Meritor's alleged breach of the illegal 1991 Written Agreement somehow excuses the government's breach of the 1982 goodwill agreement. And contrary to all competent expert testimony, the government argues that Meritor was, in December 1992, inevitably doomed on an economic basis. The first three arguments have absolutely no support in fact, law or logic. The final argument enjoys at least superficial plausibility because, in fact, Meritor had more than its share of problems in December, 1992. But on closer examination this argument too fails because the expert testimony proved at trial that Meritor was viable in 1992 and would have prospered thereafter if given the opportunity to do so.

### A. In 1992, As At All Earlier Times, The State Of Pennsylvania Followed FDIC's Lead In Seizing The Bank

Sarah Hargrove's affidavit (PX 527), which was signed under oath and with the assistance of counsel (Tr. 1862:2-13 (Hargrove)), states:

---

was a party to that transaction. It is also worth noting that, despite its holding, the Court of Appeals did "not foreclose that shareholder capital is perhaps one of several measures of damages that ultimately might be considered on the contract counts[.]" *Id.*

> In November and December 1992, I understood that as of December 19, 1992, the Federal Deposit Insurance Corporation Improvements Act ("FDICIA"), and certain regulations promulgated by the FDIC pursuant to FDICIA, would become effective. I further understood that on that date, FDICIA would give FDIC expanded powers to appoint itself receiver of state-chartered banks that were not insolvent and that had not been closed by state banking authorities, such as the Pennsylvania Department of Banking. In November and December 1992, after working with the FDIC for many weeks with respect to Meritor, I certainly expected and anticipated that on or shortly after December 19, 1992, FDIC would exercise its new authority under FDICIA to close Meritor and to appoint itself receiver as Meritor, regardless of any action I might take as Secretary of Banking for the Commonwealth of Pennsylvania. Until December 8, 1992, I had no definitive plan to close or take possession of Meritor. Nor had I taken any formal action to begin the process of actually closing or taking possession of Meritor, nor had I directed my staff to do so.

This language, which Ms. Hargrove reaffirmed under oath at trial, could not be clearer. As of December 7, 1992 she had no plans, and had taken no steps, to initiate any kind of proceeding against Meritor.

But starting on December 8, events moved swiftly. On that day FDIC received Mellon's bid for Meritor, promising a premium in excess of $180 million. PX 495; PX 603 at 12. At that time, FDIC had booked a loss reserve for the resolution of Meritor in the amount of $864 million. PX 603 at 9. The Mellon bid promised to allow FDIC to seize and sell Meritor at no cost whatsoever -- indeed, at an absolutely unprecedented profit of $42 million. PX 603 at 9; Tr. 5454:7-5455:7 (Brumbaugh). FDIC acted quickly. Ms. Hargrove testified:

> On December 8, 1992, I received a telephone call from Nicholas Ketcha, Regional Director of the FDIC. Mr. Ketcha informed me that bids to acquire Meritor, solicited by the FDIC, had been received; these included a bid from Mellon Bank, N.A., pursuant to which Mellon proposed to acquire all the deposits (insured and uninsured) of Meritor's on a closed-bank basis, under terms specified by the FDIC. Mr. Ketcha informed me that Mellon's bid was several million dollars higher than all other bids, and stated the FDIC's desire to move quickly to preserve and

> secure the Mellon bid and to promptly consummate a sale of Meritor to Mellon in accordance with that bid. Mr. Ketcha expressed the FDIC's concern that the Mellon bid might be lost if Meritor were not closed promptly. It was understood that the FDIC lacked the authority at that point to close Meritor. Mr. Ketcha asked that the Pennsylvania Department of Banking close and take possession of Meritor quickly in order to facilitate Meritor's prompt sale to Mellon. Given the request from the FDIC on December 8, 1992, the closing was set for December 11, 1992. Prior to that call, I had no intention of taking possession of Meritor on December 11, 1992.

PX 527 at 2-3.

The record establishes that Mr. Hargrove had reservations about seizing Meritor at the behest of the FDIC. The transcript of the FDIC Board of Directors meeting held the day following Mr. Ketcha's phone call to Ms. Hargrove, December 9, 1992, shows that Ms. Hargrove had demanded indemnification from FDIC in the event the State of Pennsylvania was sued for violating the 1982 Goodwill Agreement. PX 603 at 12-30; Tr. 2986:4-8 (Fritts). Beyond this, the transcript indicates that the reason FDIC would issue the Notice to Primary Regulator was to provide the State of Pennsylvania political cover for seizing the Bank at the FDIC's request. PX 603 at 3-7, 9, 18-19; *see* Pl. Tr. Br. at 135-36. Ms. Hargrove admitted under oath that the Section 8(a) Notice was one basis for her action. Tr. 1966:20-1967:18 (Hargrove); PX 572 at 15. As to whether Meritor was in an "unsafe and unsound" condition, Ms. Hargrove's handwritten notes reflect her determination to "defer to FDIC position." Tr. 1888:7-14 (Hargrove); PX 488. Ms. Hargrove's affidavit, and the transcript of the FDIC board meeting, establish that Ms. Hargrove was literally acting as FDIC's agent in seizing the Bank so that FDIC could sell it at a profit.

The government argues that Ms. Hargrove made "an independent determination" to close Meritor. The record shows, however, that Ms. Hargrove had made an "independent determination" to do absolutely nothing because, she safely assumed, FDIC would close and seize the Bank on December 19. The record shows that Ms. Hargrove made an "independent

determination" to close the Bank and hand it over to FDIC only after demanding indemnification from FDIC and only after FDIC initiated legal process to provide her with political cover. In the end, the only "independent determination" Ms. Hargrove made was to do FDIC's bidding.

In our Trial Brief we have reviewed the unrebutted testimony that FDIC as insurer *always* drives the decision to close a state-chartered Bank; that during her entire tenure as Secretary of Banking, Secretary Hargrove, and the department she headed, *never* played more than a nominal role in the regulation of Meritor; that the initiation of Section 8(a) proceedings absolutely compels the State to revoke a bank's charter; and that Ms. Hargrove, embroiled for many months in litigation over a prior attempt to close two private banks, was hardly likely to be eager to initiate another closure. *None* of this evidence is rebutted. Together with the sequence of events of December 8-11, 1992, and the FDIC Board transcripts, it proves to a practical certainty that FDIC, not the state of Pennsylvania, caused Meritor's demise.

### B. Meritor's Alleged Noncompliance With The Ratio Requirements of The 1991 Written Agreement Cannot Excuse FDIC's 1992 Breaches of the 1982 Goodwill Agreement

The government argues that "[a]ny 'breach' by the FDIC in 1992 was excused by the pre-existing material breach of Meritor with respect to the capital-related agreements of the parties, embodied in their final form of the 1991 WA." Govt. Br. at p. 35. The argument is both legally incorrect and contrary to the evidence. Legally, the government cites no authority, nor can any be found, for the proposition that Meritor's temporary noncompliance with the ratio requirements of the 1991 Written Agreement somehow excused the government from its obligations under the 1982 goodwill agreement. On the contrary, the well-settled law is that "[a] party to a contract is not excused for nonperformance due to the fact that the other party to the contract has breached a

separate contract between them." 13 WILLISTON ON CONTRACTS § 39:2, at 512 (4th ed. 2000).[27]

Second, because the 1991 Written Agreement was itself imposed on Meritor in breach of the 1982 goodwill agreement it is of no legal force or effect, and Meritor's alleged noncompliance with the illegal demands imposed in the 1991 Written Agreement can confer upon the government no rights or privileges of any kind. It would be a perverse world in which FDIC can justify its unlawful actions in 1992 by Meritor's noncompliance with unlawful demands made one year earlier.

Third, any suggestion that the actions taken by FDIC in December 1992 were in fact motivated by Meritor's alleged noncompliance with the ratio requirements in the 1991 Written

---

[27] *See also Williams v. Agribank*, 972 F.2d 962, 966 n.5 (8th Cir. 1992) (bank's breach of a memorandum of understanding did not excuse the borrower's failure to perform under a prior note between the parties because "[t]he breach of one contract does not excuse a party's performance on a completely different contract"); *Smith v. O'Mara Enters., Inc*., 100 B.R. 330, 336 (S.D. Ohio 1989) (corporate officer's breach of fiduciary duty did not excuse the corporation's obligation under a royalty agreement with the officer because "[w]here there exists two sets of obligations or contracts, the breach or non-performance of one contract does not justify the aggrieved party in refusing to perform another separate and distinct contract") (citations omitted); *Menzel v. Metrolina Anesthesia Assocs., P.A*., 310 S.E.2d 400, 403 (N.C. Ct. App. 1984) (termination of a contract between an association and a hospital did not justify a doctor's breach of an employment contract with the association because "[t]he general rule is that the breach of one contract does not justify an aggrieved party in not performing another separate and distinct contract") (citations omitted); *Northwest Lumber Sales, Inc. v. Continental Forest Prods., Inc*., 495 P.2d 744, 749 (Or. 1972) (defendant's failure to perform under a pine lumber order did not justify the plaintiff's cancellation of a stud order because "general contract law" does not "give either party to a contract the right to refuse performance because the other has breached a separate contract between them") (citations omitted); *Swaner v. Union Mortgage Co*., 105 P.2d 342, 345 (Utah 1940) (mortgage company breached its contract with a builder even though the builder breached a separate contract between the parties because "[w]here two separate and independent contracts exist between A and B, and A breaches one contract, B is not thereby justified in breaching the other contract and may be held for resulting damages if he so breaches") (citations omitted). *See, generally*, Annotation, *Breach Of One Contract As Ground For Recission Of Another*, 27 A.L.R. 1157, 1157 (1923) (noting that "[t]he doctrine is well

(continued)

Agreement is refuted by the evidence of record. When the Written Agreement was signed, FDIC knew that the ratios incorporated in that agreement had from the beginning assumed the sale of Meritor's Florida subsidiary, and while FDIC was kept informed of Meritor's capital condition on a monthly basis, FDIC never complained about any alleged shortfall and never claimed that Meritor was in noncompliance. Tr. 479:24-480:18 (McCarron). Regional Director Ketcha admitted at deposition that any alleged violation of the 1991 Written Agreement had little if any bearing on the decision to initiate insurance termination proceedings. Tr. 5067:5-9 (Ketcha). Dennis Fitzgerald, upon whose examination report the 8(a) proceeding was based, and who made the initial recommendation that insurance be revoked, similarly testified that any alleged violation of the 1991 Written Agreement "had little bearing" on the 8(a) recommendation. Tr. 1188:10-1189:2; Tr. 1616:23-1617:9 (Fitzgerald). The documentary record confirms this. The initial draft of the Notice To Primary Regulator, prepared in the Regional Office, did not even mention any alleged violation of the 1991 Written Agreement. *See* PX 496 at FSL007 0106; PX 473 at 4-5.

Finally, as Dr. Finnerty demonstrated, Meritor was fully compliant with the 1991 Written Agreement when, after Meritor had concluded the sale of Meritor FA, the Notice to Primary Regulator was actually issued. PX 530 at 22-23; Tr. 2395:3-19; Tr. 2397:4-7 (Finnerty). The Government alludes to a pro forma calculation that Dennis Fitzgerald performed on September 22, 1992. DX 1428; PFOF 407.[28] Notably, Meritor did not consummate the sale of its Florida subsidiary until December 3, 1992. Tr. 2396:2-2397:3 (Finnerty). There is no indication in the

---

established that the breach of one contract does not justify the aggrieved party in refusing to perform another separate and distinct contract").

[28] The government's description of this September 22 calculation of the effect of a transaction that would not close until December 3 as "contemporaneous," *id.*, is misleading.

record that anyone at the FDIC even bothered to attempt to calculate Meritor's capital ratios after that sale and thus to determine whether in fact Meritor was in compliance with the Written Agreement. *See* PX 530 at 12 ("If the FDIC, when it prepared the Notification, had properly reflected Meritor's asset dispositions since the beginning of the third calendar quarter and included the additional equity resulting from the sale of the Florida-based savings and loan subsidiary, the FDIC would have recognized that Meritor's capital ratios complied with the requirements of the 1991 Written Agreement.")

The truth is that Meritor's compliance with the Written Agreement was, in FDIC's eyes, moot, because the "*Bottom line is we're running out of tangible [net] worth."* Tr. 1830:17-1831:1 & Tr. 1825:6-1826:7 (Fitzgerald); PX 443 at CSL031 193 & 195; PX 444A at CSL018 0304.

### C. While More Relevant To The Damages Phase Of This Case, The Argument That Seizure Of The Bank Caused No Injury Must Be Rejected Now Because It Was Disproved By Expert And Factual Testimony

The Government argues that because Meritor was not "viable" in December 1992 its seizure and sale by the regulators did no damage.[29] The Government supports this argument by citing to contemporaneous statements by Meritor management, contemporaneous statements by FDIC officials, and by attacking the expert report and testimony of Dr. John Finnerty. With respect to statements made by FDIC officials at the time, we have shown in our Trial Brief that no one at the FDIC even attempted a meaningful analysis of Meritor's viability in 1992 and that, instead, the FDIC's actions were predicated solely upon the perceived immanence of Meritor's

[29] Any suggestion by the government that Meritor could not have operated financially if it reached zero tangible capital is simply contrary to fact. As Dr. Finnerty testified, and as is common knowledge, "there were literally dozen of thrifts that continued to operate with negative capital and were able to operate that way because of regulatory forbearance." Tr. 5366:1-7.

tangible capital insolvency.[30] The contemporaneous statements by Meritor management, upon which the Government relies, were made at an October 15 adjournment of the Meritor Board of Directors. Those statements, the record plainly shows, lend no support whatsoever to the Government's viability argument. And as for the impressive testimony by Dr. Finnerty, the Government has completely failed to raise any serious question as to the soundness of his analyses or conclusions.

### 1. Mr. Hillas and Mr. High Testified and Believed That Meritor, if left alone by FDIC, would survive and prosper after 1992

Meritor President Cullen told Dennis Fitzgerald in late September, 1992, that all the Bank needed was two to three years to clean up its remaining problem loans and return to profitability. Tr. 1829:20-1830:1 (Fitzgerald); *see* PX 443 at CSL031 0195-96. Both Mr. Hillas and Mr. High testified at trial that Meritor would have survived and prospered had FDIC not closed it. Tr. 665:1-8 (Hillas); Tr. 1134:12-1135:15 (High). The government ignores all of this testimony, and instead focuses upon negative commentary offered at an October 15, 1992 board meeting. But that commentary, for reasons that have not been rebutted, is not probative.

On October 1, 1992, Regional Director Ketcha met with the Meritor Board of Directors and demanded a resolution authorizing FDIC to market the Bank's assets to its competitors. Ketcha stated that if he did not get the resolution he would initiate proceedings to withdraw the Bank's insurance. Tr. 1001:3-8 (High); Tr. 660:7-11 (Hillas); Tr. 458:23-25, Tr. 466:3-12 &

---

[30] The proposed findings cited by the Government on this point (PFOF 289-90, 301-05, 317-19) recite the testimony and exam reports authored by Stan Shull in 1991 and Dennis Fitzgerald in 1992. In our main brief (*see* pages 93-98, 101-103, 106-107) we analyzed the 1991 and 1992 exam reports, and demonstrated that the conclusions in those reports were driven by Meritor's perceived lack of tangible capital, and that this capital insufficiency led both examiners to forego any meaningful analysis of Meritor's viability going forward.

Tr. 578:16-18 (McCarron); Tr. 1288:3-10 (Slattery). On October 15, the Meritor Board adopted the resolution.

The government takes great comfort in the October 15 resolution because, in it, Mr. Hillas and Mr. High are quoted as saying that Meritor was not viable, and that a merger with another Bank was not feasible, without FDIC "assistance." On their face, these statements appear to support the government's position that Meritor's condition in late 1992 was hopeless. The truth is, however, that Meritor's managers were instructed to make those statements by counsel, in order to protect against shareholder lawsuits. Tr. 1003:2-6 (High); Tr. 661:3-21 (Hillas). Counsel had also stressed that a failure to adopt the requested resolution would, if insurance were revoked, be the Bank's death sentence. Tr. 1293:6-17 (Slattery). In that light the statements were truthful, even if, left free of FDIC impositions, the Bank were the strongest in the land.

First, Mr. Ketcha had in fact said that without the resolution he would initiate insurance revocation proceedings, and it goes without saying that without federal insurance Meritor could not continue as a depository institution. Tr. 662:4-10 (Hillas); Tr. 1293:24-1294:7 (Slattery). Second, Meritor also needed FDIC "assistance" in the form of an assurance that the government would honor it's 1982 promises; without such assurance, FDICIA could spell the Bank's demise. Tr. 2108:2-25, Tr. 2110:15-22 & Tr. 2113:3-13 (Hillas). Mr. Hillas's statement that the Bank was not "viable" without FDIC "assistance" was thus a completely accurate statement of the Bank's regulatory predicament.

Mr. High's statements at the October 15 adjournment must be understood similarly. He too had been instructed by counsel what to say. Tr. 1003:12-1004:8 (High). If the FDIC dishonored the 1982 contract, and initiated insurance revocation proceedings, there certainly could be no merger. And, again, it was true that Meritor needed FDIC "assistance" -- in the form

of a market rate loan that would have cost the FDIC nothing -- in order to consummate project Zeta. Tr. 2108:2-25, Tr. 2110:15-22 & Tr. 2113:3-13 (Hillas); Tr. 1003:211004:8 (High); Tr. 577:4-15 (McCarron).

The fact that Mr. Ketcha succeeded in extorting this resolution from the Board of Directors provides no justification for the government's seizure of the Bank two months later.

### 2. Dr. Finnerty's Unrebutted Expert Testimony Establishes That Meritor Was Viable In December, 1992

Dr. Finnerty's expert report (PX 530, PX 539, PX 540) represents an extraordinarily thorough and careful analysis of the solvency and viability of Meritor by a distinguished expert in the field of valuation and finance who is also intimately familiar with the workings of Banks.[31] The Government's efforts to criticize Dr. Finnerty's reports and testimony were presented, in the main, by defendant's expert Dr. Barry Epstein. Dr. Epstein's testimony, and thus the Government's criticisms, were singularly unimpressive. For one example, Dr. Epstein believed that Dr. Finnerty's valuation of the assets retained by the receivership was performed on a "book value" basis, when Dr. Finnerty's report clearly sets forth a detailed market valuation of the assets retained. *See* DX 1959BB; PX 530 at Exh. 20; Tr. 5299:20-5300:25 (Finnerty). In all events, Dr. Epstein did not question Dr. Finnerty's conclusion as to Meritor's viability in 1992, as he had not been asked to develop an opinion on that subject. Tr. 4092:17-4093:21 (Epstein).

(a) Comparables Analysis

[31] As a partner at PriceWaterhouseCoopers and Finance Professor at Fordham University, Dr. Finnerty specializes in evaluation and solvency analysis of businesses. Tr. 2377:8-23 (Finnerty). Dr. Finnerty has worked in the areas of corporate finance for almost 25 years. He has published extensively (55 articles and 8 books) on valuation, financial management, financial institutions, and debt valuation. He was both a founder and CFO of College Savings Bank. PX 530 at 1. Dr. Finnerty was recognized as an expert in financial analysis, solvency analysis, corporate finance, and valuation. Tr. 2386:7-10; 2390:13-16.

Dr. Finnerty's analysis of comparable institutions provided a basis for valuing Meritor, and also demonstrated that Meritor, which was in almost every respect as strong as or stronger than the other members of the peer group, was viable, because all of the weaker institutions analyzed survived and prospered. *See* PX 530 at 49 ("Had Meritor retained its FDIC insurance and been allowed to remain in operation, it was not in danger of failing in the foreseeable future. Indeed, the comparable companies, some of which were in more serious financial condition as of the date Meritor was closed by the regulators, have not only survived, but increased in value since 1992.")[32] The government's attacks on this analysis of comparable institutions was ineffective. [33]

The government challenges Dr. Finnerty's comparable institutions on the basis that Meritor's earnings were below those of the comparables. PFOF 390. The government's criticism

---

[32] *See also* PX 530 at 29:

> The preceding comparison of Meritor with comparable institutions shows that weaker banks than Meritor, which unlike Meritor were given the chance to do so, survived and profited in the years after 1992. The regulators evidently believed in 1992 that these comparable banks were viable, and hindsight proves that they were right. The preceding comparison also suggests that Meritor was denied continued existence because, unlike these other institutions, a large portion of Meritor's capital consisted of grandfathered goodwill. In most other respects Meritor was as strong as, or stronger than, the comparable banks that were allowed to continue.

[33] The Government's efforts to criticize Dr. Finnerty's peer group analysis are offered without benefit of expert testimony, as Dr. Epstein was ruled unqualified to assess the comparability of the peer group institutions. Tr. 4174:15-4175:20. Dr. Epstein acknowledged that he has no expertise in banking, bank management, bank finance, or bank regulation. Tr. 4106:25-4109:11 (Epstein). The Court appears to have modified its ruling on Dr. Epstein's qualifications to assess comparability (Tr. 4463:1-25), but Dr. Epstein's lack of expertise in banking-related fields leads to much the same conclusion. *See* Plaintiffs' Response to Gov't PFOFs 388-409. The testimony of Mr. Clarke, who was recognized as an expert in banking, was very limited on this subject.

has two flaws. First, methodologically the selection of comparables on the basis of profitability is improper. *See* Tr. 5308:11-18 (Finnerty):

> Once you select your peer group, you then adjust in your analysis for differences in profitability. I've never seen anyone select a peer group solely on the basis of whether institutions were profitable or not. I take profitability into account in selecting multiples. I think its more proper, once you select comparable firms, to then make adjustments based on differences in profitability among those comparable firms.

Second, the criticism ignores the fact that by several measures, as detailed in Dr. Finnerty's report, Meritor's profitability was comparable to -- or at least in the range of -- that of the peer group institutions. *See* PX 530 at Exhibit 26; Tr. 5308:19-5309:16:

> Core earnings to average assets, Meritor was right in the middle as December 31, 1991. Seven of the other eight [comparables] had lost money. If you look at net interest income to average assets, Meritor was the bottom in that one. Operating expenses to average assets, according to that measure, Meritor was above average; return on average assets, Meritor was at the top; and return on average equity, Meritor was about in the middle.

The government faults Dr. Finnerty for not including in his comparables analysis, banks that the FDIC had closed. PFOF 389. But if there simply do not exist banks which, like Meritor, had significant positive capital, and which were closed by the FDIC (*See* Tr. 5305:18-5306:2 (Finnerty)), then, by definition, banks that had been closed are not comparable to Meritor.

The government cites Dr. Finnerty's failure to employ Dr. Epstein's conception of "nonearning assets." PFOF 392. But as Dr. Finnerty explained, the comparisons employed for his comparability analysis were those used in the S&L Thrift Digest, which are absolutely standard. Dr. Epstein's proposal to use a different definition of "nonearning," as opposed to "nonperforming," assets would inevitably distort the comparison. Tr. 5356:4-5357:3 (Finnerty).

The government also criticizes Dr. Finnerty's selection of comparables on the grounds that some of the comparable institutions were "at different stages" in their economic recovery, in

part because suburban banks would predictably recover from the New England recession more quickly than urban banks such as Meritor. PFOF 391. The criticism is puzzling, because it suggests that Meritor was indeed comparable to the peer group institutions and that the evidence of an incipient turnaround for the peer group institutions promised recovery for Meritor as well, albeit on a somewhat delayed basis.

As Dr. Finnerty concluded, Dr. Epstein's analysis of the selection of comparable institutions simply "suggests . . . somebody who doesn't have a lot of experience in selecting peer groups . . . ." Tr. 5314:12-14.

(b) The Liquidity "Problem"

The government challenges Dr. Finnerty's solvency analysis on the grounds that he did not subtract short-term debt. PFOF 402-406. The basis for the criticism is the argument that Meritor was illiquid, i.e., it would not be able to repay its short-term debt. Meritor's alleged liquidity problem stemmed from a small run on deposits in late 1992 and from an issue that arose with the Federal Home Loan Bank in Pittsburgh. *Id.* The argument is both incorrect and hypocritical.

In the first place, to the extent the government relies upon Dr. Epstein's testimony regarding Meritor's liquidity in late 1992, that testimony is totally incompetent. Second, the alleged run on deposits was: (a) brief, and quickly recovered; and (b) caused entirely by the government.

The total deposit "run" was approximately $130 million which, Mr. Hillas and others testified, was fully recovered by the Bank within a matter of only a few weeks. Tr. 663:22-25, Tr. 2118:3-5, Tr. 2147:15-22 (Hillas); Tr. 924:25-925:5 (High). The cause of the run was publicity in the Philadelphia Inquirer regarding the pendency of FDICIA and public statements made by an FDIC official to the effect that the FDIC could interpret its regulations under

FDICIA to exclude Meritor's goodwill. *Id.*; *See also* Tr. 477:13-479:1 (McCarron); Tr. 1172:14-22 (Fitzgerald); Tr. 1941:17-1943:6 (Hargrove). If one of the assumptions underlying Dr. Finnerty's solvency analysis is that the FDIC would honor its promises, obviously this run would not have occurred. Beyond that, the fact that Meritor recovered the lost deposits within a matter of only a few weeks is extraordinary evidence of the loyalty of the Bank's customer base. Tr. 664:15-25, Tr. 2147:15-2148:8 & Tr. 619:24-620:3 (Hillas); *cf.* Tr. 402:5-7 (McCarron).

The argument that Meritor's problems with the Federal Home Loan Bank in Pittsburgh justified skepticism about the Bank's future is bootstrapping of the most cynical kind. The entire issue, as admitted by all witnesses and as reflected in the documents themselves, arose from the FHLB's concern that if the FDIC took possession of Meritor it might dishonor collateral commitments Meritor had made to the FHLB. Tr. 925:21-926:18 (High); PX 476; PX 479; PX 483. Here, again, the problem was initiated by media coverage of FDICIA. Tr. 925:21-926:18 (High); PX 463; PX 464. Dr. Finnerty also analyzed the FHLB issue and firmly concluded that it was entirely of the FDIC's making. Tr. 5346:2-5347:9 (Finnerty); *see* PX 530 at 11("The FDIC could have prevented this adverse reaction and its consequent effect on Meritor's liquidity if it had announced that it would continue to honor its contractual commitment under the Western MOU and permit Meritor to include the Western goodwill as an asset for purposes of calculating its regulatory capital")

In the end, the issue was resolved at very limited expense when Meritor agreed to post an additional ten percent collateral for FHLB borrowings. Tr. 2149:7-2150:8 (Hillas). But to the extent the FHLB issue raised a liquidity problem, it is Kafka-esque for the government or the government's witnesses to rely on this problem as evidence of Meritor's condition, since the problem arose exclusively because the FHLB did not trust the FDIC to honor collateral

commitments. Tr. 1822:12-1823:11 (Fitzgerald); PX 476. Once again, the government seeks to bootstrap the problems that it created into justifications for later actions.

(c) Projections

Dr. Finnerty performed *ex ante* projections of Meritor's financial performance through 1995. PX 530 Exh.s 28-39. The *pro forma* analysis demonstrated Meritor's solvency and prospects for profitability, and the fact that Meritor, if left in business, would have easily maintained capital ratios well in excess of regulatory requirements. The government's criticisms of Dr. Finnerty's *pro forma* analysis fail.

The government criticizes Dr. Finnerty's projection that Meritor would by 1995 reduce the ratio of operating costs to average assets from three percent to two percent. PFOF 398. In support, the government cites Meritor's deliberately gloomy July 1991 offering circular and the testimony of Dr. Epstein. Dr. Epstein's commentary on the point is incompetent. In all events, Dr. Finnerty's assumption was firmly grounded in historical performance.

> In 1987, Meritor had an operating expense to average asset ratio of two percent; and all thrifts had an average of 1.9. In 1988, Meritor reduced that ratio to 1.7; all thrifts were at 1.8. In 1989, Meritor reduced it to 1.4; all thrifts were at 1.8. In 1990, Meritor was at 1.7; all thrifts 1.8. 1991, Meritor's ratio increased to 2; and all thrifts were at 1.9.
>
> . . . .
>
> The point is that Meritor historically had been at two percent or below. The industry had been actually below two percent. So I find it disingenuous that Dr. Epstein would do all this historical analysis and then criticize me when, in fact, the historical analysis in this case clearly indicates that two percent is very conservative.
>
> Meritor had been there for years, the industry had been there for years. And from my own experience at College Savings Bank, two percent was the standard that we practiced. It was the standard the regulators look to when the evaluated for operating expense to average assets. Assuming that Meritor could get back to what had

> been the historical average for that bank in the industry is a very conservative assumption.

Tr. 5340:5-25; PX 530 at Exh. 11.

In criticizing Dr. Finnerty's assumption that Meritor's operating cost ratio would return to historic levels, the government also points out, as Dr. Epstein had, that this operating cost ratio for thrifts generally increased in the years following 1992. As Dr. Finnerty explained at trial, however, use of the actual historical data is both methodologically improper and unfair because it picks one historical variable from several and thus creates a distorted picture.

> Dr. Epstein points out that, when you look at the comparable institutions, their ratios -- by 1997, I think, . . . the ratio of operating expenses to average assets were at 2.7 percent. If you're now going to . . . look forward at the actual data, I think it's disingenuous to only to look at one ratio. Let's look at the whole picture. What happen to interest rates? What happen to the economic environment? And if you want to judge Meritor on that basis, we know that interest rates decreased dramatically in '93 and through January of '94. We know that interest rate spreads widened. In that kind of an environment, Meritor would have done much better than I projected. In fact, I projected the rates -- I use the economic forecast, which projected rising rates. Rates, in fact, declined. If you were to look at actual data for '93, this bank would have done much, much better than I projected because of the improvement in its operating environment.

Tr. 5341:1-19. In all events, Meritor CFO Michael High testified that Dr. Finnerty's projection of the Bank's returning to its historical level of operating expenses at 2 percent of assets was perfectly reasonable at the time, and, with hindsight, a certainty. Tr. 5166:7-22 (High).

The government also criticizes Dr. Finnerty's assumption that Meritor's loan loss reserve as of the end of 1992 was basically adequate. PFOF 399-400. The government's criticisms miss the fact that the FDIC's 1992 examination of Meritor concluded that the loan loss reserve was adequate and also ignores the fundamental premise of FDIC examinations that when an examination team sets a loan loss provision for a bank its purpose is to estimate, as accurately as

possible, all losses that are likely to eventuate in the existing loan portfolio. Tr. 3438:9-3439:5 (Shull). It also conveniently disregards Dr. Finnerty's testimony as to his review of the Bank's loan committee minutes and his understanding, amply supported by the evidence, that Meritor's problematic loans were originated prior to Mr. Hillas's coming on board in 1988. Tr. 5338:3-5339:21 (Finnerty).[34]

The government also criticizes Dr. Finnerty on the basis that at least one of his projections (origination of variable rate mortgages) is inconsistent with the figures set out in Meritor's 1993 draft budget (PX 421). PFOF 396-397. Quite misleadingly, the government cites Mr. High's testimony that the assumptions in that draft budget were probably "reasonable." *Id.* The government conveniently ignores Mr. High's testimony that the projections in the draft budget were very preliminary and probably just based on the prior year (Tr. 1008:20-1009:15 (High)), and the testimony of several witnesses that the draft budget was never reviewed by senior management and was thus a long way from completion. *Id.* Tr. 2139:19-2140:6 (Hillas); Tr. 1007:17-1008:10, Tr. 1133:15-18 (High). In fact, Chairman Hillas never even saw the draft. Tr. 2120:14-17, Tr. 2154:4-10 (Hillas). *See also* Tr. 5344:14-5345:5 (Finnerty).

(d) Solvency Analysis

Dr. Finnerty employed three standard solvency tests to evaluate Meritor as of December 11, 1992, and all showed the Bank to be financially sound. *See* PX 530 at 44:

> I have concluded that Meritor's financial condition passes the cash flow test as of December 11, 1992. The model also indicates that Meritor would be expected to return to profitability by 1995, and

---

[34] Dr. Epstein also claimed that Dr. Finnerty's analysis neglected to take into account the value that Mellon presumably paid for the loss sharing agreement. The government has apparently abandoned the point, for good reason. As Dr. Finnerty explained this criticism simply reflected Dr. Epstein's failure to understand that the subtraction of the existing loan loss provision in the valuation of the receivership fully and quite reasonably accounted for the value of the loss sharing agreement. Tr. 5294:4-5295:22 (Finnerty).

> on this basis as well, Meritor is shown to have been a viable institution in late 1992.

The government's isolated criticisms of this analysis fail. In its Trial Brief, the government criticizes Dr. Finnerty's EBIT and EBITDA analysis on the grounds that he assumed that Meritor would sell its vacant office space with a return of $26 million. PFOF 408. But as Dr. Finnerty explained at trial, when an asset is earmarked for sale "it is absolutely bad appraisal practice," when valuing the enterprise, to treat the asset as held rather than sold. Tr. 5315:25-5317:8. No government witness raised serious question as to the appropriateness of the $26 million valuation, and in light of the fact that the Bank had invested some $50 million in the office space, the valuation on its face seems quite reasonable. Tr. 946:15-20 (High).

In general, Dr. Epstein's effort to criticize Dr. Finnerty's analysis merits little attention.

> I think [Dr. Epstein's] criticisms are full of misunderstandings of what I did. Some of that, I think, arises from his failure to read the report. I point out a number of those instances here where there are criticisms that simply are not right.
>
> I think the other mistake that Dr. Epstein makes in criticizing me is to focus almost exclusively on the past rather than the looking at the situation the bank was in and where the bank was headed December 11, 1992. It's the same problem that I think is evident in his report and this naïve and simplistic analysis that he does with his trend lines, which he acknowledges in his report, by the way. He acknowledges in his testimony he is naïve and simplistic. He's looking at things historically. He's not looking at the bank and looking at changes in policy. He's not looking at what the Hillas management team's accomplished. He's not looking at the changes in the loan policy. He's not taking into account the fact that the institution had downsized and had completed that program four days before they were taken down.
>
> And the criticisms are invalid because of that failure to properly analyze - and I emphasize "analyze" - that bank and where that bank was and where that bank was headed at December 11, 1992. He doesn't do any analysis. [ ] Just a superficial manipulation of the numbers.

Tr. 5357:7-5358:6.

The government commits precisely the same error in arguing that Meritor was not viable when seized. It looks at Meritor's high-cost funding, without noticing how much of that funding would have rolled off in the first three quarters of 1993. Tr. 2141:11-17 (Hillas). It looks at the volume of Meritor's troubled loans, without noticing that all of those loans were originated prior to 1988, that the vast majority of troubled loans had been dealt with, and that going forward Meritor's loss reserve was adequate. It looks at Meritor's high overhead costs, without noticing that the real estate recession in 1992 had already started to ease up (Tr. 2106:9-13 (Hillas)) and that, when relief came, the sale of Meritor's unused office space would cut costs by over $2 million annually. Tr. 946:23-947:3 (High).

More importantly, and as we showed in our Trial Brief (at 156-57), these are all questions that FDIC simply didn't ask in 1992. Dr. Finnerty's analysis confirms that fact.

### D. The Government's Failure Even To Address The Evidence Showing That FDIC's Actions In 1992 Were Driven By Tangible Capital Considerations, And Were Thus In Breach Of The 1982 Agreement, Concedes The Issue

Our Trial Brief reviewed the voluminous evidence that FDIC's actions in 1992 were driven by their focus on tangible capital. The admissions by government witnesses on this issue are so strong there is little room for argument. The government, at any rate, offers only token resistance. Instead, it invokes a legal obstacle in the form of a virtually insurmountable presumption of rectitude by government officials which, it turns out, is totally inapplicable. We also submit that the government's failure even to attempt to offer expert testimony in rebuttal of Dr. Brumbaugh is itself dispositive on most of the issues in this case.

#### 1. The Presumption Of Good Faith By Government Employees Is Irrelevant To This Case

The government argues that in order to prevail Plaintiff must show through "irrefragable proof" that "the FDIC did not act in accordance with its own regulations and in good faith."

Govt. Br. at 39. But this is a breach of contract case, and bad faith is irrelevant. If every plaintiff in this Court, who alleges simply that the government has breached its contract, were required to overcome the heavy presumption of rectitude behind which FDIC seeks to hide, the Court might as well close its doors and inform the Congress that the Tucker Act has been judicially repealed. The notion, not surprisingly, has no support in the law.

As a contractor, the government is in the same position as any private party. *See United States v. Winstar Corp.,* 518 U.S. 839, 895 (1996) ("[W]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals") (alteration, citation, and quotations omitted). To prevail, Plaintiff need only demonstrate that: (1) a valid contract existed between the parties; (2) the contract created a duty in the government owed to the Plaintiff, (3) the government breached its duty; and (4) the government's breach caused the Plaintiff damages. *See San Carlos Irrigation and Drainage Dist. v. United States*, 877 F.2d 957, 959 (Fed. Cir. 1989); *United States v. Thompson*, 293 F. Supp. 1307, 1312 (E.D. Ark. 1967) (considering breach of contract actions under the Tucker Act and stating “the breach is actionable regardless of whether the breach was negligent, or whether it was intentional, or whether it was fraudulent or mala fide").

The government's cases applying the presumption of rectitude do not apply to a simple contract suit. They involve claims that require a showing of bad faith. The Plaintiff in *T & M Distribs., Inc. v. United States*, 185 F.3d 1279 (Fed. Cir. 1999), for example, alleged a wrongful "termination for convenience." In such cases this Court's law requires the plaintiff to demonstrate "bad faith or clear abuse of discretion . . . . " 185 F.3d at 1283. The contract at issue in this case does not contain a termination for convenience clause. Similarly, *Haley v. Department of the Treasury*, 543 F.2d 1298 (Fed. Cir. 1992), involved an attempt to disqualify an administrative

law judge based on the judge's alleged "predisposition in favor of the [government]." Indeed, review of Federal Circuit and Court of Federal Claims case law reveals that the presumption defendant seeks to invoke has been applied only when bad faith was a necessary element of a particular claim, for example, contract termination, bid solicitation/selection decisions, or claims specifically alleging that the government failed to act in good faith.

The Court of Federal Claims implicitly rejected, in an unpublished decision, the argument that the government's presumption applies to a simple breach of contract case against the government. *See Amertex Enters., Ltd. v. United States*, 1995 WL 925961, *15 (Fed. Cl. Dec. 15, 1995) (unpublished decision). In *Amertex*, the plaintiff alleged that the government breached a contract to purchase certain chemical protective suits by delaying the plaintiffs' ability to perform. *See Id.* at * 1. The government defended on the ground "that it [was] not responsible for unreasonably delaying the project because the plaintiff [had] not established by well-nigh irrefragable proof that the government acted in bad faith."' *Id.* at 15. The Court rejected the government's argument, reasoning that:

> Proof of bad faith, however, let alone "well-nigh irrefragable proof" of malice, has never been the touchstone for proving entitlement to an equitable adjustment for damages caused by delay and disruption. Instead, to recover for delay, the plaintiff must prove that the defendant unreasonably delayed the completion of the contract, the defendant proximately caused the delay, and that plaintiffs costs were increased as a result . . . . Reasonableness, not bad faith, is the essence of delay analysis . . . . Furthermore, the cases cited by defendant are not delay and disruption cases, but are cases involving allegations of bad faith termination . . . . [T]here is no support for extending the bad faith burden to the settled law relating to proof of fault and injury in the delay claim regime.

*Id.* (citations omitted). The government's argument is even weaker here than it was in *Amertex*, because here there is no requirement that the government's breach be proved unreasonable.

The holding in *Winstar* also repudiates the government's argument. The breaches involved in *Winstar* were mandated by Congress; obviously no claim of bad faith on the part of the agencies involved could be made, and there was no suggestion that Congress had acted in bad faith. 518 U.S. at 870. Indeed, the Supreme Court acknowledged that Congress had enacted FIRREA "with the objects of preventing the collapse of the industry, attacking the root causes of the crisis, and restoring public confidence[,]" i.e., that Congress acted in good faith. *See Id.* at 856. The Supreme Court thus reached its decision "applying ordinary principles of contract construction and breach that would be applicable to any contract action between private parties." *Id.* at 870-71.[35]

*Winstar*, as well as the cases upon which the government relies, make clear that the "irrefragable proof" standard does not apply to the Plaintiff s breach of contract claim that is before the Court.

**2. The Evidence Of Breach In 1992 Is Overwhelming And Largely Conceded**

In our trial brief (at pages 109-130) we reviewed the fact that every single employee and officer of FDIC in any way involved with the closure of Meritor has admitted that he or she disregarded Meritor's supervisory goodwill in assessing the Bank's condition in late 1992 and that Meritor's lack of tangible capital was either a substantial factor, or the determinative factor, in FDIC's decision to close the Bank. The documents, also reviewed in our Trial Brief, tell the

[35] The government cites its 1985 regulation allowing (or requiring) the recognition of contractual intangibles. Govt. Br. at 40-41; PFOF 104-107. The suggestion is that plaintiffs' allegations entail a charge that FDIC not only violated its contract but also violated its governing regulations, and that this latter violation allows the government to invoke the presumption of good behavior. But the argument proves too much. What logic would there be in saying that the government does not have the benefit of the presumption when its only offense is an alleged breach of contract, but that it *will* enjoy the presumption when, in addition, the alleged breach would also constitute a violation of its regulatory duties?

same story and just as plainly. The government's trial brief does not meaningfully challenge any of this evidence.

### 3. Dr. Brumbaugh's Unrebutted Testimony Establishes The Government's Liability

Dr. Brumbaugh's Ph.D. thesis was an econometric analysis of the thrift industry crisis, focused on the determinants of failure, the determinants of insolvency and the determinants of cost to the federal insurance agencies. Dr. Brumbaugh worked in the Federal Home Loan Bank Board from 1982 through 1986, ultimately as Deputy Chief Economist and Director of the Division of Policy in the Office of Policy and Economic Research. From 1986 through 1989, Dr. Brumbaugh served as the Chief Executive Officer of Independence Savings and Loan, a thrift in northern California. He has continued his academic and professional pursuits as a research scholar at the Center of Economic Policy Research at Stanford, and more recently as a Senior Financial Fellow at the Milken Institute. From 1988 through 1990, Dr. Brumbaugh served as a consultant to financial institutions with Drexel, Burnham, Lambert.

Dr. Brumbaugh's primary role while at the Bank Board was to evaluate the nature of the thrift industry crisis and how the regulatory agencies should address that crisis. Dr. Brumbaugh has published approximately thirty articles in peer-reviewed journals on subjects dealing with thrifts and banks. He has authored or co-authored six books on the thrift crisis. Dr. Brumbaugh has testified before Congress twelve times on banking and thrift issues. In 1992, he served as a consultant to the National Commission on Financial Institution Reform, Recovery, and Enforcement. Dr. Brumbaugh's testimony and publications created the blueprint for FDICIA. Tr. 5410:17-5418:24 (Brumbaugh). Throughout his career as a financial institution analyst and regulator, Dr. Brumbaugh has studied the way in which the federal regulatory agencies have dealt with troubled institutions during the years relevant to this suit. Tr. 5426:4-5428:8. The

Court found Dr. Brumbaugh qualified to testify as an expert in banking and thrift operations, financial analysis of banks and thrifts, the regulation of banks and thrifts, and raising capital for banks and thrifts. Tr. 5444:125-5445:2.

Dr. Brumbaugh testified, based on his review of the entire record in this case, and upon his fifteen years as one of the country's preeminent experts on troubled banks and the regulation of troubled banks:

> I believe the 1982 MOU established a contract, part of which was that the supervisory goodwill created by virtue of the acquisition was to count towards regulatory capital. My opinion is that insofar as it counted towards regulatory capital, it had to count towards regulatory capital under all standards that prevailed thereafter, regardless of the way they changed.
>
> My opinion is also that a breach began to develop almost immediately, because there was a division between the policymakers who made the policy and the individuals who had to implement it, who opposed it in general, and then were reluctant to live up to the agreement thereafter. I believe that there are manifestations of the breach beginning almost immediately. I think that by virtue of the breach, it was done in ways which were both direct and obvious and ways that were not quite so obvious. The manner in which the capital requirements were subsequently raised so substantially above the ones that prevailed for the industry in general is an example of how the breach was engineered, in part.
>
> I also believe that, and it's my opinion, that the deterioration in the institution as an institution in terms of performance and conduct was largely caused by manifestations of the breach. And the condition of the institution in 1992, when it closed, to the extent that it was still troubled, was largely influenced by manifestations of the breach.
>
> However, notwithstanding that and notwithstanding the fact that they managed an unbelievably miraculous shrinking, they were still in a condition, given the events that were developing at the time economically and would develop dramatically afterwards, that they would have survived, if they weren't closed.

5452:9-5453:16 (Brumbaugh).[36] With respect to the reason for the seizure and sale of the Bank, Dr. Brumbaugh testified:

> I think that if you look at the institution and the treatment beginning from immediately after the agreement, the record is overwhelming that what was motivating the decisionmaking at the FDIC was . . . maintaining the highest possible tangible capital level, excluding the goodwill, in order to protect the Federal Deposit Insurance Corporation fund, and I believe the method of closure is consistent with that . . . . If, as I interpret the meaning of the original 1982 MOU, the goodwill would have had to count towards tangible capital, and if it did, their tangible capital level would have been so high that it would have been inconceivable that the institution was closed.
>
> So I think that -- and also given the record that we have from the FDIC board [] minutes at the time of closure, the fact that they had already arranged an acquisition of Meritor's assets and liabilities with the Mellon Bank at a profit to the FDIC, which is also -- it's one of the very few instances, if any, that I'm aware of in which that's happened -- added greater emphasis to get it done quickly in order to protect the fund.

5454:9-5455:7 (Brumbaugh). The government has offered no answer to Dr. Brumbaugh's testimony, which was firmly grounded not only in the voluminous documentary and testimonial evidence of the FDIC's fixation on Meritor's tangible capital, but also in the historical fact that the FDIC has always used a bank's tangible capital as the critical determinant of condition. Instead, the government's only response to this documentary and testimonial evidence, and to Dr. Brumbaugh's expert analysis thereof, is an *ex post* rationalization that is refuted by the admissions of the government's own witnesses every bit as much as by plaintiffs'.

## CONCLUSION

The facts of this case are straightforward.

---

[36] We remind the Court of its ruling at the time that Dr. Brumbaugh's references to the government's "breach" would be admitted strictly as factual and expert opinion evidence, and not as legal conclusions. Tr. 5459:19-22.

In 1982 FDIC was facing over $800 million in debt. It persuaded PSFS to assume that debt. PSFS, later Meritor, has paid the debt. Every last penny of it.

FDIC could not afford in 1982 to give PSFS cash to cover the debt. Instead, it gave the Bank an intangible accounting entry, and a promise. The promise was that, under the rules that determine whether a bank can stay in business and how large it can grow, the intangible (goodwill) would be treated as cash. The man who made the promise -- the FDIC Chairman -- testified that that is what it meant.

Keeping that promise would have been a departure. The imperative at FDIC has always been to assess a bank's solvency on a tangible basis, and to terminate banks that become tangibly insolvent, because intangibles offer the FDIC insurance fund no protection. Experts on bank regulation so testified, without contradiction.

FDIC broke its promise. Reverting to old habits, FDIC kept a constant eye on Meritor's tangible capital. When the Bank's tangible capital became low in 1988, FDIC forced the Bank to shrink, and forced it to raise cash, even at the expense of crippling the institution. When the Bank's weakened condition -- partly the result of FDIC's 1988 actions -- again threatened its tangible capital account in 1991, FDIC set for the Bank capital requirements far above those applied to banks that had no contractual goodwill. And when in 1992 the Bank's tangible capital neared actual depletion, FDIC arranged with the state charterer to seize the Bank and sell its assets.

(In 1992 FDIC had its own solvency problems; seizing and selling Meritor allowed it, once more, to eliminate a booked expense of $846 million.)

The evidence of these breaches is extensive. We respectfully submit that it is also compelling. In most contract cases, a lawyer is lucky to find one document, or one witness, admitting breach. In this case there are dozens.

FDIC does not answer the evidence. Instead, and by many feints, it tries to avoid it.

FDIC argues that the promise made, in exchange for PSFS assuming and paying off $800 million in debt, was an illusion, and that FDIC remained free to punish PSFS for having an intangible on its books. But not one person at trial said so, and many said otherwise.

FDIC argues that it was more worried about Meritor's profitability than its capital. But it is actions that speak loudly, and FDIC's actions were to sacrifice the Bank's profits for the sake of its capital. FDIC's own witnesses confess this. And the contemporaneous documents -- *hundreds* of them -- show that capital was at all times the bottom line concern.

FDIC argues that Meritor voluntarily surrendered the 1982 promise. But not one person at trial said so, and many said otherwise.

FDIC argues that the Bank freely consented to the actions taken against it in 1988 and 1991. But not one person at trial said so, and many said otherwise.

FDIC argues that its actions caused no harm to the Bank because the Bank would have done what it did anyway. But not one person at trial said so, and many said otherwise.

FDIC argues that its breach in 1992 is excused by the fact that, for a time at least, the Bank fell short of the ratios set for the Bank in 1991. But the law says otherwise, and not one witness claimed that the alleged capital shortfall mattered. It was also cured before the Bank was seized.

FDIC argues that Sally Hargrove, not FDIC, caused the Bank's closure in 1992. But Sally Hargrove swears otherwise, and the documentary record, the nature and history of FDIC, and common sense, back her up.

FDIC argues, today, that the Bank's condition in 1992 was so bad that, breach or no breach, the Bank was doomed. But in 1992 no one at FDIC even analyzed that issue. If they had, they would have found that the Bank's prospects (if given time) were reasonable, and that the Bank's troubles were due in large part to FDIC's prior breaches. Experts have proven these facts.

FDIC argues that it cannot be made to answer for its breach in 1988 because Meritor's original complaint did not mention it, and when the new allegation was filed, after the government's many delays were ended, it was too late. But the law says that when the same kind of breach of the same contract by the same party is at issue, the first complaint will serve.

We submit that none of the government's arguments holds water.

The decade at issue, 1982 -1992, was a trying time for every bank and thrift in America. It was also a trying time for bank regulators. In 1982 PSFS and FDIC agreed to help each other. PSFS performed its part. FDIC did not. By promising to credit the Bank's goodwill, and then withdrawing that credit (by means both subtle and unsubtle), FDIC made the Bank's struggle infinitely more difficult. In the end, they made it impossible.

The Court has heard the men who lived it. Todd Cooke, Fred Hammer, and Roger Hillas, the Chairmen of the Bank during its last decade, all testified. Bank counsel -- Robert Ryan, who negotiated the 1982 deal, and Jack McCarron, who lived with its betrayal -- testified. Frank Slattery, who received a most unenviable crash course in bank regulation, and who hired for Meritor the best banker in Pennsylvania, Mr. Hillas, testified. Anthony Nocella, Chief Financial Officer, and Mike High, Comptroller and Chief Financial Officer, testified. These are all men of

substance. They all described FDIC's dogged refusal to credit the goodwill, and the Hell it created. They waited seven years to tell their story.

On their behalf, and on behalf of all Meritor shareholders, we respectfully request that the Court enter Judgment for Plaintiffs and set a trial on damages with all possible speed.


Thomas M. Buchanan
**WINSTON & STRAWN**
1400 L Street, N.W.
Washington, D.C. 20005
(202) 371-5787

Attorneys for Plaintiffs

**Of Counsel:**

Eric W. Bloom
Peter Kryn Dykema
Charles B. Klein
**WINSTON & STRAWN**
1400 L Street, N.W.
Washington, D.C. 20005
(202) 371-5700


Date: May 24, 2000

**175110.8**