IN THE UNITED STATES COURT OF FEDERAL CLAIMS

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

PLAINTIFFS' REPLY MEMORANDUM IN SUPPORT OF MOTION FOR COURT TO DRAW ADVERSE INFERENCES DUE TO SPOLIATION OF EVIDENCE

Key portions of actual minutes, and verbatim transcripts, of the Board meetings at which the FDIC decided to cause Meritor's seizure and sale, have been concealed from Plaintiffs until the final days of trial -- more than six years after suit was filed. The government seeks to escape the consequences of its concealing this obviously critical evidence by arguing in effect that Plaintiffs were overly trusting of the government and should have discovered the concealment earlier than they did. Neither law nor logic supports such an argument.

I. THE GOVERNMENT FAILS TO JUSTIFY THE IMPROPER REDACTIONS IN THE FIRST INSTANCE

Tellingly, the government offers no defense whatsoever for its prior invocations of the "executive privilege" in redacting the November 10 and December 9, 1992 minutes, and, as we have only now learned, in withholding the *entirety* of the transcripts of these same FDIC Board meetings. The government, treating the issue with a wave of the hand, simply and blindly

asserts, without *any* analysis, that "the privileges had been properly invoked." Gov't Opp. at 2. The government's belated production comes amidst a concession to the obvious: that "Plaintiffs ha[ve] a legitimate need for such relevant information." Gov't Opp. at 2. Plaintiffs assuredly have had this "legitimate need' since the inception of the litigation, and the government's failure to produce the evidence earlier has significantly hampered Plaintiffs' trial preparation and trial presentation.

A succession of government counsel in this case will probably make it impossible, without some sort of inquiry, to determine by whom and under what circumstances the evidence in question was concealed. But it is perfectly clear that, while the government continues even now its cavalier approach to analyzing evidentiary privileges, the government decision makers at the time of the initial redactions wrongfully denied plaintiff material evidence that Plaintiffs would have relied upon in building their case.[1] That is the principal basis for the relief sought by Plaintiffs, and the government has failed to address it.

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[1] The government initially asserted the executive privilege to literally hundreds of documents, including the rather bold assertion of executive privilege for a single paragraph of a report from Nicholas J. Ketcha, Jr. dated February 11, 1991, which provided:

> Our concerns regarding the viability of Meritor center upon the possibility that new legislation may force a charge off of regulatory goodwill. A precedent for such legislative action exists in FIRREA. For this reason, we recently included the bank among those that may fail during 1992.

PX 298 at 2; PX 298A at 2, attached as Exhibits 1 and 2, respectively. While the same production included an *unredacted* copy of the same document, the apparent practice of redacting the most damning passages of a document -- regardless of whether even a plausible privilege claim exists -- is deeply troubling.

II. PLAINTIFFS HAD NO OBLIGATION TO MOVE THE COURT TO COMPEL PRODUCTION OF THE MINUTES AND/OR THE TRANSCRIPTS

Rather than defend its assertions of evidentiary privileges, the government employs the art of diversion, and argues that Plaintiffs are at fault for not having challenged the government's redactions at an earlier time. This is a peculiar argument because Plaintiffs' counsel should be entitled to rely on the good faith and general competence of counsel for the government. That government counsel had agreed to drop the executive privilege with respect to all but a couple of documents appeared at the time to reflect considered judgment by government counsel, who presumably opted to invoke the privilege narrowly and only when the circumstances so required. That presumption has proven to be an illusion given the production of the minutes and of the underlying transcripts.

Not surprisingly, the government cites no authority to support its absurd suggestion that Plaintiffs somehow lose their right to seek relief because they did not detect the abuse earlier. Accusing the victim of provoking, or in this case, not catching, the misconduct achieves nothing for the government for it does not erase or eliminate the government's discovery abuses.

III. NOR IS THIS A CASE OF "A SIMPLE OVERSIGHT"

The government minimizes its conduct by characterizing it as "a simple oversight." It is of course for the Court to decide whether the decisions at issue were mere "oversight," but we submit that this purported "oversight" was extraordinarily well-focused. First, the government wrongfully redacted information that it was obliged under the Federal Rules of Civil Procedure to provide to the plaintiff. Second, upon Plaintiffs' demand, the government elected to revise the redactions, disclosing all of the previously asserted executive privilege material *other than the redactions contained in the two sets of minutes*. Thus, the government twice elected to withhold these materials, and did so, in the second instance, exclusively. Moreover, government counsel

stated that he continued to assert the executive privilege to these most relevant portions of the mnutes even though he never even looked at the allegedly privileged material being redacted.

> MR. HUGHES: The second note is, as I mentioned before, the only version ever made available to me was the version that was in my files that had been produced to the Plaintiffs in the Hindes litigation. I didn't know what was behind the redacted portions in preparing for trial, and in fact, I would have liked to have it in preparing for trial because I think it actually helps us. That's all I have to say, your Honor.

<cite> 4725-26. Third, as noted in its brief in opposition to the instant motion, the government failed entirely to include the two sets of minutes on *any* version of any of the various privilege logs that were submitted to Plaintiffs.On this final point -- the elliptical privilege logs -- the government now discloses that the privilege logs' identification of "transcripts" of the FDIC Board of Directors November 10 and December 9, 1992 meetings are documents separate and distinct from the "minutes" of those meetings. In other words, unbeknownst to Plaintiffs, the government has at all times had in its possession, but has never produced, actual transcripts of the relevant FDIC Board meetings. Until the final week of trial in this case, Plaintiffs were unaware of the existence of these transcripts. The government contests this, stating that it "would not be reasonable" for Plaintiffs to have "confused 'minutes' and 'transcripts,'" because these documents "had different discovery numbers and titles." Gov't Opp. at 7. But as the government obviously recognizes, Plaintiffs *did believe* that the identified "transcripts" were the "minutes,"[2] a perfectly natural conclusion because the minutes were inexcusably omitted from *any* of the government's privilege logs.

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[2] In this connection, Plaintiffs were clearly not alone in assuming that the "minutes" could be referred to as "transcripts" by the unknown individual(s) who prepared the revised privilege log. The following exchange occurred during the government's cross-examination of Paul Fritts:

The reference to "different discovery numbers" is as unhelpful as the reference to different "titles," given the seemingly haphazard way in which the logged documents were numbered. There was no continuity in numbering between the original and revised privilege logs, attached as Exhibits 3 and 4, respectively, nor of the documents which had originally been redacted or withheld and which were subsequently produced either for the first time or with the missing portions intact. Examples abound:

1. July 13, 1992 memorandum from S. Linehan to J. Hand and M. Piracci, with various copy recipients, described as re "Meritor's Supervisory Goodwill as Regulatory Capital" or "Treatment of Meritor's Supervisory Goodwill for Regulatory Capital Calculations Under FDICIA with Related Correspondence"

   - On the original log, this was variously identified as " Doc. # RR-05"; "Doc. # 39-010"; and "Doc. 39-018"

   - On the revised log, it was identified as FSL002 503-05, FSL004 868, and FSL004 905 (Also on the revised log, no information concerning author or addressees was provided for any of the documents listed, making comparisons more difficult.)

2. July 14, 1992 memorandum from J. Hand to S. Reisman described as re "(1) The Treatment of Subject's Supervisory Goodwill Under FDICIA in the Determination of Regulatory Capital Adequacy (2) Methods Available Under the Prompt Corrective Action Provisions of FDICIA to Precipitate Receivership if an Institution is Not Critically Undercapitalized with Related Correspondence" [In other words, how do we shut it down even if we ostensibly have to give credit for the goodwill.]

Q. [Referring to DX 525, Minutes of November 10, 1992 FDIC Board Meeting] Do you recognize this document?

A. I recognize it as a transcript of FDIC Board minutes.

* * * *

Q. And turning your attention to DX 912 - you saw a PX version of this document on direct. Would you identify this [for the] record?

A. It is a transcript of the minutes of the board of directors meeting of FDIC held on December 9, 1992.

Tr. at 3052-53.

- On the original log, this was identified as “Doc. # RR-06”

- On the revised log, it was identified as FSL002 508-12

3. October 28, 1992 e-mail from P. Clark to S. Linehan, with various copy recipients, described as re “First Union’s Ability to Close the Sale of FA Before Meritor’s Mid-December Closing Target”

   - On the original log, this was identified as “Doc. # 35-076”

   - On the revised log, it was identified as FSL003 1519

Documents Produced Following Original Assertion of Executive Privilege

1. May 5, 1987 memorandum from J. Hand to The Files re Meritor - Renegotiation of IMA

   - On the original log, this was identified as “Doc. # 073612-01

   - When produced in redacted form, the document bore production Nos. CSL010 0035-37

   - In the supplemental production, the page previously redacted was produced bearing production number FSL002 0074

2. December 28, 1990 Confidential Problem Memorandum from N. Ketcha

   - On the original log, this was identified as “Doc. # 16-025”

   - When included in the supplemental production, it bore production Nos. FSL003 0423-44 and SL0003285-86

3. Supervisory Section from Report of Examination as of July 20, 1992

   - On the original log, this was identified as “Doc. # 073613-01”

   - When included in the supplemental production, it bore production Nos. FSL002 0373-386 and SL0002297-310

In light of the record, the government’s practice of blaming Plaintiffs for its own handling of privileged material is silly. To be certain, but for Plaintiffs' diligence (and current government counsel’s willingness to revisit earlier decisions), Plaintiffs would not have had available many of the documents Plaintiffs relied upon at trial. That Plaintiffs did not catch all of the

government's errors as quickly as the government would like is probative of nothing since the Plaintiffs have never been hired by the government to assist it in document production.

IV. PLAINTIFFS' POSSESSION OF THE FOIA'ED MINUTES HARDLY MINIMIZES THE HARM CAUSED BY THE GOVERNMENT'S MISHANDLING OF THE EVIDENCE

The government suggests that Plaintiffs' possession of the November 10 and December 9, 1992, minutes obtained through the Freedom of Information Act somehow either negates the government's misconduct or otherwise has eliminated the prejudice suffered by Plaintiffs as a result of the government's misconduct. Such wishful thinking ignores the facts. A simple comparison between the *unredacted* December 9, 1992, minutes (produced on January 21, 2000), Pl. Mem. Exh. 4, with the heavily redacted FOIA version, Gov't Opp. Exh.4, reveals the many paragraphs that the Plaintiffs were denied until the last couple of weeks of trial. For example, the government had denied Plaintiffs access to the following excerpts:

> Director Steinbrink expressed his concern over the timing of the DOS recommendation and questioned the need for the Board to initiate proceedings under Section 8(a) of the FDI Act in light of the Board's next scheduled agenda item proposing a resolution of Meritor.

Pl. Mem. Exh. 4 (PX 502B) at 48270. Also, for the first time, the FDIC's minutes reveal that the indemnification sought by Ms. Hargrove related to "any liability, to the extent that such liability was based on the issue of supervisory goodwill, arising from a legal challenge to the State's closure of Meritor." *Id.* at 48276. As the FDIC concedes, "the principal objective of the Secretary of Banking was to get some assurance from the Corporation that assistance would be provided in the event that Meritor's closing was challenged on the basis of the correct interpretation of the provisions of Federal Deposit Insurance Act and the Corporation's regulations related to capital." *Id.* at 48277. Mr. Fritts recommended that, if it proved necessary, the Board should approve indemnification "up to $250,000 or $300,000" if that would ensure

closure of the bank and thereby avoid potential additional costs to the FDIC. *Id.* at 48278. Director Steinbrink "noted that, even in the absence of any costs, the indemnification would be a more favorable proposition because it would yield a greater recovery for the Corporation than would delaying the bank's closing for a week." *Id.* at 48279.

It is in fact apparent that the FDIC's decision to recommend Section 8(a) proceedings was specifically intended by the agency to cause the State to close Meritor. That is why the FDIC chose not to wait until Meritor exhausted its regulatory capital, which was at a minimum more than two years away, or even to exhaust its tangible capital (which would occur after the FDICIA regulations became effective). FDIC acted swiftly to cause the closure of Meritor prior to the effective date of FDICIA's implementing regulations so as to avoid according Meritor the due process rights thereunder, which could have led to months of hearings and deliberation in federal court. Also, as the now unredacted minutes reveal, the FDIC was practically salivating at the opportunity to pull back the $864 million reserve posted by the FDIC for Meritor's resolution in calendar year 1992, and to avoid the possibility that the FDIC would bear a greater burden if Meritor did not become profitable prior to the exhaustion of its regulatory capital.

The government does not and cannot in good faith argue that this evidence lacks probity. The government should have produced the evidence during the course of discovery. Its failure to do so constitutes spoliation of evidence warranting relief from this Court.

V. THE GOVERNMENT'S LATE PRODUCTION OF THE "TRANSCRIPTS" DEMONSTRATES THE INCREASING HARM PLAINTIFFS HAVE SUFFERED AS A DIRECT RESULT OF THE GOVERNMENT'S ACTIONS

On February 11, 2000, in response to Plaintiffs' in-court demands, the government provided Plaintiffs with copies of the transcripts of the November 10 and December 9, 1992, FDIC Board Meetings. Like the minutes, the government asserted the executive privilege with respect to these documents. In contrast to the minutes, the government chose not to *redact* the

documents, but instead chose to withhold the documents altogether. That Plaintiffs did not know of the existence of these transcripts was, as explained above, the result of the government's failure to identify the minutes in any of its privilege logs, thus leading Plaintiffs to conclude that the "transcripts" were actually the minutes, which had been produced in redacted form.

While Plaintiffs have not yet received the audio, the transcripts themselves contain, at times, candid and eye-popping admissions. The transcripts make clear that the FDIC Board approved the recommended 8(a) action precisely because it believed that the Secretary of Banking for the Commonwealth of Pennsylvania would not seize Meritor and appoint the FDIC as Meritor's receiver in the immediate future unless the FDIC took this action. The FDIC was further concerned that delay now would result in more significant delays later because the FDIC could not directly seize Meritor, even under the new provisions of FDICIA, without according Meritor basic due process rights, which involved notice and the right to challenge the action in federal court.

According to the transcript, Paul Fritts recommended the 8(a) action because Meritor was "rapidly running out of capital." Tr. (Dec. 9, 1992), attached as Exhibit 6, at 2. When asked what he meant, Mr. Fritts responded that Meritor had only ".66 [percent] in the tangible equity capital. So they have less than one percent tangible capital." *Id.* There was absolutely no mention of the supervisory goodwill or the fact that Meritor's regulatory capital would not be depleted for at least two years, if ever.

That Meritor's tangible capital was not yet depleted appeared to stun Director Steinbrink, who insightfully asks:

> Why would we issue an 8(a) today? *I mean, there's got to be some reason that's not in the case.*

Id. Mr. Fritts responds:

> Because the state thinks it's time that they do something about it and *it supports their case*—to close the bank. *I was hoping to avoid saying that, but you've asked me.*

Id. Mr. Fritts subsequently reiterates:

> It clearly sup—supports that the bank is, in fact, failing and it gives the state support to take the action that it may see fit. I— I think its kosher. *It— It's sort of a December 19th kind of an action before December 19.*

Id. at 3. Mr. Fritts' frank admission that the initiation of the 8(a) proceeding is "sort of a December 19 kind of action before December 19" is an obvious allusion to the implementation of FDICIA, notwithstanding repeated denials by the government that FDICIA and its prompt corrective action requirements for undercapitalized thrifts had anything to do with the seizure.

The transcript reveals that the Board continued the discussion, focusing on the likely action of the State. In response to a question by Director Steinbrink as to whether the state will close the bank "if we don't issue this?" Mr. Fritts says only that "[t]hey will close it . . . down the road." *Id*. at 3-4.

Dir. Hope:	So when will it be out of tangible capital?
Mr. Fritts:	Well, tangible capital is really not an issue here because December the 19th, which is about eight days or nine days away, the test is 2 percent. And they're already there. You know. But – but if you use that as a t –
Dir. Hope:	But would it be out of tangible capital by – before December the 19th?
Mr. Fritts:	I don't think they will be. No.

Id. at 3-4.

When asked what the FDIC intended to do with respect to Meritor after recommending the insurance revocation proceeding, Mr. Fritts candidly remarked:

Mr. Fritts: Well, the next step is nothing if, in fact, what happens is what we think is going to happen, and that is that the bank is closed.

Dir. Hope: By the state regulator?

Mr. Fritts: Yes.

Dir. Hope: Okay.

Id. at 5. Director Steinbrink repeats his concern that the section 8(a) procedures are being misused:

Dir. Steinbrink: Does this – does this – I mean, I don't know if I even ought to ask this kind of question on the record. I mean, does this – *this appears, if I were sitting and looking at this in my own agency, that this is a CY – CYA 8(a).*

Id. (emphasis added). Steinbrink subsequently acknowledges that "it's unusual to have timing of this kind, in my opinion." *Id.* at 6. The transcripts of the November and December 1992 FDIC Board of Directors Meetings are attached as Exhibits 5 and 6, respectively.

Plaintiffs still have been severely prejudiced by the eleventh-hour production of the unredacted minutes and the transcripts. The transcripts alone represent a gold mine of information relating to issues of indemnification for Ms. Hargrove, Exh. 6 (PX 603) at 12-14, 24, Ms. Hargrove's intention not to close the bank for some time absent the FDIC's "support," *id.* at 2-4, 5-6, 23-24, the obsession of the FDIC to cause the closure of Meritor, even if it meant that it would have to indemnify Ms. Hargrove for any legal action arising out of the "state action," *id.* at 4-5, 7, 10-19, 21-22, and FDIC's interest in (1) avoiding FDICIA-mandated due process hearings; and (2) wiping out the $864 million reserve it posted for itself to the GAO in contemplation of a possible closure of Meritor in 1992. *Id.* at 3-4, 7-9. All of these facts are still contested by the government, and had the Plaintiffs had the unredacted minutes and

transcripts before trial, they could have had a field day with the government witnesses, such as Ms. Hargrove, who testified to the contrary

Had the evidence been furnished to Plaintiffs during discovery rather than after trial, Plaintiffs would most assuredly have deposed certain of the FDIC Directors. And while the government curiously notes the surprising lack of recall of government witnesses (Hartheimer, Fritts, Linehan) when shown the minutes, their denials of recall are plainly impeached by the belatedly produced transcripts and unredacted minutes. Of course, the transcripts could have been used to trigger recall. And while government counsel is candid enough to note counsel's own acknowledgement (in a deposition of a government witness) as to the seriousness with which the FDIC evaluated Ms. Hargrove's request for indemnification, *see* Gov't Opp. at 9, government counsel's admission does not constitute evidence that may be relied upon by the parties, or by this Court. Indeed, the record evidence is sparse on this point because of the alleged lack of recall among the government witnesses. It is nonetheless clear from the unredacted minutes and from the transcripts precisely how seriously the FDIC took Ms. Hargrove's request for indemnification. Indeed, that is why this Court may make adverse inferences: To undo the harm imposed by the government's wrongful actions.

CONCLUSION

The recent turn of events in this proceeding is nothing short of stunning. As it turns out, the government has withheld the most material evidence in the case – unredacted minutes and actual transcripts of the meetings of the FDIC Board of Directors in the days and weeks prior to the closure of Meritor. The decision to withhold the documents has never been justified, and the government's late efforts to provide the materials hardly remedy that wrong. Simply, the government's lone excuse – the Plaintiffs should have caught their "mistake" – is not supported

by the facts, and, in any event, neither gives license for the misconduct at issue nor constitutes grounds to deny relief for the government's misconduct.

For all the forgoing reasons, Plaintiffs respectfully request that their motion be granted and that the requested adverse inferences be ordered.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of ***Plaintiffs' Reply Memorandum in Support of Motion for Court to Draw Adverse Inferences Due to Spoliation of Evidence*** was hand delivered to:

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