INTO THE BREACH: WINSTAR DAMAGES

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I. INTRODUCTION

Early in 1942, after nations the world over had been plunged into the throes of war, President Franklin Roosevelt asked Prime Minister Winston Churchill for a suggestion about what the conflict should be called. "I said at once "The Unnecessary War,"" recalled Churchill in 1948 in the preface to his book The Gathering Storm. ""There never was a war more easy to stop than that which has just wrecked what was left of the world from the previous struggle." 1 Similarly, United States v. Winstar and all of the Winstar-related cases might well be called "The Unnecessary Litigation." During the 1980s, the Federal Deposit Insurance Corporation (the "FDIC") and the Federal Savings and Loan Insurance Corporation ("FSLIC") tried one method after another to alleviate, or at least improve the perception of, the foundering savings and loan industry. They reduced capital reserve ratios, directly injected capital, and created new accounting regimens to prop up the teetering thrifts. Towards this end, they turned to supervisory goodwill as a means to buy time, ballast to help the thrifts weather a few stormy years and reach calmer seas in the future. And indeed, this plan might well have succeeded, had Congress not thwarted it in 1989 with new legislation which banned the use of supervisory goodwill and once again set the thrifts adrift amid a troubled ocean. Many foundered, and these cases are the result.

Of course, the plight of Europe under the Axis heel is hardly comparable to the savings and loan debacle. Nonetheless, during the 1980s, the American thrift industry underwent a similarly distressing if less sanguinary experience. From 1980-1989, 747 thrifts failed, the highest number since the pre-FDIC days of the early 1930s.2 The S&L bailout will cost American taxpayers an estimated $481 billion.3 In addition, the crisis wiped out the equity of hundreds of institutions.

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3Id. This figure includes $87.9 billion spent by the Resolution Trust Corporation, the agency set up by Congress in 1989 to sell the assets of failed institutions, and $64.7 billion spent by FSLIC. The GAO figure is up to three times higher than previous estimates, mainly because it includes, in addition to direct expenditures, indirect costs such as the interest on FICO bonds.
Last July, however, in United States v. Winstar Corp., the Supreme Court held that the FDIC had breached its contracts with thrifts in supervisory goodwill cases. Currently, litigation is taking place at the Court of Federal Claims over the amount of damages in these cases, an amount that some have estimated may exceed $20 billion. For the S&Ls affected, the spectre of a huge damage payment appears like a phoenix rising from the dead ashes of the 1980s. But not everyone shares this view. The FDIC and the Department of Justice see the prospective damages as yet another fiscal disaster in a string of fiscal disasters that the S&L mess has spawned. After unsuccessfully arguing to the Supreme Court that the FSLIC did not breach its contracts, the Government now seeks to limit damages to the lowest amount possible, to stanch the flow from this open wound.

This paper, then, will address the critical issue in these cases: What amount of damages should the plaintiffs recover? To answer that question, one must consider what measure or measures of damages are appropriate, whether the plaintiffs failed to mitigate the damages, and finally the calculation of damages based on the actual cases. The individual facts are hard to come by and mainly in the possession of the opposing litigants. Thus, this paper strives to address the first two issues: to articulate the legal standard that should be used in determining what damages measure should be used and examine the leading cases through that prism.

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5GAO Report, supra note 2, budgets $9 billion as the net government outlay that will be required. Note, however, that this is lower than the gross amount of damages awarded because the FDIC should be able to recoup some losses as the subrogee of the depositors of failed thrifts.
II. ORIGINS OF SUPervisory Goodwill

Much has been written about the S&L debacle, and a full discussion of the thrift crisis in the 1980s lies beyond the scope of this paper. Nevertheless, in order to understand fully the issues in what are commonly referred to as the Winstar-related cases, it is necessary to recognize the factors that caused the crisis and the attempts regulators made to resolve it.

The postwar era was in many ways the golden age of thrifts. With home ownership expanding rapidly, borrowers were in large supply. Spurred by the demand for new housing after World War II, the number of thrifts quadrupled over 30 years, with 4,463 thrifts in 1964 holding nearly $115 billion in assets.6 By 1979, the eve of the S&L crisis 5,147 thrifts held $742.4 billion in assets.7 Moreover, the stringent regulations governing thrifts’ sources and uses of funds circumscribed their options and forced them to focus on residential mortgages, which had become highly profitable.

This halcyon era would not last forever. The massive government spending prompted by the Vietnam War and the Great Society Programs in the 1960s set off a spiral of high inflation and high interest rates that was exacerbated by the adverse oil supply shocks of 1973 and 1979. Moreover, in 1979, the Federal Reserve, under the helmship of Paul Volcker, began targeting interest rates in an attempt to halt the stagflation which had settled over the economy like a murky haze. As a consequence, nominal interest rates reached their zenith in May 1981, when three-month Treasury bill yields hit 16.3 percent.8 Further compounding the problem was the fact that because of the extraordinary growth in inflation, while nominal interest rates were at extremely high levels, real interest rates were actually negative, meaning that it was more profitable to borrow money than to lend it. Of course, the markets did not expect this perverse situation to continue, and thus the capital markets witnessed such anomalies as inverted yield curves, with the yields on 30-year Treasuries outstripped by three-month T-bills.

6PAUL Z. PILZER, OTHER PEOPLE’S MONEY 54 (1989).
8Id. at 68.
This situation posed a dire threat to savings and loans. Historically, thrifts had made money by borrowing money at short-term deposit rates and loaning it out at higher long-term mortgage rates. Until 1930, the average term for a mortgage was only 3-5 years, but terms had been increasing for several decades, so that the standard thrift portfolio in the early 1980s consisted primarily of 30-year fixed rate mortgages. Many of these had been made years earlier, when interest rates were much lower. In order to attract deposits, thrifts had to offer rates that were above the rate they were receiving on mortgages. Initially, however, they were prevented from doing so by Depression-era interest rate ceilings that capped the yield that thrifts and banks could pay on deposits. As a consequence, these traditional institutions lost deposit dollars to newer creations such as NOW accounts at mutual funds, which could pay unrestricted interest. Thus, the principal dilemma faced by the savings and loans: they were paying more for deposits than they were receiving for loans. Clearly, such a losing business could not continue to exist for very long. In fact, between 1981 and 1983, some 435 thrifts failed.9

Congress sought to correct the problem through several different avenues of reform. First, it relaxed restrictions on S&L investments; because thrifts had traditionally been involved in residential real estate lending, it seemed appropriate to allow them to venture into unsecured commercial real estate lending.10 In addition, Congress permitted thrifts to invest in commercial loans, state and municipal securities, and other new instruments.11 Second, in order to stanch the flow out of banks and thrifts, Congress eased interest rate restrictions in the early 1980s to allow banks and thrifts to compete with money market accounts for funds.12 Third, the Federal Home Loan Bank Board (the “FHLBB”) reduced thrifts’ required reserve ratios, allowing them to lend out a higher portion of their assets, and thus leverage their net equity to a greater degree. The required capital reserve ratio for thrifts dropped from 5 percent to four percent of assets in

9Winstar, supra note 4, at 2440.
November 1980, and from four percent to three percent in January 1982.\textsuperscript{13} Fourth, the FHLBB created a new set of thrift Regulatory Accounting Principles ("RAP"), as distinguished from Generally Accepted Accounting Principles ("GAAP").\textsuperscript{14}

RAP treatment differed from GAP treatment in a number of ways, all of which served to overstate the true value of thrifts' assets. The most critical of these differences revolved around supervisory goodwill. Because so many thrifts were at or close to failure, the FSLIC lacked the necessary funds to liquidate the failed thrifts and reimburse depositors. FSLIC's total reserves fell from $6.46 billion in 1980 to $4.55 billion in 1985, while the amount needed to close all insolvent thrifts had climbed to $15.8 billion.\textsuperscript{15} Recognizing this problem, the FHLBB encouraged healthy thrifts and outside investors to acquire ailing thrifts in what were termed "supervisory mergers." To encourage these mergers, the FHLBB allowed the acquiring thrift to account for the acquisition using the purchase method of accounting, which allowed the acquiror to treat the excess of the purchase price over the fair value of the insolvent thrift's assets as goodwill, an intangible asset that would be amortized over periods up to 40 years. The upshot of this was that goodwill would be counted as an asset when computing the assets of the new thrift for the purpose of capital reserve requirements. Between 1980 and 1986, over 300 supervisory goodwill mergers took place.\textsuperscript{16} Yet even despite the vast number of supervisory mergers, the FSLIC lacked sufficient funds to close down insolvent thrifts and reimburse depositors.

Ultimately, FSLIC had to be bailed out at an estimated cost of $140 billion to U.S. taxpayers.\textsuperscript{17}

The creation of supervisory goodwill provided acquiring thrifts with three important benefits: First, they were allowed to count the amount of goodwill as an asset for purposes of computing the capital reserve requirements. Effectively, then, a thrift with goodwill could reduce


\textsuperscript{14}\textit{Richard C. Breeden, Thumbs on the Scale: The Role that Accounting Practices Played in the Savings and Loan Crisis, 59 FORDHAM L. REV 571, 577 (1991).}

\textsuperscript{15}\textit{GENERAL ACCOUNTING OFFICE, TROUBLED FINANCIAL INSTITUTIONS: SOLUTIONS TO THE THRIFT INDUSTRY PROBLEM 108 (FEB. 1989).}

\textsuperscript{16}\textit{ibid. at 13.}

\textsuperscript{17}\textit{HOROWITZ, THE CONTINUING THRIFT BAILOUT, INVESTOR'S BUSINESS DAILY, Feb 1, 1996. Note that this figure does not take account of the additional millions lost by shareholders in these thrifts, and the concomitant collateral effects upon the economies in various parts of the country that were hard hit, such as Texas and Oklahoma. It also does not measure the indirect costs of this bailout, which are described in the GAO Report, supra note 2.}
its reserve requirement below the statutorily mandated 3 percent rate. This enabled thrifts to
further leverage their assets: for each dollar in goodwill, the thrift could make an additional $33
worth of loans. Second, thrifts were allowed to amortize goodwill over long periods up to 40
years. Under GAAP, businesses are allowed to amortize the price of assets over the lifetime of
the asset; because amortization results in a charge to earnings, the longer the amortization period,
the better. At the same time that the thrift acquired goodwill, however, it also had to recognize
the fact that many of its loans were worth less than their principal amounts because the thrift
was receiving a below-market yield. The difference between the market value and the principal
value of these loans was referred to as “discount.” Because loans are ultimately repaid at face
value, the amount of discount decreases as redemption nears. The average duration of these loans
was only 8 years, and thrift regulators permitted thrifts to accrete the discount over this 8-year
period. This created a mismatch: discount and supervisory goodwill were mirror images of one
another, yet the bank was able to amortize goodwill over 40 years while accreting discount over
eight. The net result of this treatment was artificially to inflate a thrift’s earnings, creating the
illusion of fiscal health. Third, in some cases FSLIC made a capital contribution to encourage the
acquisition of failing thrifts. Basically, it filled in part of the insolvent thrift’s net capital hole.
RAP treatment permitted acquiring thrifts to include FDIC’s capital contribution as well as the
entire net capital deficit in asset computations, which allowed double counting and inflated assets
for regulatory capital purposes.

Because the creation of supervisory goodwill was crucial to these mergers, the acquiring
parties entered into contracts with the FSLIC to ensure that supervisory goodwill treatment
would continue. This was necessary because RAP represented a substantial departure from
GAAP treatment. In 1983, the Financial Accounting Standards Board ("FASB") promulgated
Statement of Financial Accounting Standards Number 72 ("SFAS 72"), which concerned the
accounting treatment of thrifts.18 In SFAS 72, the FASB declared that discount and supervisory
goodwill would both be amortized at the same rate; that is, goodwill would be amortized over no

18 Accounting Standards, Original Pronouncements (July 1973-June1, 1989), 725.
longer than the period over which discount was accreted.\textsuperscript{19} This statement removed any doubt whatsoever that the RAP supervisory goodwill treatment was plainly inconsistent with GAAP. As a result, a central contractual element of these mergers was the FDIC’s promise to continue RAP treatment.

In 1989, in response to the savings and loan debacle, Congress passed and President George Bush signed into law the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA").\textsuperscript{20} One of the key provisions of FIRREA was the elimination of supervisory goodwill treatment. FIRREA required thrifts to “maintain core capital in an amount not less than three percent of the savings association’s total assets,” and defined core capital to exclude “unidentifiable intangible assets,” such as supervisory goodwill.\textsuperscript{21} The Act provided for a gradual phasing out of goodwill, with a transition rule that allowed thrifts to count supervisory goodwill toward half the core capital until 1995.\textsuperscript{22} Since FIRREA also called for higher capital reserve requirements, many thrifts’ effective reserve ratios rose from under 3 percent to 8 percent.

Despite the apparently clear mandate that the Act was designed to set firm capital standards applicable to all thrifts, FIRREA gave the Office of Thrift Supervision (the “OTS”) temporary authority to grant exceptions to the new capital standards until January 1, 1991.\textsuperscript{23} In addition, the OTS received authority to grant individual thrifts exemptions from any penalties for noncompliance with FIRREA’s capital standards.\textsuperscript{24} In fact, the OTS did not use either of these powers and made no exceptions or exemptions for any of the plaintiffs in the Winstar-related cases.

\textsuperscript{19}Ibid. at 725.
\textsuperscript{24}12 U.S.C. §1464(4)(7)(A),(B). The exceptions and exemptions that the OTS was authorized to grant were in fact quite limited. See, e.g. Plaintiffs in Winstar-related Cases v. United States, 37 Fed. Cl. 174, 1997 U.S. Claims LEXIS 5, 31-32 (1997).
FIRREA was a cold shower for thrifts. Many S&Ls which had relied upon RAP treatment now found that under GAAP that they were far too leveraged to comply with the new regulatory capital standards. Initially, numerous thrifts, including Statesman and Winstar, requested exceptions and exemptions from the new capital requirements, to no avail. Next, they sued to prevent the imposition of the new capital standards on the grounds that it was unconstitutional for FIRREA to interfere with their preexisting contract rights. These lawsuits failed as well. Finally, S&Ls were left with a choice: either decrease their loans or raise new equity capital, only by adopting one of these strategies could these thrifts possibly comply with the new FIRREA capital requirements.

III. FACTUAL BACKGROUND AND WINSTAR LITIGATION TO DATE

During the 1980s, the FSLIC approved over 200 separate thrift acquisitions involving goodwill. The three leading cases given priority by the Court of Federal Claims involve Glendale Federal Bank, FSB, Winstar Corporation, and the Statesman Group, Inc., which acquired failed thrifts in 1981, 1984, and 1985, respectively. In the wake of FIRREA, Winstar and Statesman’s thrifts failed to adhere to the new capital standards, and were seized and liquidated by federal regulators; Glendale’s thrift also fell out of regulatory capital compliance, but managed to avoid seizure through a massive private recapitalization.

Glendale was approached about a possible merger by the First Federal Savings and Loan Association of Broward County in September 1981, which at the time was insolvent to the tune of $734 million. Liquidating Broward would have cost FSLIC approximately $750 million. Glendale, which had a net worth of $277 million, agreed to the merger, and submitted a merger proposal to the FHLBB, the regulatory body which had to approve all thrift mergers. Under Glendale’s proposal, the merger would be treated as a purchase of assets for accounting purposes, and thus would create supervisory goodwill. On November 19, 1981, the FHLBB approved the merger, or “Supervisory Action Agreement,” which promised to permit Glendale to count the supervisory goodwill towards regulatory capital. In particular, FSLIC’s contract gave Glendale the right to count the net difference between the fair values of Broward’s liabilities and assets as goodwill for regulatory capital purposes, with $716 million of this amount to be amortized over 40 years.

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26 See United States Court of Federal Claims, Plaintiffs in All Winstar-Related Cases at the Court v. United States, Nos. 90-8 C, et al. Omnibus Case Management Order. See also Winstar, supra note 4, at 2447.
27 Winstar, supra note 4, at 2447.
28 Id. at 2448.
29 This is the amount that the FSLIC estimated it saved through the merger. See Winstar Corp. v. United States, 64 F.3d 1531, 1537 (Fed. Cir. 1995): “By the government’s estimates, the Glendale-Broward merger saved the government approximately three quarters of a billion dollars.”
30 12 U.S.C. §1467(a)(e)(1)(A) and (B); 12 U.S.C. §1817(j)(1); Winstar, supra note 4, at 2448.
31 Winstar, supra note 4, at 2448.
32 Glendale Federal Bank, FSB, v. United States, Civil Action No. 90-772 C, Plaintiff’s Motion In Limine Concerning Damages 3 (citing Statesman Savings Holding Corp. v. United States, 26 Ct. Cl. 904, 910-911, 913; and 64 F.3d at 1537, 1541.)
In 1983, FSLIC solicited bids for the acquisition of Wisdom Savings and Loan Association, a Minnesota thrift on the brink of failure.\textsuperscript{33} At the time, the estimated net cost to FSLIC of liquidating Wisdom was estimated at $12 million.\textsuperscript{34} A group of private investors formed Winstar Corporation for the purpose of acquiring Wisdom, and submitted a merger plan to FSLIC calling for capital contributions of $2.8 million from Winstar and $5.6 million from FSLIC as well as supervisory goodwill to be amortized over 35 years.\textsuperscript{35} The FHLBB approved the transaction. Consequently, FSLIC saved more than half the cost of liquidating the thrift. In the “Assistance Agreement” approved by the FHLBB, the section on accounting principles provided that the supervisory goodwill treatment mandated by the agreement would trump GAAP expressions to the contrary.\textsuperscript{36}

In the third transaction, Statesman approached FSLIC in 1987 regarding the possible acquisition of a subsidiary of First Federated Savings Bank, an insolvent Florida thrift.\textsuperscript{37} FSLIC would only agree to grant Statesman favorable accounting treatment if it acquired all of First Federated as well as three other failed thrifts in Iowa.\textsuperscript{38} FSLIC had solicited 96 financial institutions and 41 private investors to bid on the four thrifts, but Statesman was the only one to make a proposal.\textsuperscript{39} After protracted negotiations that lasted over twelve months, Statesman acquired the four deeply insolvent thrifts in March 1988.\textsuperscript{40} Statesman invested $21 million in the newly merged institution, while FSLIC contributed a $60 million capital infusion, but the

\textsuperscript{33}\textit{Winstar, supra} note 4, at 2450.
\textsuperscript{34}\textit{Id.} at 2450.
\textsuperscript{36}The Agreement contained the following section on accounting treatment:
“Except as otherwise provided, any computations made for the purposes of this Agreement shall be governed by generally accepted accounting principles as applied on a going concern basis in the savings and loan industry, except that where such principles conflict with the terms of this Agreement, applicable regulations of the [FHLBB] or the [FSLIC], or any resolution or action of the [FHLBB] approved or adopted concurrently with this Agreement, then this Agreement, such regulations, or such resolution shall govern. If there is a conflict between such regulations and the [FHLBB's] resolution or action, the [FHLBB's] resolution or action shall govern. For purposes of this section the governing regulations and the accounting principles shall be those on effect on the Effective Date or as subsequently clarified, interpreted, or amended by the [FHLBB] or the Financial Accounting Standards Board ("FASB"), respectively, or any successor organization to either. \textit{Winstar, supra} note 4, at 2450.
\textsuperscript{37}\textit{Id.} at 2450.
\textsuperscript{38}\textit{Id.} at 2450-51.
\textsuperscript{39}\textit{Winstar, S. Ct. Resp. Brief, supra} note 35, at 5 (citing C.A. App. 69 (under seal)).
\textsuperscript{40}\textit{Id.}, at 5.
institution remained insolvent by some $9 million. In addition, FSLIC promised to treat the $25.8 million of supervisory goodwill created in the transaction as regulatory capital that could be amortized over 25 years, and record FSLIC's $26 million cash contribution as a direct and permanent credit to the thrift's regulatory capital. Shortly thereafter, the Chairman of the FHLBB noted in Congressional testimony that the deal had cost the government "$50 million less than the cost to FSLIC of liquidating the four institutions." The parties also signed agreements similar to those in the Winstar transaction; according to the Regulatory Capital Maintenance Agreement, "any determination of [Statesman's] Required Regulatory Capital... shall include... amounts permitted by the FSLIC in the Assistance Agreement and in the forbearances issued in connection with the transactions discussed herein." After Congress passed FIRREA in 1989, all three of the above thrifts fell out of regulatory compliance because they were unable to satisfy FIRREA's new more stringent minimum capital standards. FIRREA's new capital requirements became effective when the OTS promulgated implementing regulations in on December 7, 1989. Initially, some thrifts filed suit to block implementation of the new standards, arguing that FIRREA did not change the accounting requirements for thrifts with preexisting forbearance agreements. However, these claims, while garnering some support in district courts, were rejected on appeal and the regulations allowed to stand. In addition, some thrifts made requests to the OTS for exceptions or exemptions from

41Id. at 5-6.  
42Id. at 6.  
43Id. at 6, citing Oversight on the Condition of the Financial Services Industry: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs, 100th Cong., 2d Sess. 356 (1988).  
44Winstar, supra note 4, at 2451.  
45Office of Thrift Supervision, Thrift Bulletin No. 38-2, Capital Adequacy: Guidance on the Status of Capital and Accounting Forbearances and Capital Instruments Held by a Deposit Insurance Fund (1990): "The Office of Thrift Supervision is applying the new capital standards to all savings associations, including those associations that have been operating under previously granted capital and accounting forbearances. All savings associations presently operating with these forbearances, therefore, should eliminate them in determining whether or not they comply with the new minimum regulatory capital standards.  
46For example, Transohio Savings Bank, a thrift which had undertaken a supervisory merger, sued the OTS and the FDIC claiming that the OTS had mistakenly interpreted FIRREA’s new capital requirements to invalidate its forbearance agreement. Transohio also sought to enjoin the implementation of the new minimum capital standards, to no avail. Michael S. Levitt, The Abrogation of Forbearance Agreements: FIRREA’s Ambiguities Demand a More Principled Analysis, 61 Geo. wash. L. Rev. 1314, 1317.  
the FIRREA capital standards, but these efforts were rebuffed as well. As a result, both the Winstar and Statesman thrifts failed to comply, were placed into receivership by federal regulators and then liquidated. Glendale managed to survive, but only through a massive private recapitalization plan. Nonetheless, in November 1992 Glendale fell below various regulatory capital requirements and was classified by the OTS as a "troubled thrift" under OTS regulations. Consequently, Glendale had to pay increased annual premiums of $14 million to the government for FDIC deposit insurance, as well as increased assessments of $4 million to the OTS because of Glendale’s capital problems.

After failing to acquire exceptions or exemptions, Statesman, Winstar and Glendale filed suit against the United States in the Court of Federal Claims, seeking damages based on contractual and constitutional theories. The trial court granted partial summary judgment to the plaintiffs on the question of contract liability, finding that the government had breached its contracts with them by eliminating the use of supervisory goodwill as regulatory capital. The court held that the government had entered into an express contract with Statesman and an implied-in-fact contract with Winstar and had breached its obligations, and rejected the government’s claims that it was protected by the sovereign acts and unmistakability doctrines. The court also consolidated the Statesman, Winstar and Glendale cases and certified its decisions for interlocutory appeal.

A divided panel of the Federal Circuit reversed the trial court’s rulings. However, the panel decision was vacated by a decision of the full court sitting en banc which affirmed the


48Glendale Motion, supra note 32, at 45.
49Id. at 45.
51Id. at 25.
52Winstar Corp. v. United States, 994 F. 2d 797 (Fed. Cir. 1993).
rulings of liability by the Court of Federal Claims.\textsuperscript{53} In July 1996, the Supreme Court affirmed this decision by a 7-2 vote, with Justice Souter writing an opinion for the four-justice plurality. Souter rejected the government’s claims of sovereign immunity because FIRREA was not a “public and general sovereign act.”\textsuperscript{54} In so doing, he stressed the importance going forward of requiring the government to be bound to its partners as though it were a private party, lest it find others unwilling to transact business with it. The Court remanded the case to the Court of Federal Claims to determine the correct level of damages.

There are currently 124 \textit{Winstar}-related cases pending before the Court of Federal Claims. All of these cases have been assigned to Chief Judge Loren Smith, who is serving as Managing Judge.\textsuperscript{55} Since all of the cases share certain characteristics, Judge Smith has assigned specific matters to “Issue Judges” for resolution in order to speed the trial process.\textsuperscript{56} In December, another judge resolved the issue of when the statute of limitations ran on thrift claims against the FDIC. The government argued that the statutory claim period commenced on the date FIRREA was signed into law, August 8, 1989. Plaintiffs argued that this date was too early; rather, they alleged, the claim period did not begin tolling until the OTS promulgated its implementing regulations, in December 1989. The resolution of this issue was important, because many of the plaintiffs filed suit in anticipation of the \textit{Winstar} decision in July 1996. Because the statute of limitations for these claims is six years, if the court accepted the government’s argument, all claims filed after August 9, 1995, would be barred. Other plaintiffs argued that the period began still later, when the thrifts were forced to comply with the new capital requirements. Rejecting the government’s argument, the Court held that the statute of limitations began to run when the

\textsuperscript{53}\textit{Winstar Corp. v. United States}, 64 F. 3d 1531 (Fed. Cir. 1995) (en banc).
\textsuperscript{54}\textit{See} 110 HARV. L. REV. 345, 348 (1996).
\textsuperscript{55}\textit{Omnibus Case Management Order}, 2.
\textsuperscript{56}\textit{Id.} at 2.
OTS promulgated its implementing regulations.\textsuperscript{57} The upshot of this was to deny the government’s motion to dismiss in all but two of the \textit{Winstar}-related cases.\textsuperscript{58}

Another issue common to many cases involving failed thrifts was the FDIC’s motion to substitute itself as plaintiff and its motion to intervene. When a thrift fails, it is placed in receivership by the FDIC. The FDIC must make the depositors whole by reimbursing them for their losses up to the level of federal deposit insurance, which is $100,000 per account. Thus, in \textit{Winstar}-related cases involving closed thrifts, two main parties in interest are attempting to recover damages: (1) the shareholders of the closed thrifts; and (2) the FDIC, which became the subrogee of the depositors when it made them whole. The critical question here is whether the FDIC will be able to recover instead of the shareholders of these closed thrifts. The FDIC filed on July 24, 1996 to substitute itself as plaintiff for failed thrifts in two goodwill cases, and later filed for an additional 42 cases.

Under FIRREA, the FDIC is the successor to FSLIC as conservator or receiver.\textsuperscript{59} Acting in its capacity as receiver, the FDIC may sue for breach of contract. According to the statute, the FDIC as receiver succeeds to all rights, powers and privileges of the insured depository institution.\textsuperscript{60} In this capacity, the FDIC can press all claims that would have been available to the failed institution.\textsuperscript{61} Therefore, no statutory provision prevents the FDIC in its capacity as receiver from bringing a breach of contract claim in federal district court against the FDIC in its corporate capacity or in the Court of Federal Claims against the United States.

\textsuperscript{58}The Court of Federal Claims granted the government’s motion to dismiss with respect to two plaintiffs that had filed after the statute of limitations had run: Ariadne Financial Services, which filed on April 16, 1996, and Shane, a shareholder in Mercury Savings and Loan, who filed on February 22, 1996. \textit{Id}.
\textsuperscript{59}12 U.S.C. §1821(a)(5).
\textsuperscript{60}The [FDIC] shall, as conservator or receiver, and by operation of law, succeed to...all rights, titles, powers, and privileges of the insured depository institution, and of any shareholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution. 12 U.S.C. §1821(d)(2)(A)(i).
\textsuperscript{61}“The conservator or receiver may enforce any contract, other than a director’s or officer’s liability insurance contract or a depository institution bond, entered into by the depository institution notwithstanding any provision of the contract providing for termination, default, acceleration, or exercise of rights upon, or solely by reason of, insolvency or the appointment of a conservator or receiver.” 12 U.S.C. §1821(e)(12). In addition, the statute provides that: “The [FDIC] shall have all the rights and remedies available to the insured depository institution (before the appointment of such conservator or receiver) and the [FDIC] in its corporate capacity, including removal to federal court and all appellate rights.” 12 U.S.C. §1821(d)(13).
As noted above, the FDIC as receiver can make claims on behalf of the failed thrift. The FDIC succeeds the RTC in its role of injecting capital into the failed thrifts that were subsequently repackaged and sold. In this scenario, the damages award goes to the FDIC as receiver. These funds cannot be commingled with other FDIC assets, for two reasons. First, the FDIC is a party to this case not in its corporate capacity but rather as a receiver succeeding FSLIC; the money must be distributed by the receiver to various claimants. Under this prioritization schedule, the FSLIC Resolution Fund has the highest claim as the subrogee of the depositors, since it made the depositors whole. Therefore, any funds paid to the FDIC qua receiver must go first to the FSLIC Resolution Fund. In January, the Court of Federal Claims ruled that the FDIC could not substitute itself as plaintiff in the *Winstar*-related cases. However, it did allow the FDIC to intervene in the cases involving closed thrifts. This opens the door for the FDIC as subrogee to recover the amounts it paid out to the depositors of these thrifts.

By far the most important question that has been addressed to date has been the issue of whether the plaintiffs would be allowed to present evidence relating to lost profits damages. As will be seen below, the government made a motion *in limine* concerning damages, requesting that the court issue an order specifying the standard to be applied in determining the amount of damages in the cases and precluding the introduction of evidence inconsistent with that

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62(1) Depositor Preference —

(A) IN GENERAL. — Subject to section 1815(e)(2)(c) of this title [12], amounts realized from the liquidation or other resolution of any insured depository institution by any receiver appointed for such institution shall be distributed to pay claims (other than secured claims to the extent of any such security) in the following order of priority:

(i) Administrative expenses of the receiver.

(ii) Any deposit liability of the corporation.

(iii) Any other general or senior liability of the institution (which is not a liability described in clauses (iv) or (v)).

(iv) Any obligation subordinated to depositors or general creditors (which is not a liability described in clause (v)).

(v) Any obligation to shareholders or members arising (including any depository institution holding company or any shareholder creditor of such company). 12 U.S.C. §1821(d)(9).

63—Notwithstanding any other provision of federal law, the law of any State, or the Constitution of any State, the [FDIC], upon the payment to any depositor...shall be subrogated to all rights of the depositor against such institution or branch to the extent of such payment or assumption.” 12 U.S.C. §1821(g)(1).


65Id.
standard. Specifically, the government pressed for a standard that did not permit damages for lost profits. The court rejected the government's motion, and held that the plaintiffs could introduce evidence to prove the amount of lost profits damages.

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66 Defendant's Motion In Limine Concerning Damages, and Opposition to Plaintiff's Motion In Limine, 1.
IV. LEGAL ISSUES

A. EXPECTATION DAMAGES

In general, the purpose of a damages award is put the injured party in the position he would have been in had the contract been performed.68 This idea of giving the injured party the benefit of his bargain is traditionally referred to as rewarding him with his "expectation interest."69 Normally, when a court concludes that there has been a breach of contract, it enforces the broken promise by granting the injured party expectation damages.70 The expectation interest is based not on the injured party’s hopes at the time of contract, but rather on the actual value the contract would have had to him had it been performed.71 Courts apply the expectation measure unless the use of this standard is for some reason inappropriate; for instance, if the plaintiff cannot show that the damages were foreseeable and prove the amount of damages with reasonable certainty, one of the two alternative measures of damages may be employed, and the plaintiff will have to be content with reliance damages or restitution.72 To recover expectation damages, the injured party must meet a three-part test. He must show that lost profits were foreseeable at the time of the contract, were proximately caused by the breach, and are calculable with reasonable accuracy.73 In the Winstar-related cases, the plaintiffs seek expectation damages from the government. In particular, they request that the court award them the amount of profits that they would have earned had the favorable supervisory goodwill treatment continued under the terms articulated in the contracts.

Traditionally, expectation damages have been broken down into two types. The first type, often referred to as “direct” or “immediate” damages, are those where the breach proximately

68Courts seek to “place the injured party in as good a position as he or she would have been in had the breaching party fully performed.” Wells Fargo Bank, N.A. v. United States, 88 F. 3d 1012, 1021 (Fed. Cir. 1996).
69Restatement (Second) of Contracts §344.
70Id. comment a.
72Or perhaps in some cases both of these, where they do not overlap.
73Statesman Savings Holding Corp. v. United States, Civil Action No. 90-773C, Memorandum of Law in Support of Plaintiffs’ Motion in Limine 9.
caused the harm to the plaintiff. The second type are known as “indirect” or “consequential” damages. No particular degree of separation, either temporal, geographic, or theoretical, and no particular number of intervening events, has ever been laid down as a hard and fast rule in answering the question whether damages are in fact recoverable. Nonetheless, over the years several general principles have developed which help to get a handle on the limits to recovery.

1. FORESEEABILITY

The first test is one of foreseeability: To be recoverable, the injured party’s damages must have been foreseeable at the time the contract was signed. According to Professor Farnsworth, “a party in breach is not liable for damages that the party did not at the time of contracting have reason to foresee as a probable result of the breach.” This sentence contains several very important nuances worthy of further elaboration. First, note that the relevant time when considering foreseeability is at the time of contracting, not at the moment of breach. Second, only the party in breach need foresee the damages; the rule does not require that the injured party actually foresee or have reason to foresee the damages. Third, the term “reason to foresee” is generally accepted to include those events actually foreseen by the breaching party. The Restatement (Second) of Contracts (the “Restatement”) provides that a loss may be foreseeable as a probable result of breach if it follows from the breach in the ordinary course of events or “as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.” Finally, it is important to note that the party in breach need only see that the damages are a probable, not certain, result of the breach.

The archetypal case regarding the foreseeability doctrine, Hadley v. Baxendale, created a distinction that has since prevailed between direct and consequential damages. Hadley declared that the injured party may receive damages that “may fairly and reasonably be considered [as]

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74 ARTHUR LINTON CORBIN, 5 CORBIN ON CONTRACTS §997 (1964).
75 Farnsworth, supra note 71, §12.13.
76 Restatement §351.
arising naturally, *i.e.* according to the usual course of things, from the contract itself.”

However, it denied recovery of “consequential” damages unless the loss was “such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract as the probable result of the breach of it.” Thus, *Hadley* carved out a distinction that has persisted, albeit with ebbs and flows, between direct and consequential damages.

In this case, the plaintiffs seek as damages the lost profits they allegedly would have earned had supervisory goodwill treatment been continued. Clearly, they are correct in their statement that expectation damages are the usual measure used to recompense injured plaintiffs. In fact, the government has not disputed this. The interesting question in this regard turns, however, on the degree to which lost profits can be considered a proximate or direct result of the government’s breach. If direct, they are fully recoverable in any case. If merely consequential, then they are only recoverable if they followed “as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.” The critical question, then, becomes whether the government had reason to know that lost profits would result from a breach.

The plaintiffs admit that as general rule, the breaching party is not presumed to foresee financial harm only remotely caused by the breach, so the plaintiff may recover only if the party in breach actually foresaw the special circumstances giving rise to collateral damages. Nonetheless, they argue that this stricter standard is inapplicable in this case; rather, they declare that where, as here, “if the purpose of the contract was for the plaintiff to make profits, then it is, by definition, foreseeable (and actually foreseen) that a breach will directly deny the plaintiff those profits, *i.e.* the very benefit of its bargain.” In support for this proposition, plaintiffs

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79 *Id.* at §12.14.
80 We do not challenge the fact that Statesman is entitled to seek legitimate expectancy damages, but we do challenge Statesman’s method of calculating those damages, and the losses that Statesman claims would have occurred.” Defendant’s Motion *In Limine* Concerning Damages, and Opposition to Plaintiff’s Motion *In Limine* 13.
81 Restatement §351.
82 Statesman Mem. of Law, *supra* note 73, at 10.
83 *Id.* at 10.
cite the recent decision in *Wells Fargo Bank, N.A. v. United States*, which declared that damages were recoverable when "the very purpose of the contract... was for the plaintiffs to make profits on the subject of the contract."\(^8^4\)

While this argument represents an interesting twist in its use of *Wells Fargo* as support, it clearly has a logical limit. In a sense, the purpose of *every* contract is for the plaintiff to make profits, else why would the plaintiff make the contract in the first place? But such an expansive reading of "purpose" to include this background purpose that infuses every contract, as well as most other corporate acts, would vitiate the rule of *Hadley* and blur to illegibility the distinction between direct and consequential damages in any lost profits case. Rather, the rule must be somewhat more narrow. In fact, a close reading of the *Wells Fargo* excerpt cited by the plaintiffs provides some assistance: The Federal Circuit in *Wells Fargo* speaks not of a purpose or some purpose but rather of the purpose, intimating that in order to be recoverable, lost profits must have been the primary, or at least one of the primary, purposes for entering into the contract.

Consequently, we are forced to look at each transaction to determine whether its primary purpose was to garner profits for Winstar, Glendale, and the other thrifts. Clearly, in any negotiating session, the parties to a contract will have different reasons for entering into a binding relationship. In promoting supervisory mergers, FSLIC's main purpose was to arrange for an alternative way of making depositors in failed thrifts whole that would be less expensive than liquidation, and more politically palatable than raising taxes. In doing so, FSLIC should have been cognizant of the long-term implications of its strategy. As it recognized, the FSLIC fund was becoming increasingly pusillanimous next to the ballooning bailout costs. If the combined thrift were not able to earn greater profits as a result of the transaction, FSLIC's cleanup responsibilities could wind up even worse than before. What FSLIC hoped to do was combine strong thrifts with weaker ones, and by relaxing capital reserve standards, give strong thrifts a hand in propping up failing thrifts. If the combined thrift went on to profitability, this arrangement would alleviate FSLIC's liquidation burden. But if, on the other hand, the failing

\(^{8^4}\)Id. at 12, citing *Wells Fargo*, *supra* note 68, at 1023.
thrift turned out to be merely a drag on the strong thrift's earnings, FSLIC ultimately would have to bail the combined institution out, a far less palatable alternative given that FSLIC was already $50 billion in the red.\textsuperscript{85} Of course, the acquiring thrifts themselves entered into these agreements largely because of the supervisory goodwill treatment they were afforded. Indeed, the Supreme Court noted in its \textit{Winstar} plurality opinion that it "would, indeed, have been madness" for any of the acquiring thrifts to engage in these transactions without the benefit of goodwill treatment, for they would have been immediately insolvent (or at least less solvent) to the tune of the difference between the failed thrift's assets and liabilities.\textsuperscript{86}

Why, then, did the acquiring thrifts agree to the transactions? The answer must be that they saw them as a way effectively to lower their capital reserve ratios. As noted above, supervisory goodwill was counted as an asset for computing capital reserve requirements. As a result, if two thrifts each had the same amount of assets, and then one of them acquired a thrift that was insolvent by $100 million, the acquiror could make an additional $3 billion worth of loans. Obviously, a thrift has the potential to earn more profits the more loans it makes, by allowing a thrift greater leeway to leverage its capital, supervisory goodwill would permit it to earn higher profits. In its \textit{Winstar} opinion the Supreme Court agreed with this assessment: "From Glendale's perspective, however, the treatment of supervisory goodwill was attractive because it... allow[ed] the thrift to leverage more loans (and, it hoped, make more profits)."\textsuperscript{87} Moreover, the plaintiffs point to the government's own statements in oral argument before the Court, where the FDIC's counsel declared that "the leveraging [Glendale] was getting was enormous. They could have made enormous profits."\textsuperscript{88} These statements, as well as a rational view of the transactions from the plaintiffs' perspective, provide persuasive evidence that lost profits were the primary purpose of the transactions.

\textsuperscript{85}\textit{Winstar, supra} note 4, at 2441.
\textsuperscript{86}\textit{Id.} at 2451.
\textsuperscript{87}\textit{Id.} at 2443.
\textsuperscript{88}\textit{Winstar, supra} note 4, April 24, 1996, Oral Arg. Tr. at 11-12. See also Glendale Motion at 21.
Unfortunately for the plaintiffs, that does not end the matter of foreseeability. The government argues that the contracts between FSLIC and the thrifts can best be analogized to a contract to lend money. In such a contract, the traditional measure of damages is not the amount of profits that the recipient would have earned on the loan, but rather the sum owed. The government bases this argument on *Estate of Berg v. United States*, where the United States government failed to redeem treasury bills at face value, as it was required to do when the proceeds would be used to pay estate taxes. In that case, the damages awarded were the difference between the fair market value of the bonds at the time of breach and their par value; not the interest that the plaintiff would have received from the other money that it had to use to pay the estate taxes. In addition, the government points to *Myerle v. United States* as standing for the proposition that if profits are "such as would have been realized by the party from other independent and collateral undertakings, although entered into in consequence and on the faith of the principal contract, they are too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of the contract in suit." In *Northern Helex Co. v. United States*, the Claims Court followed this prescription, allowing damages for profits lost from the instant transaction, while denying them for profits lost from collateral transactions. Concluding the argument, the government insists that "a plaintiff's losses or gains from separate contracts are irrelevant to the calculation of damages. All that matters is the market value of what was lost from the breached contract."

While it remains true, as noted above, that remote, collateral damages are not recoverable, the government's argument for a *per se* rule limiting damages to the sole transaction undertaken in the contract is not well taken. First, it runs flatly contradictory to Professor Corbin's well-accepted statement that there is no set line, either temporally, spatially, or cognitively, that demarcates the

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89 Def. Motion, *supra* note 66, at 26-27.
90 *Estate of Berg v. United States*, 687 F.2d 377 (Ct. Cl. 1982).
91 See Def. Motion, *supra* note 66, at 27.
See also Def. Motion, *supra* note 66, at 30.
94 Id. at 30.
remote from the direct. Clearly, the presence of other transactions and their proximity to the immediate contract should constitute a factor in determining remoteness. However, there appears little reason to create an artificial construct such as the presence of other transactions as the sole measure of remoteness; there is little reason to believe that this would serve better than a half dozen other arbitrary standards that might be used. Most damning, however, is that the government's argument would prevent lost profits damages in cases where the "collateral" transactions were a recognized element of the initial contract.

The main problem, however, with the government's argument is that the cases it cites provide scant support. For instance, *Estate of Berg, Myerle*, and several of the others involved general contracts where the government was obliged to pay money to the recipient. In such cases, it is reasonable to say that profits the recipient might have earned on other transactions enabled by the receipt of money are too remote from the transaction at hand. Conversely, when the contract is specifically designed to allow the recipient to make profits, then the presence of collateral transactions should not preclude recovery, because their existence was a presumed part of the contract. According to the government, its breach of the contract to provide regulatory capital guarantees "is tantamount to the Government failing to pay Statesman a sum of money owed to it."95 The plaintiffs attempt to distinguish the supervisory goodwill contracts from the line of cases cited by the government by arguing that these contracts did not concern the payment of money to the plaintiffs, and that if such money had been paid, they would not have been in as good a position as if the regulatory capital guarantees had been extended.96 Clearly, the government's obligation to provide regulatory capital is not exactly the same as an obligation to advance funds. But if, hypothetically, the government had decided to scrap the regulatory capital treatment and instead had given the plaintiffs cash instead (as plaintiffs suggested at one point to the FDIC), it is difficult to see why the plaintiffs would not have been better off. The thriffs

95Id. at 26. See also Statesman Statesman Savings Holding Corp. v. United States, Civil Action No. 90-773C, Plaintiffs' Opposition to Defendant's Motion In Limine Concerning Damages and Reply to Defendant's Opposition to Plaintiffs' Motion In Limine 19.
96Statesman Reply Brief, supra note 95, 19.
could have used the additional capital to expand their loan base, just as they did with regulatory capital; in this sense, actual cash and regulatory capital are very similar, because they both constitute assets on which a thrift can earn a return. Moreover, unlike supervisory goodwill, cash is not subject to amortization. Therefore, to some extent the government is justified in arguing that the contract here was similar to a contract to lend money.

This causes serious problems for the plaintiffs in the wake of the recent Wells Fargo decision. In Wells Fargo, the government promised to guarantee a loan made by the plaintiff bank to finance construction of an ethanol plant. Though the bank made the loan, the government refused to issue the guarantee, and the bank was forced to charge the loan off as a loss because the unguaranteed loan was virtually worthless. The bank pressed a claim not only for the amount of the guarantee, but also the lost profits from loans that it would have undertaken had it not been forced to contract its loan base to comply with capital reserve requirements as a result of the charge. The Court of Federal Claims awarded lost profits damages, but was reversed on appeal by the Federal Circuit, which stated that “remote and consequential damages are not recoverable... especially... in suits against the United States.” Moreover, the court found that “Wells Fargo’s loss of interest on additional loans it could have made had there been no breach is ‘too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of contract in this suit.’” Ultimately, the court awarded $389,423 in damages equivalent to the amount of the guarantee, but denied Wells Fargo’s claim for lost profits damages of $10.5 million on the other loans it could have made.

In a sense, the Wells Fargo decision is very troubling for the Winstar-related plaintiffs. The game at this point is for the plaintiffs to distinguish Wells Fargo, while the government attempts to bring these cases under the Wells Fargo umbrella. To that end, the government applies the reasoning that “just like the bank in Wells Fargo, Statesman seeks profits it speculates the thrift

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97Wells Fargo, supra note 68.
98Id. at 1021; see also Def. Motion, supra note 66, at 32-34 for discussion of Wells Fargo.
99Id. at 1023 (citing Ramsey v. United States, 121 Ct. Cl. 426, 101 F.Supp. 353 (1951), cert. denied, 343 U.S. 977 (1952)).
100Id. at 1025.
would have earned from separate transactions” in contrast to “profits the thrift would have earned from the contract that was breached.”

According to the government, the common thread is the presence of “at least one intervening causal step between the government’s breach and the claimed lost profits” in both Wells Fargo and Winstar.

On the other hand, the Wells Fargo opinion also contains language quite helpful to the Winstar-related plaintiffs. First, it distinguished Neely v. United States, a case which plaintiffs have attempted to use as support for their lost profits claim. In Neely, the plaintiff, a mining company, leased land from the government for the purpose of strip mining coal and selling it at a profit. Though the plaintiff had informed the government of its intention to strip mine the coal, after the contract the government refused to allow the plaintiff to mine the coal in this fashion. The court awarded damages in the amount of lost profits that the plaintiff would have earned on sales of the coal it would have mined. The Wells Fargo court distinguished Neely by pointing out in Neely, the only purpose of the contract was for the plaintiff to make profits on the subject of the contract, not to make profits in general. Similarly, the court held, “the purpose of the guarantee was to enable Wells Fargo to make profits from the interest on its loan to High Plains, not on some other loans that it might make.”

The question, then is which element of the Wells Fargo holding trumps: the fact that there were intervening steps, or the fact that the lost profits were not part of the purpose of the contract? The answer to this question should establish whether Wells Fargo supports the plaintiffs’ argument or the defendants’.

An objective reading of Wells Fargo supports the contention that the purpose of the contract is more central to the court’s reasoning than is the presence or absence of “intervening causal steps.” True, the court does use the latter term twice during the opinion; but on both occasions it is quoting the Court of Federal Claims’ opinion that “the lost capital damages

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101 Def. Motion, supra note 66, at 34.
102 Id. at 35.
104 Wells Fargo, supra note 68, at 1023. This is also discussed briefly in Statesman Mem. of Law., supra note 73, at 19.
105 Id. at 1023.
claimed by Wells were foreseeable at the time of contracting, and...there was no intervening causal step between the government's breach and the damages claimed by Wells."\textsuperscript{106} Other than these two moments when it is simply rejecting the holding of the lower court, the circuit court does not rely upon the notion of "intervening causal steps." On the other hand, the court does stress the centrality of the purpose of a contract in its reasoning. For instance, in distinguishing \textit{Neely}, the court notes that there

"the profits lost on the mine were caused directly by the breach and were proven with certainty. Unlike the present case, the profits lost in \textit{Neely} were profits on the use and the subject of the contract itself. Indeed, the only purpose of the contract in \textit{Neely} and the other cases was for the plaintiff to make profits on the subject of the contract -- through mining, dairy cow operations, or property resale."\textsuperscript{107}

Thus, while the court staunchly supports the position that lost profits from unrelated business transactions are never recoverable against the government, it measures the degree of relation not through intervening causal steps, but rather by whether the plaintiff's profits comprised the purpose of the contract.

Emphasizing the purpose of the transaction does not ensure the plaintiffs' victory on this point. Nonetheless, it is hard to see what the purpose of the regulatory capital could be, if not to enable the thrifts to earn additional profits by allowing them to keep lower reserves. The available evidence provides ample support for this proposition. For instance, a key element in all of the transactions were the projections that the acquiring thrifts put together to show the salutary effect of regulatory capital on profits. The FHLBB placed a strong emphasis on these in deciding whether or not to approve each transaction. Additionally, in some cases FSLIC negotiated to receive a share of the profits that would result from the acquisition. And finally, of course, there is the fact that supervisory goodwill was dreamed up by FSLIC itself as a means of resolving the thrift fiasco. The origins of the treatment lend credulity to the assumption that FSLIC was fully cognizant of the importance of supervisory goodwill to the plaintiffs, and

\textsuperscript{106}Id. at 1022.
\textsuperscript{107}Id. at 1024.
recognized that its sole value to thrifts was to permit them to engage in additional leveraging. Indeed, the government’s own statements corroborate this, particularly government counsel’s concession in oral argument before the Supreme Court that “the leveraging they [Glendale] were getting was enormous. They could have made enormous profits.”\textsuperscript{108} Taken together, these facts provide strong support for the argument that profits were an “essential element” of the bargain struck between the two parties. Unlike in \textit{Wells Fargo}, the “loan” made by the government here was in fact designed to allow the entire S&L institution to make profits. As plaintiffs argue, “the difference between this case and \textit{Wells Fargo} is that the subject matter of the contract here was not one loan, but was the entire thrift. While the government’s guarantee in \textit{Wells Fargo} enabled the bank to realize profits on only one loan, the government’s regulatory capital guarantee here facilitated profits on any loans supported by the bargained-for regulatory capital.”\textsuperscript{109} Consequently, profits represented one of if not the primary purpose of the contract, and should not be excluded as consequential or indirect.

2. \textbf{ACTUAL FORESIGHT}

The rule articulated in \textit{Hadley} denied damages unless the loss was “such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract as the probable result of the breach of it.”\textsuperscript{110} In that famous case, the court rejected lost profits damages because the carrier did not know that any delay he caused would result in the mill’s sitting idle. Springing from that case, the basic rule now is that damages otherwise remote and consequential, because they could not be said to derive naturally from the contract itself, are recoverable if the party in breach had actual knowledge or reason to know of the results of a breach. The Restatement supports this view, stating:

\textsuperscript{108} Oral Arg. Tr., \textit{supra} note 88, at 11-12.
\textsuperscript{109} Statesman Mem. of Law., \textit{supra} note 73, at 22.
\textsuperscript{110} Ex. at 354, 156 Eng. Rep. at 151, as quoted in Farnsworth, \textit{supra} note 71, at §12.14. Farnsworth provides a more complete discussion of the issues in \textit{Hadley} than is possible or advisable here.
(1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.

(2) Loss may be foreseeable as a probable result of a breach because it follows from the breach
   (a) in the ordinary course of events, or
   (b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.\textsuperscript{111}

Included within the term “reason to know” is the case where the breaching party has actual knowledge of the losses that will follow from a breach. For instance, Farnsworth notes that in \textit{Hadley}, “[h]ad the miller notified the carrier of all the circumstances, the result would presumably have been different.”\textsuperscript{112} Thus, it has become well-established that a breaching party with actual knowledge or who can be charged with reason to know will face liability for damages that would otherwise be remote or consequential; that is, the first part of the \textit{Hadley} test on foreseeability only applies in the absence of reason to know or actual knowledge.

In this case, lost profits will not be barred on foreseeability grounds if the plaintiffs can establish that the government knew or had reason to know that the result of its breach of the regulatory capital promise in the contract would cause the plaintiffs to lose profits. Thus, even if as a matter of law the lost profits were too remote for recovery, if as a matter of fact the government knew they would result, it cannot escape damages on foreseeability grounds.

Several arguments may be put forth in support of plaintiffs’ recovery on this score. Perhaps the strongest claim is that the economic realities of the transaction dictate that FSLIC must have contemplated profit potential at the time of contracting. In support of this, plaintiffs may point to the acquired thrifts’ capital positions at the time of acquisition. For example, when Statesman Group acquired the four failed thrifts, they had net negative capital of $9 million. This means that they were insolvent by $9 million. From the start, then, the success of the acquisition depended upon FSLIC’s continuation of regulatory capital treatment. In fact, it is safe to say

\textsuperscript{111}Restatement (Second) of Contracts §351.
\textsuperscript{112}Farnsworth, \textit{supra} note 71, at §12.14.
that without a commitment to such treatment, the acquisition would never have taken place at all. The Supreme Court’s statements fully support this proposition:

"[T]heft regulators let the acquiring institutions count supervisory goodwill toward their reserve requirements under 12 C.F.R. §563.13 (1981). This treatment was, of course, critical to make the transaction possible in the first place, because in most cases the institution resulting from the transaction would immediately have been insolvent under federal standards if goodwill had not counted toward regulatory net worth. From the acquiring thrift’s perspective, however, the treatment of supervisory goodwill as regulatory capital was attractive because it inflated the institution’s reserves, thereby allowing the thrift to leverage more loans (and, it hoped, make more profits)."\(^{113}\)

Thus, it is evident that regulatory capital treatment represented the linchpin of the thrifts’ survival and potential success; without it, they would have been insolvent from day one. Knowing this, it is no stretch to conclude that\(^{113}\) cessation of such treatment would have serious adverse consequences for thrifts by reducing both their asset bases and their earnings. Another part of the puzzle regarding economic realities is the question of why the acquiring thrifts were willing to undertake these acquisitions in the first place. As the Supreme Court noted above, the thrifts hoped to use the supervisory goodwill obtained in the purchases to enhance their leverage and increase their profits. Indeed, the government conceded that “it was the profit-making potential of these transactions that led respondents to engage in them.”\(^{114}\) The fundamental point here is that the thrifts had no use for the supervisory goodwill other than as a mechanism for leveraging more loans. It had no cash value; there was no market for secondary goodwill. All supervisory goodwill could be used for was to create more leverage which would increase the prospects for profitability. This fact must have dawned on FSLIC regulators who had dreamed the idea of supervisory goodwill in the first place. Or did they just assume that Winstar, Statesman, Glendale and others were willing to make these acquisitions out of sheer beneficence? It strains credulity to argue that FSLIC did not realize, during the course of over 120 separate acquisitions, why supervisory goodwill would be attractive to thrifts. Moreover,

\(^{113}\) Winstar, supra note 4, at 2443.

\(^{114}\) Winstar, supra note 4, Reply Br. of the United States, at 9. This is cited in Statesman Mem. of Law, supra note 73, at 27.
but a small logical step remains between comprehending why regulatory capital treatment was attractive to understanding the implications of taking it away.

Even if, contrary to reason, FSLIC’s full understanding of the attraction and dangers of goodwill cannot be assumed, Statesman points to direct evidence that FSLIC had contemporaneous knowledge of the impact of a breach. First, the Assistance Agreement states as one of the transaction’s purposes that “the ACQUIRING CORPORATION [Statesman Group] may receive the benefits and assume the risks contracted for, and expense to the CORPORATION [FDIC] may be reduced.”¹¹⁵ This statement does little to prove Statesman’s point, however, as it does not define the “benefits” contracted for; indeed, the benefits could be, as FSLIC has argued, simply construed as the right to have supervisory goodwill –- it says nothing about profits. More convincing, however, is the fact that FSLIC contracted to share in a portion of the future profits earned by Statesman.¹¹⁶ Finally, Statesman cites the business plans and earnings projections presented by Statesman when it sought approval of the acquisition by the FHLBB. The projections included explicit qualifications noting that the figures were dependent upon the assumption that the government would continue to accord regulatory capital treatment to Statesman.¹¹⁷ While these pieces of evidence do not prove that FSLIC accepted the inevitability of profits, they do support Statesman’s claim that FSLIC was cognizant of the plaintiffs’ motivations. It is worth recalling at this point that the Restatement and controlling cases do not mandate that the breaching party foresee injury as absolutely certain, but merely probable.¹¹⁸ Just as lost profits would have been foreseeable in Hadley if the miller had told the carrier that the mill stood idle while the crankshaft was being repaired, in the Statesman acquisition it appears that the government was put on notice that the plaintiffs were relying on supervisory goodwill to earn greater profits.

¹¹⁵Statesman Mem. of Law, supra note 73, at 28
¹¹⁶id. at 28.
¹¹⁷id. at 29.
¹¹⁸Restatement §351.
In countering the plaintiffs' arguments, the government advances the proposition that the party in breach is not liable for consequential damages unless it had entered into a "tacit agreement" to assume that liability at the time of contract.\textsuperscript{119} In support, they rely on \textit{Globe Refining Co. v. Landa Cotton Oil Co.}, quoted in Farnsworth's \textit{Contracts}, where Justice Holmes wrote for the majority that the scope of damages "should be worked out on terms which it fairly may be presumed he would have assented to if they had been presented to his mind."\textsuperscript{120} This would create a stricter standard than that contemplated in \textit{Hadley}. The government neglects to mention, however, that the \textit{very next sentence} in Professor Farnsworth's treatise reads as follows:

The underlying concept of damages as somehow based on agreement between the parties has not prevailed, however. The "tacit agreement" test has been generally rejected as overly restrictive and doctrinally unsound, and it is explicitly condemned in the comments to the Uniform Commercial Code."\textsuperscript{121}

Thus, the modern trend represents a narrowing of the \textit{Hadley} foreseeability limitation, not an expansion of it. Moreover, the government implies that the Supreme Court expressed support for the \textit{Globe} tacit agreement test in its \textit{Winstar} opinion.\textsuperscript{122} In fact, the Court never cites \textit{Globe}. Further, the government claims that the Court "approvingly acknowledged the principle that damages for breach of contract should be based upon what the breaching party could be expected to have agreed to if the matter had been negotiated at the time of contract formation."\textsuperscript{123} This statement mischaracterizes the Supreme Court's statement in two ways. First, the quoted statement from the defendants' brief implies that the judgment of whether the party in breach would have agreed to certain damages shall be determined from that party's perspective; in fact, the sentence from Posner and Rosenfield that the Court cited speaks of "contract terms that the

\textsuperscript{119}Farnsworth, supra note 71, at §12.14.
\textsuperscript{120}Globe Refining Co. v. Landa Cotton Oil Co., 190 U.S. 540, 543(1903); see also Farnsworth, supra note 71, at §12.14.
\textsuperscript{121}Id. at §12.15; see also UCC 2-715, Comment 2 ("The 'tacit agreement' test for the recovery of consequential damages is rejected.")
\textsuperscript{123}Id. at 48.
parties would probably have adopted.”¹²⁴ More importantly, the citation appears not in a discussion of damages measurements but rather an appraisal of the government’s unmistakability defense. As such, it is *dicta* and if at all relevant to the damages issue is certainly not controlling.

The government cites two additional sources for support of the tacit agreement test. According to Cooter and Eisenberg, “the injured party’s recovery should be measured under the damages rule the parties would have agreed to at the time of contract formation if they had bargained under ideal conditions and had addressed the issue.”¹²⁵ Likewise, the government quotes Scott to the effect that “[w]here transactions costs are high for parties to fashion their own rule, it may be normatively correct to provide them with the rule they probably would have chosen for themselves had they been able to bargain.”¹²⁶ These sources provide only a thin veil of support for the government, if that. The government cites no recent cases in favor of the *Globe* court’s tacit agreement formulation, and must rely solely on theorists to prop up its argument. Unfortunately, these pillars fail to support the proposition; the quotation from Scott speaks of instances where transactions costs are too high for parties to create their own rule; there is no reason to believe that transactions costs were prohibitively high in these acquisitions. Finally, these arguments are founded on economic notions of efficiency rather than legal bases such as precedent.

Following its discussion of the tacit agreement test, the government argues that had the thrifts and FSLIC included a damages measurement in the contracts, FSLIC “[c]learly” would not have agreed to any measure that provided for damages for “speculative profits.”¹²⁷ But this is not axiomatic. The government bases its argument on the notion that “[t]here simply would have been no rational reason” for FSLIC to accept a lost profits measure, “especially when the loss of the thrift could have been avoided by replacing the eliminated capital.”¹²⁸ One wonders. Two

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¹²⁶*Id.* at 48, citing SCOTT, THE CASE FOR MARKET DAMAGES: REVISITING THE LOST PROFITS PUZZLE, at 1172.
¹²⁷*Id.* at 49.
¹²⁸*Id.* at 50.
factors seem to point in the opposite direction. First, at the time of the Statesman contract, the FDIC had a deficit of $50 billion. It was under severe pressure to solve the S&L crisis without exacerbating costs to the American taxpayer. Therefore, in any contract negotiation at the time, FSLIC did not obviously have the upper hand; its options were to liquidate the thrift, which would cost $9 million up front, sell to Statesman, or wait around for another suitor, while savings and loan failures were increasing rapidly. Consequently, its position was more reminiscent of the Alamo than Thermopylae, and any a priori conclusion about what FSLIC would have agreed to is unwarranted. Second, the government’s statement suggests that FSLIC would have been foolish to gamble with the risk of paying higher lost profits damages. The flaw in this argument is that it assumes that a breach was inevitable. Otherwise, the FDIC could very rationally have concluded that it was better off taking the chance of a breach and paying higher lost profits damages. By taking this chance, FSLIC postponed any payment it would have to make, surely a strong incentive for an insolvent institution, and also may have lowered the expected value of its payout, so long as it perceived the probability of breach as sufficiently low.

All in all, then, it appears that the plaintiffs have made out a formidable case that the government possessed actual foresight that a breach would engender lost profits. Under the language of the Restatement and numerous supporting cases, this should suffice to establish foreseeability and ensure that the plaintiffs’ damages claims are not barred on these grounds. Of course, discovery is still continuing, and the government may marshal evidence that refutes the plaintiffs’ claims that FSLIC knew or reasonably should have known that lost profits would ensue. At this preliminary stage, however, the plaintiffs’ evidence and arguments remain more compelling.
3. Certainty

The general rule in contracts damages cases is that recovery for lost profits will be allowed only if their loss is proved with a reasonable degree of certainty. When first developed by American courts during the mid-19th century, the certainty requirement posed a more onerous burden for the plaintiff, declaring that damages must "be shown with certainty, and not left to speculation or conjecture." Since then, the test has been relaxed to require only reasonable certainty, which proves less of an impediment to plaintiff's recovery. The Restatement has adopted this modern view, stating simply that "[d]amages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty." Moreover, damages need not be calculable with mathematical precision, but may be approximated, and an increasing willingness of courts to rely on expert testimony regarding economic and financial issues has served to alleviate the plaintiff's task of proving certainty.

Importantly, the key issue here is whether the probability of injury can be established with reasonable certainty, not whether the exact amount of damages is calculable. In a sense, the certainty requirement acts in a similar manner to the foreseeability requirement and the causation requirement; the plaintiff must show that the profits lost were sufficiently certain to occur in the absence of a breach. In Story Parchment Co. v. Patterson Parchment Paper Co., the Supreme Court laid down the rule that "if a reasonable probability of damage can be clearly established, uncertainty to the amount will not preclude recovery." Therefore, any certainty inquiry must focus on the question of whether lost profits would have occurred before tackling the question of what they would amount to. Moreover, failure to determine precisely the latter question will not preclude recovery if it can be shown that lost profits of some amount were reasonably certain.

131Restatement §352.
132Restatement §352 comment a.
As the Court has stated, "certainty as to the amount goes no further than to require a basis for a reasoned conclusion." Professor Corbin states the rule somewhat more eloquently:

There are many cases in which, by reason of the experience and belief of mankind, the trial court is convinced that substantial pecuniary harm has been inflicted, even though its amount in dollars is incapable of proof. If the defendant had reason to foresee this kind of harm and the difficulty of proving its amount, the injured party will not be denied a remedy in damages because of the lack of certainty."

The Court of Claims also specifically adopted this rule in Joseph Pickard's Sons Co. v. United States, where it declared that "there is a clear distinction between the measure of proof necessary to establish the fact that petitioner had sustained some damage, and the measure of proof necessary to enable the jury to fix the amount. The rule which precludes the recovery of uncertain damages applies to such as are not the certain result of the wrong, not to those damages which are definitely attributable to the wrong and only uncertain in respect of their amount." The increasing reluctance of courts to use the certainty requirement as a bar to lost profits recovery may be due in part to the belief that the defendant should not be unjustly advantaged by the plaintiff's difficulty of proof, especially since the defendant's breach caused the injury in the first place. Consequently, while the burden of proving reasonable certainty remains upon the plaintiff, doubts will generally be resolved in favor of the injured party and against the breaching party. In order to survive the certainty hurdle, the plaintiff thrifs in the Winstar-related cases must prove that the lost profits damages they seek would have occurred with reasonable certainty.

135Corbin, supra note 74, at §1020.
137Corbin, supra note 74, at §1022; Restatement (Second) §352 comment a: "Doubts are generally resolved against the party in breach. A party who has, by his breach, forced the injured party to seek compensation in damages should not be allowed to profit from his breach where it is established that a significant loss has occurred." See also Bagley v. Smith, 10 NY 489 (1853) ("Nor are we the more inclined to refuse to make the inquiry, by reason of its difficulty, when we remember that it is the misconduct of the defendants which has made it necessary")
Statesman argues that three methods of calculating lost profits are available to show that profits were reasonably certain. These include calculating earnings from prior performance and extrapolating forward, valuing the business using a P/E ratio or some other multiplier, or examining the earnings of comparable companies in the industry.\textsuperscript{138} All of these methods have been used in various cases, and in fact all are sanctioned by the Restatement.\textsuperscript{139}

In this case, Statesman seeks to use projections of future earnings extrapolated from the thrift’s 20-month record prior to the government’s breach. Moreover, it hopes to utilize projections created before the agreement to show that both the government and the thrift believed that even though the thrift would lose money initially, over time it would have positive profits. Statesman must argue this way because if only performance prior to the breach is examined, it will show that the thrifts had no lost profits, because Statesman lost money during the 20-month period prior to FIRREA. Statesman hopes to show, however, that the losses that actually occurred were lower than those projected. Therefore, it will argue, the thrift was actually ahead of the curve in returning to profitability, and the earnings projected by these early models should serve as a floor for damage calculations. To this end, Statesman maintains, rather convincingly, that the FHLBB accepted the figures at the time of contract. Indeed, according to Statesman, the government used these projections as the “primary basis” for its decision to enter into the transaction.\textsuperscript{140} Without having all of the facts before us, it is impossible from our vantage point to evaluate this claim. One caveat to using these projections should apply, however. While the FHLBB may have accepted the projections for the purpose of appraising the transaction, it is well-known that projections are subject to misuse; an analyst with a spreadsheet can create a model that will produce virtually any result he desires. The mere fact that the FHLBB approved the transaction does not mean that it necessarily signed off on Statesman’s numbers; indeed, it may have haircut them by what it felt to be a reasonable percentage and still considered the deal

\textsuperscript{138}Statesman Mem. of Law, supra note 73, at 34-37.
\textsuperscript{139}Restatement §352 comment b.
\textsuperscript{140}Statesman Mem. of Law, supra note 73, at 34.
worthwhile. Therefore, one must be chary of embracing Statesman’s argument that because the FHLBB liked the package, it must have liked the packaging.

The government paints a starkly different picture of Statesman’s thrifts. It alleges that rather than being ahead of the curve in terms of meeting its projections, Statesman actually lagged. The thrift fell short of its goals of its January 1988 business plan, and Statesman’s management conceded disappointment in its performance.¹⁴¹ According to the testimony of John Matovina, a witness for Statesman, the thrift lost money, did not perform up to Statesman’s expectations, and was the least successful of all the ventures entered into by the Statesman Group.¹⁴² On the basis of these statements, the government claims that these admissions “underscore[ ] the totally speculative nature of doing business in the thrift industry.”¹⁴³

We are poorly positioned to judge the relative merits of the government’s and Statesman’s views of the thrifts’ performance and profit-making potential. Nonetheless, this colloquy is instructive because it is apt to be repeated in all of the cases before the court. On these facts alone, it seems surprising that the government only points to a single month out of 20 where Statesman did not exceed its projections. Does this imply that the thrift was on or ahead of target for the other 19 months? Moreover, the government’s broadside about the “totally speculative nature” of the thrift industry cannot be read without a chuckle. One must recall that the same agency that is making this argument is also responsible for regulating it; Congress and the American public would surely be surprised to learn that it is insuring depositors for up to $100,000 in an industry that is little better than a gambling arena.

The government’s next argument cannot be dismissed so lightly, however, and indeed may prove problematic for a number of the Winstar plaintiffs. Seizing upon Statesman’s lack of profitability during the 20-month interval between the acquisition and breach, the government claims that “the absence of a history of profits in a particular business is fatal to a claim of lost

¹⁴¹ Def. Motion, supra note 66, at 45.
¹⁴² Id. at 45, citing Matovina Dep. 120-123, 128, 176; App. 204-205, 207, 208
¹⁴³ Id. at 45.
profits due to a breach of contract.” 144 If accepted by the court, this argument could not only doom Statesman but other similarly situated thrifts that had not achieved a track record of profitability by the time of the breach.

The question of whether a new business, or a business without a history of profits, can recover lost profits cannot be answered simply, because it varies by jurisdiction. For a long time, the historical rule was that a new enterprise could not recover lost profits. 145 A number of jurisdictions still retain this rule. Nonetheless, in recent years there has been a trend toward allowing new businesses to recover. The Restatement supports this movement. While noting that “if the business is a new one or if it is a speculative one that is subject to great fluctuations in volume, costs or prices, proof will be more difficult. Nevertheless, damages may be established with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like.” 146 Consequently, in recent years the erstwhile minority position has now become the majority one, and few courts retain a per se rule against lost profits damages for new enterprises. 147

144 Id. at 45.
145 “The development of the law has been to find damages for lost profits of an unestablished business recoverable when they can be adequately proved with reasonable certainty.” Robert L. Dunn, Recovery of Damages for Lost Profits § 4.2 at 280. See also Mid-America Tablewares, Inc. v. Mogi Trading Co. Ltd., 100 F. 3d 1353 (7th Cir. 1996).
146 Restatement § 352 comment b. Note that Illustration 6 to comment b illustrates how this might be done: “A contracts with B to construct a new outdoor drive-in theatre, to be completed on June 1. A does not complete the theatre until September 1. Even though the business is a new rather than an established one, B may be able to prove his lost profits with reasonable certainty. B can use records of the theatre’s subsequent operation and of the operation of similar theatres in the same locality, along with other evidence including market surveys and expert testimony, in attempting to do this.”
147 See, e.g., Chung v. Kanoshi Center Co., 62 Haw. 594, 606, 618 P. 2d 283, 291 (1980) (allowing recovery of lost profits by a restaurant that never opened and stating that “it would be grossly unfair to deny a plaintiff meaningful recovery for lack of a sufficient ‘track record’ where the plaintiff has been prevented from establishing such a record by defendant’s actions”); Welch v. United States Bancorp Realty & Mortgage Trust, 286 Or. 673, 704-705, 596 P. 2d 947, 963-64 (1979) (allowing recovery of profits by unestablished business and observing that expert testimony as to plaintiff’s expected returns was all that could be expected under the circumstances and to require more “would be tantamount to holding that the defendant could breach this particular contract with impunity”); Fera v. Village Plaza Inc., 396 Mich. 639, 648, 242 N.W. 2d 372, 376 (1976) (affirming award of lost profits by store that never opened and noting that precision in the assessment of damages is not required “[p]articularly...where it is defendant’s own act...that has caused the imprecision”); Super Valu Stores, Inc. v. Peterson, 506 So. 2d 317, 327-30 (Ala. 1987) (allowing recovery for grocery store that never opened, Court stated “the weight of modern authority does not predicate recovery of lost profits upon the artificial categorization of a business as “unestablished,” “existing,” or “new” particularly where the defendant itself has wrongfully prevented the business from coming into existence and generating a track record of profits”).
This does not foreclose the question, however. The vast trend has been away from a per se rule towards what at least one court has termed "an evidentiary rule that creates a higher 'level of proof needed to achieve reasonable certainty as to the amount of damages.'" But these cases are not controlling for the Court of Federal Claims. Therefore, in order to ascertain whether or not lost profits are absolutely precluded here, we must examine the cases cited by the defendants in support of that proposition.

The first case the government looks to for support is Neely. As we have seen, in that case, the government leased lands to the plaintiff for coal mining. After the contract was signed, the government refused to allow the plaintiff to extract the coal through strip-mining, the only profitable method he could pursue. Consequently, the plaintiff assigned the lease to another company, withdrew from the enterprise, and sued the government for breach of contract, seeking lost profits damages. The court held that this was a breach of contract. In considering the question of damages, the court noted that "almost always, in the case of a new venture, the fact that there would have been a profit, had there been no breach, is too shrouded in uncertainty for loss of anticipated profits to form a reliable measure of the damages suffered." However, the court found that in this case, because the lands were strip-mined by another company which received government approval five years later, the profits made by that company formed a fairly reliable basis for estimating the plaintiff's lost profits.

Clearly, Neely hardly represents the absolute barrier to recovery that the defendants suppose. The case itself leaves open the possibility that lost profits are available; "almost always" is not equivalent to a per se rule. Therefore, taken alone, Neely's holding does not prevent a recovery by Statesman and other claimants lacking a profitable track record. Of course, Neely is not entirely bereft of bite; it does stand for the proposition that while an established

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150 Id. at 440.
151 Id. at 443.
152 Id. at 443.
business may be awarded anticipated profits based on its prior experience, a new business is generally precluded from recovering because its loss is too remote, contingent and speculative.\textsuperscript{153} This is an important limitation, but not a \textit{per se} preclusion. Therefore, the government is left with the untenable argument that \textit{Neely} absolutely precludes recovery by Statesman, when by its own explicit terms it does not. The court could, of course, adopt a harsher rule than \textit{Neely} and state that lost profits will never be recoverable for a new business. Such a course would be unwise, however, for in addition to allowing defendants in some cases to breach with impunity, this would buck the trend both as articulated in the Restatement and in countless cases in many jurisdictions that have rejected the old \textit{per se} rule. Moreover, it would ill accord with the purposes behind the rule. In \textit{L'Enfant Plaza Properties, Inc. v. United States}, the court gives a clue as to what purpose the rule serves: After citing \textit{Neely}, it states that "[r]emote and consequential damages may not be recovered in a common law suit for breach of contract against the United States."\textsuperscript{154} Putting these two side by side, it appears that the two tests are coextensive, and are both designed to root out the same problem: both seek to extirpate remote and consequential damages; thus, lost profits damages for new enterprises are usually precluded because such profits are usually remote and consequential. The flip side of this coin is that when these profits are not remote or consequential, they ought to be allowed, because they do not encroach upon the zone of damages forbidden by \textit{Northern Helex}. Thus, in resolving this issue, the court should look to the modern trend and not preclude lost profits here simply because Statesman had been an unprofitable enterprise. On the other hand, it is perfectly acceptable for the court to force Statesman to shoulder a heavier burden of proof; if Statesman is unable to prove with reasonable certainty that its fortunes would have turned around and it would have returned to profitability, then it should not receive lost profits damages.


\textsuperscript{154} \textit{id.} at 590 citing \textit{Northern Helex Co. v. United States}, 207 Cl. Ct. at 886, 524 F. 2d at 720.
4. **Mitigation**

The next crucial issue that arises in the *Winstar*-related cases is that of mitigation. The government contends that the failed plaintiff thrifts had a duty to mitigate their losses by raising sufficient capital to enable them to comply with minimum capital requirements and thereby prevent seizure by regulators. On the other hand, plaintiffs claim that the duty to mitigate does not apply to them, and that therefore their lost profits damages should not be decreased because they failed to raise additional capital to substitute for the removed supervisory goodwill.

Under the doctrine of avoidable consequences, courts will not compensate injured parties for losses they could have avoided by making efforts appropriate to the circumstances.\(^{155}\) Although the requirement that an injured party make reasonable attempts to minimize his losses is often described by courts as a "duty to mitigate," in a strict sense no such duty exists, because the injured party incurs no liability by failing to take steps to mitigate damages.\(^{156}\) In a Hohfeldian sense, there is no duty involved, because no correlative affirmative right is created for the party in breach.\(^{157}\) That is to say that the party in breach does not acquire a cause of action or other right by virtue of the injured party's failure to mitigate. Rather, failure to mitigate is an affirmative defense that may be raised by the defendant as a way to limit recovery of damages. The injured party's recovery will be exactly the same whether he makes an effort and mitigates his loss, or not; but if he fails to make a reasonable effort and consequently his injury exceeds what it otherwise would have been, he cannot recover for the amount of this avoidable and unnecessary increase.\(^{158}\)

The Restatement sets forth the basic rule regarding mitigation of damages:

(1) Except as stated in subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.

\(^{155}\)Farnsworth, *supra* note 71, at §12.12.

\(^{156}\)Id. at §12.12.

\(^{157}\)"[T]he failure to take reasonable action to limit damages creates no affirmative right in anyone." 22 Am. Ju.r 2d §499. See also Hohfeld, *Fundamental Legal Conceptions*, 23 Y.L.J. 710.

\(^{158}\) Corbin, *supra* note 74, at §1039.
(2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.\textsuperscript{159}

From a policy standpoint, the rationale behind the mitigation doctrine is to encourage injured parties to lessen the overall harmful results that spring from a breach, by forcing them to bear the consequences if they fail to act. It is important to recognize that under subsection (2) above, the injured party need not be successful in his efforts to mitigate; he must simply take reasonable steps to prevent greater loss. The query as to what constitutes a reasonable effort is a question of fact that must be determined upon a case-by-case basis.\textsuperscript{160} Nonetheless, the prevailing legal standard conforms to the Restatement’s doctrine that the injured party need not make extraordinary efforts, but need only act with reasonable diligence and ordinary care, or what some commentators have referred to as the actions that an ordinary prudent individual would adopt.\textsuperscript{161}

In general, the burden of proving a failure to mitigate damages falls upon the shoulders of the party in breach. The breaching party must also show that the steps, if any, taken by the plaintiff to mitigate loss were inappropriate or unreasonable at the time they were taken. Thus, the party in breach may not, with the benefit of hindsight, criticize the plaintiff for taking steps which seemed reasonable at the time but led to unfortunate results. Furthermore, if the plaintiff does take such reasonable steps, he will also be protected from any subsequent injury he suffers as a result of this attempt to mitigate, even if such injury exceeds what he would have suffered if nothing had been done. The policy behind this doctrine is to ensure that the party in breach does not reap undue advantage from the avoidable consequences doctrine, since it was he who necessitated the preventive action in the first place. The Third Circuit expressed this clearly in a well-known passage:

When a choice has been required between two reasonable courses, the person whose wrong forced the choice cannot complain that one rather than the other was chosen. The rule of mitigation of damages may not be invoked by a contract breaker as a basis for hypercritical examination of the conduct of the injured party, or merely for showing that the injured person

\textsuperscript{159}Restatement §350.

\textsuperscript{160}22 Am. Jur. 2d at §508: “Since the primary question is one of the reasonableness of the action of the nondefaulting party, each case must necessarily turn on its own facts.”

\textsuperscript{161}Id. at §508.
might have taken steps which seemed wiser or would have been more advantageous to the defaulter. One is not obligated to exalt the interest of the defaulter to his own probable detriment.\textsuperscript{162}

Consequently, in this case the government must show that the plaintiff thrifs either failed to mitigate when such mitigation would not have entailed undue risk, burden, or humiliation; or alternatively that steps taken by the thrifs were unreasonable under the circumstances.

One of the most important concepts related to the doctrine of avoidable consequences is the notion of covering. When a party's breach consists of a failure to deliver goods or furnish services, it is often possible for the injured recipient to arrange for a substitute transaction and acquire those goods or services on the market.\textsuperscript{163} Of course, this is not always possible, and there are some instances where it will be impossible for the injured party to arrange an alternative transaction. This problem arises most often in cases where the good or service that the breaching party was to provide is so unique or specialized that no market exists for it. Nonetheless, the injured party is expected to make appropriate efforts to avoid loss by arranging a substitute transaction even where there is not a well-established market for the good or service.\textsuperscript{164} In such cases, however, where no well-established market exists, the party in breach bears the burden of proving that a substitute transaction was available to the plaintiff.\textsuperscript{165} For example, suppose A contracts to supervise the production of B's crop for $10,000, but breaks his contract and leaves at the beginning of the season. By appropriate efforts, B could obtain an equally good supervisor for $11,000, but does not do so, and the crop is lost. B may recover the $1,000 from A, but B's damages do not include the loss of his crop.\textsuperscript{166}

It is also important to note that a substitute transaction need not be identical to that originally intended by the parties. Whether an available alternative transaction qualifies as a suitable substitute depends on the totality of the circumstances existing at the time, including the

\textsuperscript{162}In re Kellett Aircraft Corp., 186 F. 2d 197, 198-199 (3d Cir. 1950).
\textsuperscript{163}Restatement §350 comment c.
\textsuperscript{164}Ibid.
\textsuperscript{165}Ibid.
\textsuperscript{166}Restatement §350 Illustration 6.
similarity of the performance and the times and places that they would be rendered.\textsuperscript{167} For example, suppose A contracts to sell B a machine to be delivered at B’s factory on June 1 for $10,000. A breaks the contract by repudiating it on May 1. By appropriate efforts, B could acquire a similar machine from another seller for $11,000. However, the other seller will not deliver the machine to B’s factory, and insists that B take possession of it two weeks earlier than he will be able to install it in his factory. However, B can arrange to have it stored for two weeks and shipped to his factory for an additional $1,500. Suppose further that if B does not engage in the other transaction, he will lose profits of $25,000 that he would have made from the use of the machine. In this case, B may recover the $2,500 cost differential between the price of A’s machine and the price of the other seller’s machine. However, if B does not buy the other machine, he cannot recover the $25,000 lost profit that he suffered.\textsuperscript{168} The important point here is that the other machine need not be identical; rather, it need only serve the purpose of reducing B’s total loss in order to qualify as a substitute.

While in a strict sense the injured party may lack a “duty” to mitigate, as we see from the example above, in fact he has a very strong incentive to do so, lest he bear the risk of greater damages. Therefore, in the \textit{Winstar}-related cases, the plaintiff thrifts hope to escape the strictures of mitigation by claiming that the doctrine is inapplicable. On the other hand, the government is expected to press hard on the mitigation issue because if the court embraces lost profits as the correct barometer of damages, mitigation will be the government’s best way to limit plaintiffs’ recovery.

In the Statesman case, which involves a closed thrift, the government argues that Statesman’s damages should be limited because it could have and should have injected necessary capital into the thrift to replace capital credits and supervisory goodwill that was removed by \textit{FIRREA}.\textsuperscript{169} As of December 31, 1989, Statesman needed $11.8 million to meet its regulatory capital

\textsuperscript{167}Restatement §350, comment d.
\textsuperscript{168}This is a combination of Illustrations 5 and 12 to Restatement §350.
\textsuperscript{169}Def. Motion, supra note 66, at 52.
requirements and an additional $15.8 million to restore its pre-FIRREA capital levels. The government points out that between 1985 and 1990, Statesman Group raised an estimated $25 million in debt and preferred stock offerings, and an additional $180 million from 1990 to 1993. In addition, according to the government's expert witness, American Life and Casualty Insurance Co., a Statesman affiliate, possessed enough liquid funds to replace the four thrifts' lost capital, as did another insurance company subsidiary of Statesman. From these facts, the government draws the conclusion that Statesman could have salvaged the ailing thrifts, but refused to avail itself of this opportunity. Why would Statesman refuse to do so, given the unlikelihood in 1989 that it would prevail in a breach of contract action against the FDIC? The question is even more relevant since Statesman has presented evidence that it expected to earn healthy profits on the thrift in subsequent years. Why would Statesman willingly give up the promise of such future gains? The government posits that Statesman did not act to save the thrifts because it realized that they were unprofitable, and that any profits that Statesman now claims it would have made with reasonable certainty are purely a chimera. As the government's brief asserts, "If Statesman had actually believed that it possessed the outstanding opportunities for earning profits that it now claims as damages, it would have, could have, and should have mitigated its losses by investing sums necessary to replace the capital eliminated by FIRREA." Consequently, the government claims, the doctrine of mitigation completely precludes Statesman's lost profits claim.

This is a powerful argument, and if adopted in its entirety would completely preclude lost profits damages for Statesman and other closed thrifts that failed to mitigate. However, there are several reasons why the court should not accept this argument entirely. In order to understand

\footnote{\textit{Id.} at 51-52.} \footnote{\textit{Id.} at 52.} \footnote{\textit{Id.} at 52, citing Matovina Dep. 256-259, 261-62; App. 214-15.} \footnote{\textit{Id.} at 52. See also Govt. App. at A-7 n. 3: "A rational investor would have responded with unconditional capital infusions large enough to save the bank, had it been worth the investment."} \footnote{\textit{Id.} at 53.}
them fully, however, we must unpack the government’s argument and examine its component parts.

First, the government asserts that Statesman should bear the cost of its failure to avoid further losses. Let us assume arguendo that this is true, i.e. that the mitigation doctrine applies. We must then determine whether the plaintiff had a reasonable substitute for the lost regulatory capital. The government asserts the existence of two sources for substitute capital: (a) the capital markets, on which Statesman raised over $205 million between 1985 and 1993; and (b) internal financing. According to the government, given Statesman’s alleged future profitability, the thrift could have and should have tapped either of these sources to shore up its capital; doing so would have been the reasonable course of action in this instance. Conversely, it was unreasonable of Statesman to ignore both of these alternatives. This syllogism produces two alternative conclusions, each of which is perfectly acceptable to the government: (1) Since Statesman had the opportunity to mitigate and avoid greater, virtually certain, losses, but opted not to do so, its action was irresponsible and unreasonable. Therefore, Statesman should bear the cost of these increased losses and only recover the cost of mitigating. (2) Statesman is a rational actor, and acted reasonably in this case. It realized that future profits from the thrifts were speculative at best; therefore, it sought to cut its losses by effectively pulling the plug on the thrifts when it did. Therefore, the court should look to Statesman’s own actions and recognize that the thrifts would not have been profitable entities in the future, and therefore deny lost profits recovery.

Propelled by the zephyrs of theory, this argument sails along quite nicely; unfortunately, it founders on the rocky shoals of reality. The government’s argument hinges on the fact that a substitute source of capital was available; otherwise, the mitigation rule does not apply. The mere fact that Statesman could have transferred capital from some of its affiliates to shore up the thrift does not mean that such a transfer would have been a good idea, and thus an adequate substitute. For one thing, the evidence suggests that Statesman’s thrift was less profitable than

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175 See 5Corbin, supra note 74, at §1039: “If, however, no such goods or any adequate substitute can be obtained by a new purchase, the rule does not apply.”
either of these insurance companies. If indeed the thrift had a lower return on assets than either of these other entities, Statesman acted reasonably in not transferring the capital. If Statesman had diverted assets from one of the insurance companies to the thrift, where it would have yielded a lower return, this would have exacerbated its losses, not ameliorated them. Given this, leaving the assets with the insurance subsidiaries was the wiser course. Moreover, this argument implicates the lost volume doctrine. Under this doctrine,

the mere fact that an injured party can make arrangements for the disposition of the goods and services that he was to supply under the contract does not necessarily mean that by doing so he will avoid loss; if he would have entered into both transactions but for the breach, he has lost volume as a result of the breach, and the second transaction is not a substitute for the first one.\textsuperscript{176}

As is apparent from the Restatement language quoted above, the lost volume doctrine traditionally has been applied to sellers of services who have been injured when the buyer breached.\textsuperscript{177} However, from a theoretical perspective, there is no reason to limit the doctrine to sellers. Here, if FSLIC had not breached, Statesman could have continued to make all of the thrift loans that it had previously done while also earning a return on the insurance company capital. Therefore, Statesman would have lost volume as a result of mitigating in this fashion. Even if lost volume did not apply, however, Statesman would still be able to recover the profits that it would have earned from the insurance company assets. An illustration may clarify this point: Suppose that the Statesman thrifts earned an annual return on assets ("ROA") of 2 percent, while the insurance companies had an ROA of 1.5 percent. By transferring funds from the insurance companies to the thrift, Statesman could have saved itself 50 basis points. If lost volume does not apply, the cost of avoiding losses was the opportunity cost of the capital, \textit{i.e.} the 150 basis points that Statesman's insurance company would have earned, so Statesman should recover this

\textsuperscript{176}Restatement §350, comment d.
\textsuperscript{177}See, e.g. 5 Corbin, \textit{supra} note 74, at §1039: "If a buyer of goods repudiates, the seller can usually make another sale or make other use of his goods. A similar rule therefore measures the seller's damages by the contract price less the market price— the price actually obtained or reasonably obtainable by a new sale. The rule properly applies, however, only when the new sale is to a customer that the seller could not have supplied but for the buyer's repudiation."
amount. On the other hand, if lost volume applies, the insurance company assets should not be considered a suitable substitute, and Statesman may recover the full 200 basis points lost profits damages. Of course, if the numbers are reversed, lost volume is irrelevant, because it would not be reasonable for Statesman to transfer the funds in the first place.\textsuperscript{178}

As the government has pointed out, however, Statesman’s financing options may not have been limited to tapping the funds of its affiliates. It could also have attempted to raise funds in the capital markets. In this regard, then, the government is essentially arguing that if Statesman’s profits were as certain as it claims, it could have raised sufficient funds in the capital markets to keep the thrift solvent and alive.

Statesman responds in a number of ways. First, it contends that a plaintiff is not required to expend time or money in an effort to avoid injurious consequences unless the advantage to be gained from such expenditure is almost certain.\textsuperscript{179} According to Professor Corbin, “The plaintiff is not required to run the risk of increasing his loss,” or to undertake measures that would entail a risk of further economic damage.\textsuperscript{180} As support for this position, plaintiffs turn to the statement in \textit{In re Kellett Aircraft} that “[o]ne is not obligated to exalt the interests of the defaulter to his own probable detriment.”\textsuperscript{181} But even a cursory reading of that case shows that is inapposite here. It involved a breach of contract by the debtor, Kellett Aircraft, to make and assemble certain stall showers for Amerform Corporation.\textsuperscript{182} When Kellett notified Amerform that it would not be able to fulfill the contract, Amerform had the work done by Cutler at a higher price, even though another manufacturer made an offer to do the work at the same price Kellett would have charged.\textsuperscript{183} The defendant argued that Amerform did not mitigate damages because it opted for a more expensive substitute.\textsuperscript{184} The court rejected this argument, and noted that there were

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\textsuperscript{178} State insurance commissioners may have objected to use of the $25 million to salvage thrifts, because this capital shift might have knocked Statesman out of compliance with insurance regs in some states. Such a transfer might implicate corporate law fiduciary issues as well.
\textsuperscript{179} Statesman Reply Brief, \textit{supra} note 95, at 8; 5 Corbin, \textit{supra} note 74, §1042 at 264.
\textsuperscript{180} \textit{Id.} at §1042.
\textsuperscript{181} Statesman Reply Brief, \textit{supra} note 95, at 11. In re Kellett Aircraft Corp., 186 F. 2d 197, 199 (3d Cir. 1950)
\textsuperscript{182} \textit{Id.} at 197.
\textsuperscript{183} \textit{Id.} at 197.
\textsuperscript{184} \textit{Id.} at 197.
\end{flushright}
nonprice reasons why Cutler was the better choice. Most importantly, though, the court noted that Amerform "immediately approached some four or five companies located in various Pennsylvania and New Jersey cities in an effort to produce the cabinets as soon as possible." In re Kellett, then, involved a case where the defendant objected to the method of mitigation used by the plaintiff; unlike the Statesman case, the plaintiff did not argue (and the court did not hold) that it had no obligation to mitigate; it merely objected to the defendant’s insistence on a certain type of mitigation. It does not stand for the proposition, as plaintiffs here seem to assume, that the plaintiff has no obligation to mitigate its damages. Indeed, the court placed special emphasis on the alacrity of Amerform’s mitigation.

Plaintiffs also rely on C.J. Langenfalder & Son Inc. v. United States to support the proposition that the plaintiff need not risk further losses. But this case also provides Statesman little cover. Statesman’s basic argument here is that it did not have to mitigate damages because doing so would have exposed it to further risk. In C.J. Langenfalder, however, the court spoke not merely of enhanced risk in holding for the plaintiff -- it also explicitly accepted the trial court’s findings that “it would have been ‘impracticable,’ ‘expensive,’ and ‘uneconomical’” to undertake the mitigation suggested by the defendant. Furthermore, in that case the defendant even conceded that it would not have been practical to proceed in any other way than the plaintiff had proceeded. This represents a finding that mitigation would have failed; not just that it would have exposed the plaintiff to greater risk of loss. Consequently, it does little to bolster Statesman’s argument.

Despite the scant support provided by the cases it cites, Statesman may nonetheless rely on language in several treatises that lends support to its position that it was not required to take on

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185 Id. at 198.
186 Id. at 198, see also MCCORMICK ON DAMAGES, Sec. 35 (1935).
187 Statesman Reply Brief, supra note 95, at 8; C.J. Langenfalder & Son, Inc. v. United States, 384 F. 2d 1005 (Ct. Cl. 1967).
188 Id. at 1006.
189 Id. at 1007
significantly greater risk by attempting to mitigate.190 Profits, it claims, were not certain, especially since the government might have raised capital requirements again in the future. Therefore, because of the further risk that injecting more capital into the thrifts would have entailed, Statesman maintains that it had no obligation to mitigate.

While this argument may succeed on its own, it flies in the face of the plaintiffs’ earlier argument regarding certainty of profits. As we have seen, in order to recover lost profits damages, plaintiffs must show that these were reasonably certain. Here, they must make the opposite argument, that the profits were so uncertain as to preclude Statesman from the obligation to mitigate. Fortunately for plaintiffs, the two standards do not completely overlap: the quotation from Corbin speaks of “almost certain” advantages, while the “certainty” requirement for expectation damages merely requires that lost profits be “probable.” Plaintiffs may be able to negotiate the treacherous passage between the Scylla of certainty and the Charybdis of mitigation by demonstrating that the profits were probable enough to have been reasonably foreseeable at the time of contracting, but not absolutely certain. Interestingly, Statesman is not the only party afflicted by the need to make seemingly contradictory arguments: recall that in contending that profits are not probable, the government attacks the “totally speculative nature of doing business in the thrift industry.”191

As a corollary to its previous argument, Statesman also contends that under the original supervisory merger agreement, it was not willing to invest any more money in the thrift than the $21 million it actually put up.192 Consequently, the argument runs, it would be inequitable, and contrary to the mitigation doctrine, for the court to insist that Statesman should have made additional investments on top of this amount. Since returns from an additional capital infusion were not guaranteed, the thrift insists that recovery should not be precluded. Taken to its logical extreme, this argument clearly fails. Inherently, every mitigation case requires the plaintiff to

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190 See, e.g., 5 Corbin, supra note 74, §1042: “It is never necessary to expend time or money in an effort to avoid injurious consequences unless the advantage to be derived from such expenditure is almost certain. The plaintiff is not required to run the risk of increasing his loss.”
191 Def. Motion, supra note 66, at 45.
192 Statesman Reply Brief, supra note 95, at 9.
take some additional action in order to avoid damages. True, in some cases it is easier to find a substitute than in others; when faced with a buyer’s breach and an easily accessible, perfectly competitive market for his product, the seller will undertake little if any additional risk by unloading his product. But logically, the affirmative defense of failure to mitigate cannot be eviscerated by the claim “We did not want to do anymore.” If this theory were accepted, the exception would swallow the rule, for only in very few cases can the injured party risklessly and costlessly (including opportunity costs of time spent) arrange an equivalent substitute transaction. American Jurisprudence notes that “[e]fforts required of the injured party to prevent or lessen his damages may include a reasonable expenditure of money, which he may recover as part of his damages. He is not, however, required to incur substantial expenses, as the doctrine of avoidable consequences does not apply where the expenditure is so large as to make the requirement impracticable.”¹⁹³ Moreover, the Restatement and most treatises generally discuss the injured party’s obligation to make a reasonable effort; comprised within that description is the notion that impracticable, overly risky actions are not mandatory.¹⁹⁴ The following quotation provides a good summary of the prevailing doctrine:

A nondefaulting party to a contract usually is not required to spend more money to avoid future damage, since compelling an innocent party to make additional expenditures to mitigate damages would force upon him risks beyond those he assumed in his contract. However, a party may be required to mitigate damages caused by a breach of contract if (1) the expenditures are small in comparison to the probable losses, and (2) it is virtually certain that the expense incurred will avoid at least a part of the loss.¹⁹⁵

¹⁹⁴See id. at §507: “Since the primary question is one of the reasonableness of the action of the nondefaulting party, each case must necessarily turn on its own facts;” Farnsworth, supra note 71, at : The injured party is expected “to take reasonable affirmative steps to make appropriate substitute arrangements to avoid loss... If the buyer could with reasonable effort have covered, but did not do so, the amount of loss that could have been avoided is subtracted from the buyer’s damages;” UCC 2-715: “Consequential damages resulting from the seller’s breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise...” Am Jur: “There is a requirement of good faith and fair dealing -- the injured party need not make extraordinary efforts or do what is unreasonable or impracticable; reasonable diligence and ordinary care are all that is required to allow full recovery.” (emphasis added)
¹⁹⁵22 Am Jur 2d §514. See also Tampa Electric Co. v. Nashville Coal Co., 214 F. Supp. 647 (M.D. Tenn.) (plaintiff is never given judgment for damages for losses that he could have avoided by reasonable effort without risk of other substantial loss or injury).
Thus, the statement that the injured party need not undertake any additional risk, read in conjunction with the other tenets of the mitigation doctrine, can only mean that he need not take on any unreasonable risk; it does not excuse him from taking any action at all. In the past, neither the Court of Federal Claims nor any other federal court has exhibited an inclination to gut the doctrine of mitigation, and to do so here would be inequitable in the present litigation and provide an unfortunate precedent for the future.196

What is a reasonable amount of risk to expect Statesman and other thrifts to undertake here? Asked another way, what constitutes a “substantial” additional investment that would be excused? In accord with the rest of the mitigation doctrine, whether or not an amount is substantial should be determined by looking at the totality of the circumstances and ascertaining what the parties could reasonably be expected to do.197 Therefore, so long as the amount that Statesman would have needed to put up was minor compared with the profits it anticipated, the sums should not be considered too substantial. Note that in this context we are not considering whether Statesman actually could have raised the money, but rather whether the amount was simply too large even to ask that Statesman raise it. Of course, the injured party’s lack of (and lack of access to) sufficient funds will always excuse an absence of effort to mitigate damages.198 Here, then, the question becomes one of risk: How much extra risk would Statesman have undertaken if it injected additional capital to shore up the thrifts? Clearly, this money would have been at some risk. But in determining the level of risk, one cannot ignore the plaintiffs’ statements that profits were reasonably certain -- once again, the inquiry returns to this issue and places them in a bind. Moreover, one must consider the risk of doing nothing here as well. Simply allowing the thrift to fail meant that Statesman would lose its $21 million investment,

196 Statesman argues in its brief that “Statesman was not willing to invest any more than $21 million in the failed thrift, and it was the government’s only bidder.” Statesman Reply Brief, supra note 95, at 9. The fact that Statesman was the only bidder for the thrifts is a non sequitur. While it may demonstrate that the government, desperate to unload the failed thrifts so it could avoid liquidating them, possessed a poor bargaining position at the time and could not have extracted more money from Statesman, it surely has no bearing on Statesman’s “duty” to mitigate.
197 “What constitutes reasonable care depends upon the circumstances of the particular case, taking into consideration time, knowledge, opportunity, and expense.” 22 Am. Jur. 2d §498.
198 Corbin, supra note 74, §1039.
while additional capital might be able to salvage it. Thus, inserting more cash into the thrifts might have allowed Statesman to recoup what would otherwise be certain losses.

Statesman also claims that where the defaulting party has promised to provide some special or unique performance, the law does not require the plaintiff to accept the promised performance on less favorable terms.199 The general rule is that if the party in breach offers to perform the contract for a different price, this may represent a suitable alternative.200 However, such is not the case if the subsequent contract is conditioned on surrender by the injured party of his claim for breach.201 Of course, if accepting the new contract would embarrass or humiliate the injured party, he is not required to do so.202 Statesman contends that the promised performance in this case was so unique as to be unavailable from any source other than the government. Since the government, through OTS regulations, determines the minimum levels of regulatory capital required and what will qualify as regulatory capital, according to Statesman, it was contractually obligated to provide a unique and special service. The trouble with this argument, however, is that it fails to recognize that the law does not require a perfect or exact substitute; it is enough that the replacement will serve the basic purposes that the original would have. While Statesman claims that supervisory goodwill was unique and utterly irreplaceable in the market, a quick examination of its purpose debunks this contention. As we have seen, regulatory capital treatment of supervisory goodwill allowed thrifts to expand their loan bases by effectively permitting them to hold less than the required reserve ratios. Thrifts could not acquire supervisory goodwill elsewhere; that is certainly true. But they could acquire something even better: cash. By raising capital elsewhere, the thrifts could have maintained the same outstanding loans as before. Of course, raising capital would have entailed additional costs, and a rational thrift would naturally prefer to have an expanded loan base through supervisory goodwill rather than a larger amount of actual capital, not least because the former would bump up its return on

199Statesman Reply Brief, supra note 95, at 11 n. 6.
200Restatement §350 comment e. See also Restatement §350 illustration 14.
201Restatement §350 comment e.
202Restatement §350 comment f: "[T]he aggrieved party is not expected to put himself in a position that will involve humiliation, including embarrassment or loss of honor and respect."
equity (assuming that the new capital was raised as equity). While additional equity capital may not have been an exact substitute for supervisory goodwill, a functional analysis shows that it falls clearly within the definition of a suitable substitute. 203

Another argument against application of the mitigation doctrine to this case is that the plaintiff thrifts had no obligation to mitigate because the government had an equal opportunity to mitigate the damages. An injured party has no obligation to mitigate damages if the other party, who had the duty to perform the contract, had equal opportunity to perform and equal knowledge of the consequences of nonperformance. 204 The plaintiffs here contend that the government, fully cognizant of the adverse effects flowing from its breach, was better situated to infuse cash into the failing thrifts.

Did the government have an equal opportunity to mitigate the damages in this case? The evidence suggests that it possessed equal, if not superior, knowledge of the consequences of nonperformance, because the government itself was responsible for seizing and liquidating the thrifts. 205 This does not mean, though, that the government could have actually solved the problem. The plaintiffs suggest three ways in which the government allegedly could have salvaged the ailing thrifts: First, the government could have injected additional cash that would have replaced the lost supervisory goodwill. 206 At the time of breach, however, the FDIC was insolvent to the tune of $50 billion. Therefore, it is spurious to suggest that the FDIC could have simply drawn on a limitless slush fund in order to shore up the ailing thrifts. Second, and more credibly, plaintiffs contend that the FDIC had the ability to cure the thrifts' capital deficiency

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203 Restatement §350 comment c: "Whether an available alternative transaction is a suitable substitute depends on all the circumstances, including the similarity of the performance and the times and places that that they would be rendered."

204 22 Am. Jur. 2d §508. The Claims Court has held that "[t]he duty to mitigate damages is not applicable where the party whose duty it is to primarily perform a contract has equal opportunity for performance and equal knowledge of the consequence of nonperformance." Midwest Industrial Painting of Fla., Inc. v. United States, 4 Cl. Ct. 124, 133 (1983), quoting S.J. Groves & Sons v. Warner Co., 576 F. 2d 524, 530 (3d Cir. 1978). See also Shea S&M Ball v. Massman-Kiewit-Early, 606 F. 2d 1245.

205 As the Statesman plaintiffs point out, "[T]he government certainly had knowledge concerning what it would do if additional capital was not contributed to the thrift -- the government knew that it would do exactly what it did do." Statesman Reply Brief 10.

206 Id. at 10.
without expending any additional cash.\textsuperscript{207} Since FIRREA gave the OTS the power to grant exceptions from the application of the new capital requirements until 1991 and exemptions from any penalties for noncompliance that specific thrifts might face, the plaintiffs contend that the OTS should have granted such exceptions or exemptions in cases where the government had reneged on its supervisory goodwill promises: "[G]iven that the government had a cost-free method of mitigating the damages caused by its breach, but gratuitously refused to exercise it, its insistence now that Statesman was obliged to take costly measures to mitigate its damages comes with poor grace."\textsuperscript{208} Statesman and many other thrifts requested such exceptions and exemptions, but all of these requests were denied.

While this argument does have its appeal, it is unclear that the OTS could have simply granted exceptions or exemptions to thrifts which had entered into supervisory merger agreements with FSLIC. One of the primary purposes of FIRREA was the elimination of supervisory goodwill; the Congressional Record is replete with comments about the "accounting gimmick" that this purchase accounting treatment allegedly represented. Given this goal, it is at least arguable that granting exemptions to thrifts purely because of the prior contracts would have been inconsistent with the agency’s mandate to enforce the will of Congress. Even though FIRREA did authorize the OTC to grant exceptions and exemptions, this power was nonetheless tightly constrained. As the Court of Federal Claims recently noted,

"FIRREA provided that thrifts could apply to the OTS Director for two important exceptions to the new capital standards. The first was a total exemption from the standards, potentially effective until January 1, 1991. Under the second, a thrift not in compliance with the new standards could avoid various OTS sanctions, including possible restrictions on payment dividends and compensation, although restrictions on asset growth would still be imposed. Thus, one exception was temporary in duration, and the other partial in coverage. There was never any chance that thrifts could avoid FIRREA’s capital standards completely; it was only a question of whether or not they could gain a temporary exemption from the standards, or escape certain sanctions."\textsuperscript{209}

\textsuperscript{207}\textit{id.} at 11.
\textsuperscript{208}\textit{id.} at 11, citing Winstar Corp v. United States, 994 F.2d 797, 816 (Fed. Cir. 1993) (Newman, J., dissenting).
\textsuperscript{209}Plaintiffs in Winstar-related cases, supra note 24, at 31-32. Moreover, in FIRREA, Congress specifically prescribed standards for the OTS to use in deciding whether to grant exceptions or exemptions. For instance, the
So the exception and exemption power hardly constituted *carte blanche*. By the same token, given the Congressional antipathy towards supervisory goodwill, the OTC would have been hard-pressed to argue that granting exemptions in these particular cases would have been consistent with the will of Congress. Moreover, it is critical to remember that even though the United States government is the defendant in all of these cases, the government is not a monolith: the contracts at issue here were primarily between FSLIC and the various thrifts; the organization responsible for liquidating failed thrifts was the RTC; the agency in charge of adopting and enforcing implementing regulations was the OTC. While it is clear from the Supreme Court’s decision that the government as party to the contracts did bear the risk of a change in prevailing law, it is less obvious that the OTC *per se* had any obligation to mitigate damages in these cases by granting exemptions, especially given the apparent tension between doing so and thereby prolonging the use of supervisory goodwill as regulatory capital, and the stated purpose of FIRREA to eradicate such treatment. In this sense, then, the government was not equally well situated to mitigate the damages, because the regulatory structure ensured that the entity that breached was under different control than the entity that possessed an opportunity to mitigate.

As we have seen, the plaintiffs’ strongest argument that the doctrine of avoidable consequences should not apply is that they would have had to invest substantial amounts of money that would have faced some degree of risk, no matter how certain the thrifts’ future profits. While the case law provides support for the notion that an injured party need not undertake substantial additional investments, the generally accepted practice is that “[w]here a large loss can be avoided by using a little time and effort or by the expenditure of a small amount of money, damages are not recoverable for losses that could have been avoided by incurring such effort or expense.”

So while we must reject the plaintiffs’ argument that no further investment is ever required, we must accept the contention that the doctrine of avoidable

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OTS Director must conclude that “such exemption poses no risk to the affected deposit insurance fund.” 101 Pub. Law. 73, §301(b)(7)(C).

Corbin, *supra* note 74, at §1042.
consequences does not mandate an infusion of substantial additional sums. In the Statesman case, it appears that substantial sums were involved: Statesman made an initial investment of $21 million in the four thrifts. After the government's breach, Statesman would have had to invest an additional $16 million in order to maintain their compliance with regulatory capital standards. This can hardly be viewed as an insubstantial increase relative to their existing investment, representing as it does almost an 80 percent in their amount of capital at risk. From this perspective, it appears that the doctrine of avoidable consequences should not apply, and Statesman ought to receive full expectations damages. On the other hand, $16 million is minimal compared to the profits that Statesman estimates it would have earned: these figures run into the hundreds of millions.

Statesman may encounter another problem because the contract at issue here was very similar to a contract to loan money. Of course, it was not identical to such a contract, and supervisory goodwill is not cash. But as we have seen, from the standpoint of considering what would serve as a functionally equivalent substitute, the contract can be analogized to a contract to lend funds. Unfortunately for the plaintiffs, a special legal doctrine has developed around such contracts: in legal contemplation, money is always in the market and procurable at the lawful rate of interest. Consequently, the traditional damages for breach of a contract to lend money is the difference between the interest the borrower contracted to pay (here, zero) and what he was compelled to pay to procure a replacement loan. Furthermore, the fact that Statesman may have been unable to obtain other funding does not save it:

Even though the prospective borrowers were not able to obtain other financing, the proper measure of damages for breach of a contract to lend money is the difference between the rate of interest during the term of credit as specified in the contract, and the rate of interest generally available to the borrowers on the date of the breach.

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211 22 Am. Jur. 2d §93.
212 Id. at §93.
213 Id. at §93.
If this doctrine that money is always available in the market is accepted, albeit perhaps at a prohibitively high price, then it becomes difficult for Statesman to argue that it should receive full expectations damages; rather, the damages ought to be capped at the difference between the rate at which it could have obtained alternative financing and the cost of the supervisory goodwill treatment from the government, which of course was nil.

The resolution of this question is critical because Statesman's (and, one suspects, many of the other closed thrifts') strongest arguments for full recovery even if the doctrine of avoidable consequences does apply is that it simply was unable to find alternative financing: it tried to do so and failed. To this end, Statesman produces testimony from its chairman, Mr. Noble, illustrating the lack of interest in the capital markets:

I was in constant contact with sources of capital... The Bank was such an issue that certainly any conversation I had with anybody over capital would have involved the bank... Wall Street was certainly telling me that they were not interested in raising capital for them -- for banking... I will tell you based on my opinion there was no outside source of funds available to place in a bank that we were having material government disagreement over."\(^{214}\)

The final sentence of this quotation is important, because it alludes to a fact that the government appears to have ignored in its arguments that Statesman could have tapped the capital markets for additional funds. Immediately after the breach, the government insisted that it was not subject to the supervisory merger agreements, and could breach them with impunity. Moreover, there were other aspects of the agreements that the government had not breached which were crucial to the thrifts' success. For example, since it was widely recognized at the time of the Statesman acquisitions that the value of the loan portfolios was declining due to a depressed real estate market that had increased default rates, the government and Statesman entered into a covered assets agreement which stipulated that the government would indemnify Statesman for 93 percent of any of the losses on covered loans. Such an insurance policy was quite valuable; yet how secure could such a promise be, when the government was asserting its ability to breach

\(^{214}\)Statesman Reply Brief, supra note 95, at 16.
other aspects of the contract with impunity? Such a risk would obviously lead potential suppliers of capital to wonder whether the government would take the further step of breaching this aspect of the agreement; thus, the perceived risk of investing was obviously exacerbated by the prospect of adverse government action in the future, especially in an industry as highly regulated as the thrift industry.

Whether or not thrifts such as Statesman made a sincere, good faith effort to raise money in the capital markets is a question of fact, and cannot be answered by the limited evidence to which we are privy. Nonetheless, defendants point out that Statesman Group raised over $180 million between 1990 and 1993 in debt and preferred stock.\footnote{Def. Motion, supra note 66, at 52.} This could represent evidence that Statesman did in fact possess the capacity to raise sufficient funds from the capital markets to meet the regulatory capital requirements. However, in their brief, defendants do not elaborate on this funding, and their terse statement cannot be regarded on its own as proof positive that Statesman could have salvaged the thrifts. When companies raise money, they must explain to investors what the funds will be used for; it is a rare investor that is willing to sign a check when he has no idea what the company will do with the money. Evidently, Statesman’s insurance affiliates were profitable companies, earning returns on equity in the high teens. Therefore, it is not surprising that Statesman was able to access the capital markets to finance these operations. But this does not show, nor even tend to show, that Statesman could have tapped the markets for thrift funds with equal facility. At the time, investors were edgy about the thrift industry: the S&L crisis had famously depleted the federal till; worse, some thrifts that from a purely economic standpoint should have died natural deaths years earlier had been kept on life support through accounting adjustments such as supervisory goodwill.\footnote{The government’s breach of these contracts in FIRREA may have had a second order effect as well in that the government initially maintained that it was free to take away goodwill as it pleased, raising the spectre of future moves by the government that might have a deleterious effect upon savings and loans.} Now that such extraordinary treatment had been removed, investors wondered what it would take to resuscitate the ailing thrifts.
B. RELIANCE AND RESTITUTION DAMAGES

In addition to their request for expectancy damages, plaintiffs in the Winstar-related cases also seek reliance and restitution damages. As noted above, the standard remedy courts impose is to grant the injured party his expectation interest. In some cases, however, courts may grant an injured party his reliance interest, which represents an attempt by the court to put the injured party back in the position that he would have been in the absence of the contract.\footnote{Farnsworth, supra note 71, at §12.1; Restatement §344(b): The reliance interest represents the injured party's "interest in being reimbursed for loss caused by reliance on the contract by being put in as good a position as he would have been in had the contract not been made."} The Restatement states that as an alternative to expectation damages, the injured party has the right to recover expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty that the injured party would have suffered had the contract been performed.\footnote{Restatement §349.} That is, the measure of damages based on the reliance interest is the amount that a nondefaulting party has been induced to expend on the faith of the contract.\footnote{219 Am. Jur. 2d §50.} Generally, the reliance interest is regarded as affording a means for giving some relief when the full expectation interest is for some reason inappropriate.\footnote{Farnsworth, supra note 71, at §12.16. Professor Farnsworth elsewhere notes: "Situations in which damages have been measured by the reliance interest have characteristically been those in which damages measured by the full expectation are for some reason regarded as inappropriate and the court turns to the reliance interest as a lesser included component that will give a measure of relief." Farnsworth at §12.1.} For example, the most common use of the reliance measure occurs when the injured party clearly incurred expenses as a result of the party in breach's nonperformance, but is unable to prove lost profits with certainty.\footnote{221 22 Am. Jur. 2d §51: "If anticipated profits are too speculative to be determined, monies spent in past performance or in reliance on the contract are recoverable."} This is not always the case, however; if the injured party would have lost money on the contract, he may do better suing for reliance damages, because then at least he can recover the amount of its

\footnote{Farnsworth, supra note 71, at §12.1. See also 22 Am Jur 2d §51: "Although [the reliance interest] may be equal to the expectation interest, it is ordinarily smaller because it does not include the injured party's profit."}
reasonable expenditures, though this amount will be reduced somewhat by the amount of losses he would have incurred. Nonetheless, even after such a deduction, the injured party may have a net recovery, whereas when a court adopts a net rather than gross expectation damages measure, a losing contract will provide no recovery.

As an alternative to lost profits, Glendale claims that it should be recompensed for the “massive out-of-pocket losses” it suffered as a result of the Government’s breach. In calculating these damages, Glendale sums its alleged losses from (a) the assumption of Broward’s net liabilities of $734 million; (b) $18 million in interest payments to the FDIC; (c) increased cost of funds in the amount of $324 million; and (d) increased deposit insurance premiums and OTS assessments of $18 million. All told, according to the testimony of Glendale’s experts, Glendale’s net loss from entering the contract with the FSLIC exceeds $800 million. This represents a good deal less than Glendale seeks from lost profits, but is still quite a large figure. Moreover, according to the Glendale brief, “[t]he government has indicated that it may not challenge reliance damages as a proper measure of damages in this case.”

Glendale ought to have the least trouble proving the first part of its reliance damages, Broward’s net capital hole that Glendale filled in at the time of acquisition. This amount was clearly spent on the faith of the government’s contractual performance. However, the path to recovery of the rest of Glendale’s reliance interest claim contains greater obstacles. Of the remaining elements of the claim, by far the most significant is the $324 million loss Glendale claims it suffered in the form of an increased cost of funds. Presumably, this higher cost of capital was the result of Glendale’s successful effort to salvage the thrift in 1993 by raising additional equity. In this case, since Glendale was able to raise the funds from the capital markets, it may possibly recover this amount. However, in general, the courts have been hostile

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223 Note, however, that this amount will be offset by the amount of losses that the injured party would have suffered had the contract been completed.
224 Glendale Motion, supra note 32, at 40.
225 Id. at 40.
226 Id. at 40.
227 Id. at 39-40.
to recovery for this type of incidental reliance. As Professor Farnsworth notes, "[I]t is important to understand that the law has generally not recognized yet another kind of reliance – reliance that consists of forgoing opportunities to make other contracts." 228

While Glendale contends that the government has expressed a desire not to challenge the use of reliance damages, the government certainly will seek to minimize Glendale’s recovery by the offsetting benefits that Glendale received from the government’s partial performance of the contract. 229 Since the goal of reliance damages is to put the injured party back in the position he would have occupied absent the contract, these benefits must be deducted from his recovery in order to prevent his receipt of a windfall. The calculation of these benefits is of course a factual matter, and the government must shoulder the burden of proving their existence with reasonable certainty. Nonetheless, we can make a stab at examining what offsetting benefits Glendale and other thrifts received under their contracts. First, the most obvious benefit received was the ability to count as regulatory capital the supervisory goodwill created by the merger, which resulted in lower effective reserve ratios. As we have seen above, supervisory goodwill was amortized by the thrifts over 40 years on a straight-line basis. If Glendale had $750 million in supervisory goodwill at the time of the acquisition, this would have been reduced annually by $18.75 million. In 1982, Glendale had $731.25 million in supervisory goodwill, in 1983 $712.5 million, and so on. Thus, by the time the government breached the contract in 1989, Glendale’s supervisory goodwill had been reduced by a fifth to $600 million. The key question here is how to determine the benefits received by Glendale over this eight-year span. One option is simply to deduct $150 million from the amount that Glendale paid for Broward. Since the standard measure of damages for breach of contract is expectation damages, reliance damages will proceed in this case based on the assumption that Glendale cannot prove lost profits following the 1989 breach with certainty. Nonetheless, this does not mean that profits cannot be calculated with certainty for the period before the breach, from 1981-1989; not only can they be calculated, they

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228 Farnsworth, supra note 71, at §12.1.
229 In fact, Glendale acknowledges that the government will indicate offsetting benefits that Glendale received. Glendale Motion, supra note 32, at 49.
are already a matter of public record in Glendale’s 10-K reports filed with the SEC. This seems to be the better way to calculate the offsetting benefits that Glendale received from the contract; as the Claims Court, the Circuit Court, the Supreme Court, and Glendale itself have noted repeatedly, the treatment of supervisory goodwill as regulatory capital allowed the plaintiff thrifts to achieve tremendous leverage, and thus greater profits than if the contract had not been made. Therefore, it appears correct to offset Glendale’s, and other similarly situated plaintiffs’, reliance damages by the extra profits they were able to earn over the period of the government’s performance.

As an alternative to expectation and reliance damages, Glendale also seeks recovery based on the restitution theory. Unfortunately, the jurisprudence regarding restitution in the Court of Federal Claims is very confused. The Restatement’s description of restitution appears simple enough: it simply states that “[a] party is entitled to restitution under the rules stated in this restatement only to the extent that he has conferred a benefit on the other party by way of part performance or reliance. The Restatement goes on to state that the restitution interest should be measured under one of the following two methods:

(a) the reasonable value to the other [breaching] party of what he received in terms of what it would have cost him to obtain it from a person in the claimant’s position, or

(b) the extent to which the other party’s property has been increased in value or his other interests advanced.231

Essentially, the first of these is simply a market value measure; the injured party should receive the market value of whatever performance he delivered to the party in breach.232 The advantage of using this method, presumably, is that it is more administratively feasible, especially when the

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230 Restatement (Second) §370. See also Restatement §344(c): Plaintiff’s restitution interest is “his interest in having restored to him any benefit that he has conferred on the other party.”
231 Restatement (Second) §371.
232 Restatement (Second) §371 comment a.
market for such performance is readily ascertainable. According to Professor Farnsworth, the purpose of restitution is “to prevent unjust enrichment of the party in breach.”233 Further,

“[t]he objective is not to put the injured party in as good a position as that party would have been in if the contract had been performed, nor even to put the injured party back in the position that party would have been in if the contract had not been made; it is, rather, to put the party in breach back in the position that party would have been in if the contract had been made.234 (emphasis in original)

This seems clear enough, and indeed stands as a pillar of both the Glendale and Statesman arguments for restitution damages. Among the benefits allegedly received by the government, according to Glendale, were Glendale’s assumption of Broward’s liabilities, which saved the FSLIC the cost of liquidating the thrift in 1981; the cash payments made by Glendale to FSLIC pursuant to the interest-rate provision of the contract; increased FDIC insurance premiums and OTS assessments because Glendale fell into a higher risk category after the breach; and the earnings that the government gained from these foregoing benefits.235

In order to prove the first type of benefits received, obviation of the need to liquidate Broward, Glendale must show that this was FSLIC’s only remaining option at the time. That is, if FSLIC could have found another acquiror to take over Broward, then the only unjust enrichment that FSLIC received was at the margin; it may have preferred Glendale, but only marginally over other thrifts. Therefore, the linchpin of Glendale’s restitution case must be that there were no other investors willing to acquire the ailing Broward. And indeed, Glendale makes such an argument, pointing out that “two other Florida thrifts refused the same deal that Glendale accepted.”236 This may be a key differentiating feature among the various cases before the Court of Federal Claims, because in some instances, such as Statesman’s acquisition of First Federated and the three Iowa thrifts, FSLIC had approached many potential suitors only to meet with rejection, while other thrifts may have proved more attractive and enticed other potential

233Farnsworth, supra note 71, at §12.19
234Id. at §12.19.
235Glendale Motion, supra note 32, at 43.
236Id. at 44.
acquirors as well. This is of course a factual issue that must be determined on a case-by-case basis, but it is worth noting that the answer may differ markedly in the various cases. Glendale, however, also has the benefit of favorable language in the Supreme Court and lower courts’ opinions suggesting that this transaction was the only means of salvaging Broward and avoiding the costs of liquidation, and plaintiffs do not overlook this in their brief. 237 Interestingly, Glendale also points in its brief to what it apparently views as inculpatory language contained in the brief of the United States before the Supreme Court in Winstar that states “The [Glendale] merger transaction permitted FSLIC to avoid (at least for the time being) substantial losses that would have occurred had Broward been put into receivership.” 238 Glendale fails to understand that this statement is hardly tantamount to an admission that Glendale snatched the helpless Broward from the tracks seconds before the train arrived. The government brief declares merely that substantial losses would have resulted if Broward had been placed in receivership; it omits the crucial intervening step, that Broward would have been put in receivership but for the acquisition by Glendale.

Irrespective of its faulty semantic analysis, Glendale probably does have a good case regarding this element of the restitution claim, and should be able to show that FSLIC did indeed benefit from the contract because it no longer had to liquidate Broward. Similarly, the interest rate payments appear to represent a good claim for Glendale. 239 On the other hand, Glendale’s claim that the increased FDIC insurance premiums and OTS assessments that Glendale had to pay is a very aggressive one that deserves rejection. In 1992, largely as a result of the government’s breach, Glendale fell below various regulatory capital requirements and was classified as a troubled thrift under OTS regulations, which meant that Glendale was forced to pay higher premiums for deposit insurance to the FDIC and increased assessments to the

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237 Id. at 44: “Thus, FSLIC entered into its contract with Glendale ‘[a]s an alternative to liquidating [Broward] and expending the FSLIC’s insurance funds’ and ‘in this way the regulators tried to avoid paying off the failing thrift’[s] deposits out of the FSLIC’s insurance fund.’” (citing 64 F.3d at 1535).
238 Id. at 44.
239 Neither the plaintiff’s nor the defendant’s briefs discuss this issue in any detail, and we lack access to the original contract documents which presumably would clarify it. Therefore, we do not waste any additional energy in what could only prove an incomplete analysis.
Glendale argues that since “the government would not have received these additional premiums and assessments from Glendale had the contract never been consummated,” they should be included in Glendale’s restitution award. This argument lacks merit. If we return to what Glendale accepts and states to be the purpose of restitution, it is to prevent the unjust enrichment of the party in breach. Logically, for these higher assessments and insurance premiums to be includable in the restitution award, they must constitute unjust enrichment to the government. But do higher premiums really enrich the government? Certainly, they increase the amount of cash that flows in; but the only reason Glendale had to pay more was that it had become a troubled thrift, and was in greater peril of insolvency. Under the risk-based capital guidelines adopted by FDICIA, the FDIC was obliged to charge insurance premiums based on individual thrifts’ capitalization. The rates charged by the FDIC were related to the probability that these institutions would fail, in which case the FDIC would absorb the costs of liquidation. As with any insurance, there is no reason to believe that the FDIC gained simply from receiving higher premiums, since it was now exposed to greater risks. A life insurance company which rewrites its policy and charges a higher premium to a man who has just announced that he will devote the rest of his life to skydiving and chain smoking enjoys no inherent benefit; the higher premium simply reflects the greater risk faced by the company. In the same way, Glendale’s argument that the FDIC was somehow unjustly enriched because Glendale had become a troubled thrift in more danger of failure is entirely specious.

Glendale’s final claim regarding restitution is that the FDIC received earnings on the estimated $785 million that it would have spent liquidating Broward in 1981, as well as on the $18 million of interest payments and the $14 million in increased premiums and assessments.

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240 Glendale Motion, supra note 32, at 45.
241 Id. at 46.
242 See Glendale Motion at 44–45, citing Restatement (Second) §373 comment a and 1 Dobbs §4.1(2) at 559: “Thus, restitution serves ‘to prevent the unjust enrichment of the’ party in breach. As a leading treatise explains, ‘the unjustness of allowing the defendant to retain the plaintiff’s performance is established as soon as we know that he is liable for the breach.’”
244 Glendale Motion, supra note 32, at 46.
As we have seen, the last of these clearly lacks merit and warrants no further discussion, since if the assessments and premiums do not represent unjust enrichment, neither can the earnings thereon. But the magnitude of this element of the claim is minuscule compared to the earnings on the $785 million that the FDIC allegedly saved in not liquidating Broward.

The main problem that Glendale runs into in asserting this claim is the bar against prejudgment interest in claims against the United States government. In a typical case involving two private parties, Glendale would be able to recover interest on the damages from the date of breach. However, in a suit against the United States government, a plaintiff cannot recover interest unless such recovery is expressly provided for by statute or by contract between the parties. In some cases, the government has waived its sovereign immunity and allowed interest, including prejudgment interest, to be awarded. But, as the Supreme Court stated in Library of Congress v. Shaw, "[i]n the absence of express congressional consent to the award of interest separate from a general waiver of immunity to suit, the United States is immune from an interest award." In that case, the attorney for an employee who had brought a job-related discrimination action against the Library of Congress sought an award for attorney's fees. The Court stated that waivers of immunity would be interpreted narrowly:

"[T]here can be no consent by implication or by use of ambiguous language. Nor can an intent on the part of the framers of a statute or contract to permit the recovery of interest suffice where the intent is not translated into affirmative statutory or contractual terms. The consent necessary to waive the traditional immunity must be express, and it must be strictly construed."  

245 "Certainly in any normal commercial dispute over property, the disputed property would, as soon as practical, be placed in an escrow account to earn interest that would go to whoever was the ultimate winner." United States v. $277,000 U.S. Currency, 69 F. 3d 1491, 1494 (9th Cir. 1995).
247 For example, a plaintiff can recover prejudgment interest for taxes wrongfully withheld by the government.
248 Library of Congress v. Shaw, 478 U.S. 310 (1986). As a sovereign, the United States is immune from suit unless it consents to be sued. See, e.g., United States v. Sherwood, 312 U.S. 584 (1941). The rule that a plaintiff cannot recover interest in the absence of express waiver is a long-standing one. See Angarica v. Bayard, 127 U.S. 251, 260 (1888) ("The case, therefore, falls within the well-settled principle that the United States are not liable to pay interest on claims against them in the absence of express statutory provision to that effect.") (cited in 478 U.S. at 315).
Applying this rule, the Court held that even though the applicable statute did waive sovereign immunity from suit, it did not contain an express waiver of sovereign immunity from interest; thus, the Court denied the plaintiff's motion for attorney's fees.250

Glendale seeks to avoid the bar against prejudgment interest by asserting that the money the FDIC earned by investing the alleged benefits constitutes earnings, not prejudgment interest.251 Earnings, Glendale claims, are part of the res itself, not the interest thereon; put another way, this money is a limb of the tree and not one of its fruits. In support of this contention, Glendale points to United States v. $277,000 U.S. Currency, a forfeiture case where the government was found to have wrongfully seized an individual's assets.252 The Ninth Circuit held that in addition to returning the wrongfully seized assets (in this case, currency) themselves, the government must also deliver earnings it had received or should have received on that property; these gains were “part of the res, to be returned with the res to the claimant.”253 Analogizing to that case, Glendale claims that the FDIC's earnings differ from prejudgment interest, which is intended to “compensate[] the plaintiff for delayed performance of a government obligation to pay money” and rather should be viewed as part of the actual claim itself.254

In its argument for restitution damages, Statesman also seeks return of the “actual earnings” by the government on the use of Statesman's capital contribution and its cost savings from not delaying liquidation. According to Statesman, “disgorgement of the government’s actual earnings is not tantamount to an award of prejudgment interest,” and indeed is necessary in order to prevent the government’s unjust enrichment.255 Likewise, Statesman relies on the holding in $277,000 U.S. Currency.

250 Shaw, supra note 247, at 323.
251 Note that Glendale does not concede here that prejudgment interest is barred in this case; rather, it attempts to bring the “earnings” received by the FDIC outside the purview of the federal bar against prejudgment interest.
252 $277,000 U.S. Currency, supra note 244.
253 Id. at 1496-98; see Glendale Motion at 47.
254 Glendale Motion, supra note 32, at 47.
255 Statesman Mem. of Law., supra note 73, at 41.
Unfortunately for both of these plaintiffs, $277,000 U.S. Currency provides poor support for their argument, and is clearly distinguishable from the Winstar-related cases for several reasons. First, the case involved the wrongful forfeiture of the claimant’s property, not a breach of contract action. In their argument that the court should follow this case, Statesman claims that in $277,000 U.S. Currency, “the court distinguished between pre-judgment interest and an award of restitution based on the earnings that the government actually made on the money,” and found that “restitution in that case was warranted.”\textsuperscript{256} However, the court expressly recognized this as an unusual case, since the government had organized a fund to place these type of seized assets in so that they would earn interest, but inexplicably had not placed this money in the fund; in effect, the government had lost track of the money, and the court adopted a scolding tone as it chastened the government for keeping the money where it sat idle and unprofitable.\textsuperscript{257} These peculiar facts, rather than any general principle, explain the holding in $277,000 U.S. Currency. Indeed, the court itself expressed agreement with the government’s basic argument that in general, prejudgment interest is barred in cases like this.\textsuperscript{258} At any rate, $277,000 U.S. Currency is not controlling, and neither the Federal Circuit nor the Court of Federal Claims has ever applied this reasoning to a breach of contract claim against the government, and the holding has received only mixed support in the handful of other cases which have cited it.\textsuperscript{259}

More critically, we must consider what the difference is between what the plaintiffs variously refer to as the government’s “earnings” or “actual earnings” and prejudgment interest. While Glendale and Statesman seek to escape the reach of the no-interest bar, in fact it cuts a wide swath. In Shaw, the Court declared that “[t]he character or nature of interest cannot be changed by calling it damages, loss, earned increment, just compensation, discount, offset, or any other term, because it is still interest and the no-interest rule applies to it.”\textsuperscript{260} Accordingly, in

\textsuperscript{256}Id. at 41.
\textsuperscript{257}“Where a disputed res is capable of being put to use for someone, it makes no sense whatsoever that a pile of dollar bills should be left doing no good for anyone.” $277,000 U.S. Currency, supra note 244, at 1494.
\textsuperscript{258}Id. at 1494.
\textsuperscript{259}See Schneider v. California Department of Corrections, 1997 WL 154384 (N.D. Cal) (distinguishable because there was no seizure of plaintiffs’ assets by government and their funds were not held improperly or illegally).
that case the Court rejected the plaintiff's argument that he sought "compensation for delay," not prejudgment interest; in effect, said the Court, "[i]nterest and a delay factor share an identical function. They are designed to compensate for the belated receipt of money."\textsuperscript{261} Despite the plaintiff's wordplay in the Glendale and Statesman cases, both are really asking for an award that is indistinguishable from prejudgment interest.

Furthermore, the Court of Federal Claims and the Federal Circuit have considered several similar cases and adopted a posture that bodes ill for the plaintiffs on this question. For example, as the government points out in its brief, the Federal Circuit denied an award of accrued interest on money wrongly withheld by the government as payment for government travel.\textsuperscript{262} Similarly, in Detroit International Bridge Company v. United States, the Court of Federal Claims rejected the plaintiff's prayer for "unpaid rent," although it allowed recovery for the valid underlying contract claim.\textsuperscript{263} The plaintiff brought suit under the Contract Disputes Act of 1978, which "does not create a statutory right to interest, except insofar as it permits interest on a claim."\textsuperscript{264} Because the plaintiff recognized this, he argued that the relief he sought was not interest on a claim, but interest as a claim.\textsuperscript{265} This argument appears strikingly similar to Glendale and Statesman's attempt to find support in the language of S277,000 U.S. Currency broadly defining the res. The court rejected this argument, however, and noted that except for very limited circumstances, a demand for interest alone is not a claim under the Contract Disputes Act.\textsuperscript{266}

In general, then, we see that the courts, especially the Federal Circuit and the Court of Federal Claims, have been hostile to attempts to avoid the prejudgment interest bar through semantic prestidigitation. Perhaps the most pertinent case in this regard is AT&T Technologies, Inc. v. United States.\textsuperscript{267} In that case, an unsuccessful bidder for developing a publishing system

\textsuperscript{261}\textit{id.} at 322.
\textsuperscript{262}Alaska Airlines, Inc. v. Johnson, 8 F.3d 791, 798 (1993).
\textsuperscript{263}Detroit International Bridge Company v. United States, 32 Fed. Cl. 225 (1994).
\textsuperscript{264}\textit{id.} at 229 (emphasis added). That is, the statute allows the contracting parties to provide for interest recovery, but does not mandate such recovery or provide for recovery in the absence of a contractual provision.
\textsuperscript{265}\textit{id.} at 229.
\textsuperscript{266}\textit{id.} at 228.
\textsuperscript{267}AT&T Technologies, Inc. v. United States, 18 Cl. Ct. 315 (1989).
for the government brought suit to recover damages after its request for a proposal was
terminated due to a technical error in the government’s procurement process.268 In addition to
proposal preparation costs which the bidder requested, he also submitted a claim for $701,736 in
damages as the “cost of money.”269 According to the plaintiff, this amount constituted part of
its reliance interest and was fully recoverable.270 The court rejected this argument, accepting the
defendant’s riposte that these costs represented “no more than a disguised claim for prejudgment
interest.”271 Thus, the plaintiff thrifts are unable to point to any controlling cases where the
Court of Federal Claims or the Federal Circuit has allowed a plaintiff to escape the rigors of the
prejudgment interest bar by recasting the interest as plaintiffs attempt to do here. Indeed, as we
have seen in the only case that they do rely on for support, the court noted that the case before it
was atypical, and that in general the government was perfectly correct in arguing that the
prejudgment interest rule bars such claims.272 On a conceptual level, it is quite difficult to
distinguish between prejudgment interest and the FDIC’s alleged earnings here. In effect, these
earnings were merely the returns that the FDIC received by investing the money in treasury bills,
which is really no different from an interest calculation. Therefore, both of these claims should
be rejected.

Even though the claims by Glendale and Statesman that seek damages equivalent to
prejudgment interest warrant rejection, the lion’s share of both of their claims --their initial
capital infusions to fill in the failing thrifts’ net capital holes-- is valid under the traditional view
of restitution. Under this view, the purpose of restitution is to prevent the unjust enrichment of
the party in breach; therefore, the party in breach must be returned to its status quo ante. The
Court of Federal Claims’ jurisprudence on this issue is not, however, so pellucid.

In response to Glendale and Statesman’s claims for restitution, the government declares that
“restitution is measured by what is necessary to restore the innocent party to its pre-contract

268Id. at 315.
269Id. at 326.
270Id. at 326.
271Id. at 326.
272$277,000 U.S. Currency, supra note 244, at 1493.
position, typically by awarding the innocent party its costs."273 This seems flatly contradictory to what Farnsworth and other leading commentators assert is the purpose of restitution. Nonetheless, the government points to two Claims Court cases which buttress its argument. In Acme Process Equipment Co. v. United States, the Court of Claims stated that "restitution is permitted as an alternative remedy for breach of contract in an effort to restore the innocent party to its pre-contract status quo, and not to prevent the unjust enrichment of the breaching party."274 Similarly, the court declared in Pacific Architects and Engineers, Inc. v. United States that "[r]estitution would entitle plaintiff merely to be restored to the status quo ante, pursuant to which it would be limited to its prudent costs."275 Clearly, these statements are contrary to the general view of restitution that we have already seen, and instead envisage restitution as more akin to reliance, in that both measures are designed to place the injured party in the status quo ante. The question remains, then, whether these simply represent anomalous statements selectively quoted by the government and unrepresentative of the general view of the Court of Federal Claims, or whether they accurately portray its jurisprudence in this area.

While they acknowledges that the Court of Claims has not always hewn to the position that restitution is measured by the benefit received by the party in breach, it claims that Acme stands for the proposition that an award of "restitution is not limited to the value of the goods received by the government under contract."276 True, the court did use this language in Acme; nevertheless, the primary holding in Acme as well as Pacific was that restitution is measured by what it takes to return the injured party to the status quo. The above-quoted language does nothing to controvert this holding, and provides no basis for Statesman's conclusion that "[t]hus, Acme is in no way inconsistent with the notion that the government must return any benefits it

273Def. Motion, supra note 66, at 57. (emphasis added)
276Statesman Reply Brief, supra note 95, at 23, citing Acme, supra note 273, at 359.
has received under a contract it has breached.”

Nonetheless, the plaintiffs are correct in asserting that a generally accepted measure of restitution is to put the breaching party back in the status quo, and its purpose to prevent unjust enrichment by that party. How, then, to explain the different view that the Court of Federal Claims has adopted on the subject? First, it is necessary to understand that “restitution” has traditionally referred to two separate concepts. One is that in the absence of a contract, a court may imply a contract between the parties, and award restitution to the innocent party in the amount that the other party was unjustly enriched. The second concept of restitution occurs when one party seeks to undo an extant contract through rescission. Rescission undoes the contract, but does not in itself undo the harm to the innocent, non-breaching party. Therefore, in such cases, restitution is awarded to the non-breaching party to compensate him for his differences. In this situation, restitution is seen as an alternative to other contract damages measures, not as a means of preventing unjust enrichment. The crucial point is that Acme, Pacific Architects, and the Winstar-related cases all involve the latter case, where a valid contract already existed. And in such cases, the Court of Federal Claims measures restitution by the costs inflicted upon the injured party, not the benefits received by the party in breach. Thus, the court in the cases cited above did not reject the notion that restitution in the absence of a contract, where one must be implied, should be used to prevent unjust enrichment. Rather, it said that when there already is a contract, restitution is a proxy for damages, not an antidote to unjust enrichment.

The government’s argument is not clear on this point, and in fact contributes to the confusion. As we have seen, the government maintains that restitution is designed to place the injured party in the status quo ante. But in demanding that a plaintiff seeking restitution return any benefits received, it cites Svendborg v. United States for the proposition that “for plaintiffs to rescind and obtain restitution, the plaintiffs had to place the Government in the status quo

\[277\] Id. at 23.
Additionally, the government quotes the Restatement of Contracts that “[t]he objective is to return the parties, as nearly as practicable, to the situation in which they found themselves before they made the contract.” Both of these quotations muddle the issue, because they appear to lend support to the plaintiffs’ argument that the government must be returned to the status quo. In fact, however, they simply reflect a desire to return both parties to the original position before the contract was adopted. Crucially, however, the court determines that original position by measuring the costs borne by the plaintiff (in effect, the reliance interest), and not by the benefit obtained by the defendant. Thus, when the court speaks of returning the breaching party to the status quo ante, it measures the status quo ante by the costs borne by the injured party. That is why the court has placed emphasis on measuring the value of the benefits received by the injured party; these benefits must be offset against the costs the injured party bore in order to determine the net damage suffered by the innocent party. For example, in Arizona ex. rel. Arizona Department of Transportation v. United States, the court noted that “[r]estitutionary recovery is limited to the reasonable value of the injured party’s performance, measured as of the time it was rendered, less the amount of benefits conferred upon plaintiff by the part performance of the breaching party.” In contrast, if the court were using the breaching party’s benefit as a yardstick, the benefits received by the innocent party would be irrelevant; instead, the court would weigh the benefits received by the breaching party against its costs. As we have seen, the court focuses on the injured party, and thus if the Court of Federal Claims seeks to follow its own precedent, it will measure restitution in this case by the amount needed to return Statesman and Glendale, not the government, to the status quo ante. Moreover, this measure has the added virtue of comporting with the court’s widely shared view that the plaintiff should not profit from the breach. For example, in the oft-quoted case Northern Helex Co. v. United States, cited by both the plaintiffs and the government, the Court of Claims held

278 Def. Motion, supra note 66, at 60.
279 Id. at 61.
280 Arizona ex. rel. Arizona Department of Transportation v. United States, 216 Ct. Cl. 221, 575 F.2d 855 (Ct. Cl. 1978). See also Restatement §347.
that "the plaintiff is entitled to recover the full measure of the bargain it made with the
government.... Its entitlement is to be made whole for the damages it suffered from, but not to
make a profit from, the breach." 281 The court also makes this point forcefully in Torres v.
United States, declaring that "[i]n a suit for breach of contract plaintiff is not entitled to profit on
the amount of his damage." 282 By measuring restitutionary recovery by the injury to the
plaintiff, the court could avoid giving a windfall to the plaintiff thrifts.

What implications does this have for our case? For one thing, it sheds new light on the
argument between the parties over whether a party can recover both restitution and reliance
damages in the same case. Both Glendale and Statesman maintain that a plaintiff is entitled to
recover both restitution and reliance damages to the extent that these damages do not overlap. 283
Thus, contrary to the government's accusation, they do not urge the validity of double recovery
here. 284 Moreover, plaintiffs' reliance upon CBS, Inc. v. Merrick, where the Ninth Circuit held
that "[a] party injured by a breach of contract may recover both restitution and reliance
damages," is also well-founded. 285 However, the problem here, and the reason for the confusion,
is that the government points out that under the Court of Federal Claims' past jurisprudence,
restitution is measured by the amount needed to put the plaintiff back in his original position.
This is the same as the reliance measure. Thus, under the government's reading, granting
restitution and reliance to the plaintiff is akin to giving him his reliance measure twice. On the
other hand, the plaintiffs' view restitution as different from reliance, and insist that both may be
recovered so long as no overlap exists. While the plaintiffs are correct in theory, once again they
are confusing the two types of restitution. In the Winstar-related cases, the court's jurisprudence
dictates that it use restitution not as a remedy for unjust enrichment, but as an alternative to

281 Northern Helex Co. v. United States, 634 F.2d 557, 563 (1980). See also Kinzley v. United States, 228 Ct.
Cl. 620, 626 (1981).
283 See Statesman Mem. of Law, supra note 73, at 38 ("It is well established that a party may recover both
restitution and reliance damages to the extent that there is no overlap between the two." See, e.g., 3 Dobbs, Law of
Remedies §12.7 (1); Restatement §370.)
284 Statesman Reply Brief, supra note 95, at 24.
285 CBS, Inc. v. Merrick, 716 F.2d 1292, 1296 (9th Cir. 1983).
normal contract damages. Therefore, while theoretically the plaintiffs may be correct, in fact the reliance and restitution measures would be coextensive in these cases.

Several other restitution and reliance issues warrant discussion. In the event that restitution is awarded, as we have seen, the plaintiff’s restitutionary recovery is offset by “the amount of benefits conferred upon the plaintiff by the part performance of the breaching party.”286 Professor Corbin states that where a plaintiff sues for damages for breach of contract, the breaching party’s

“part performance must be allowed as a credit against the value of the full performance promised by the defendant. If, instead of suing for damages, the plaintiff asks for the alternative remedy of restitution, a similar credit must be allowed against the value of the performance rendered by the plaintiff for which he asks judgment. A plaintiff who recovers the full value of such performance as he may have rendered, and at the same time is allowed to retain a part performance that he had received, is thereby put in a better position than he occupied before the contract was made.”287

Such a result would ill comport with the tenet that the injured party should not profit from the breach, which the Court of Federal Claims has embraced in the past.288 In general, courts agree that restitution requires the return or offset of what the plaintiff received through the breaching party’s part performance.289 The Restatement similarly states that “[a] party seeking restitution of a benefit that he has conferred on the other party is expected to return what he has received from the other party.”290 Glendale accepts the offset doctrine, though it notes correctly in its brief that the breaching party shoulders the burden of proving the fact and amount of any offset.291

Offset would play a pivotal role in any restitution award here, because recovery would be reduced by the value to Glendale of the government’s part performance, which should be

286Arizona, supra note 279, at 864.
287Corbin, supra note 74, at §1114.
288Torres, supra note 281, at 79. See also Farnsworth, supra note 71, at §12.8: “It is a fundamental tenet of the law of contract that, regardless of the character of the breach, an injured party should not be put in a better position than had the contract been performed.”
289See 5Corbin §1114, citing 26 cases to this effect.
290Restatement §384 comment a.
291Glendale Motion, supra note 32, at 48.
measured by the profits Glendale was able to earn on the supervisory goodwill from 1981 to
1989. This would likely be a large number, especially given that amortization had not yet
significantly reduced the size of the supervisory goodwill available for Glendale. Glendale
contends that there should be no offset in this case "because any benefits conferred by the
government on Glendale are exceeded by the expenses incurred by Glendale as a result of entering
the contract that the government later breached." 292 This argument is hard to accept. What
Glendale describes as the "expenses" it incurred is simply the amount that it spent for the benefit
of the government; this figure should have been included in the original restitution amount.
Therefore, in order to ensure that Glendale does not profit from the breach, it is necessary to
deduct the value Glendale received from the government's part performance of the contract from
1981 to 1989. While Glendale may be correct in stating that its expenses exceeded any benefits
from the government's part performance, this means nothing more than the net restitution figure
will be positive. Perhaps Glendale is referring here to expenses that it incurred which did not
benefit the government. However, courts and commentators agree that a plaintiff cannot recover
in restitution for any expenditures that did not benefit the breaching party. 293 As the
Restatement notes, "a party's expenditures in preparation for performance that do not confer a
benefit on the other party do not give rise to a restitution interest." 294 Consequently, Glendale
cannot avoid offset in this manner.

In arguing against a restitution award in the Statesman case, the government claims that such
an award would be ill-advised because "the nature of the transactions in this case makes the
award of restitution extremely difficult," and would require "a long, expensive, arduous trial or
difficult issues." 295 According to the government, the court should "decline to engage in the
expensive and time consuming task" of determining restitution and focus on expectancy damages

292 Id. at 49.
293 See, e.g. Harris v. Metropolitan Mall, 112 Wis 2d 487, 334 Nw2d 519; 22 Am. Jur. 2d §56: "Restitution is
allowed only to the extent the injured party has conferred a benefit on the other party by way of part performance or
reliance...an injured party who has not conferred a benefit is not entitled to restitution, and he may recover only for
those expenditures he made in reliance on the defendant's representations. And he is only entitled to recover
restitution damages to the extent that the defendant was unjustly enriched as a result of the plaintiff's actions.
294 Restatement §370 comment a. See also Illustration 1 to Restatement §370.
295 Def. Motion, supra note 66, at 53-54.
instead. In the two paragraphs it devotes to this argument in its brief, the government uses the words "complicated," and "difficult" five times, but otherwise gives no reason why restitution damages would be so much harder to calculate than expectancy damages that the court should eschew a restitution measure altogether. Of course, saying something five times does not make it any more true than saying it once. Moreover, the government's argument here would carry a lot more water if it had not also complained that Statesman's expectancy damages claim "would require an enormous expenditure of resources," and yet still endorsed using the expectancy measure because it "would provide Statesman with the benefit of its bargain." Furthermore, the government fails here to lodge a similar claim against the use of the reliance measure of damages, even though the reliance and restitution measures under Court of Federal Claims jurisprudence are identical. From a practical standpoint, no reason exists for circumscribing the court's restitution inquiry on the basis of the government's overblown and overstated fears regarding the difficulty of such a task.

One final point regarding restitution is in order. Statesman points out that by inducing it to acquire thrifts that otherwise might have had to be liquidated, the government by its own estimates saved $50 million. Statesman also notes correctly that the reasonable value of the injured party's performance is measured as of the time it was rendered. Combining these two, Statesman concludes that the government's unjust enrichment should not be reduced by the amount that it later cost to liquidate the thrift after the breach. Leave aside for now the fact that restitution for breach of contract in the Court of Federal Claims is not measured by the breaching party's unjust enrichment. Statesman is correct in maintaining that the breaching party was still enriched even if it later squandered these benefits. According to the Restatement, "[t]he requirement of this Section [that a plaintiff is entitled to restitution only to extent that he has

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296 *Id.* at 54.
297 *Id.* at 45, 54.
299 *Id.* at 39, citing 216 Ct. Cl. 221.
conferred a benefit on the other party] is generally satisfied if a benefits has been conferred, and it is immaterial that it was later lost, destroyed, or squandered. 300 Similarly, Professor Corbin writes that "It is clear... that the value to be recovered by the plaintiff is not diminished by the fact that the defendant has lost or thrown away that which it received." 301

All of this seems rather straightforward. But in a sense, Statesman's arguments here are inconsistent. Statesman maintains that the government saved $50 million initially because otherwise it would have had to liquidate the thrift; by virtue of the acquisition, the probability of liquidation was reduced from 100 percent to 0 percent. But when the FHLBB chairman announced that the government had "saved" $50 million, he may have meant simply that its out-of-pocket costs at the time were reduced by $50 million. In reality, the probability of liquidation was not reduced to zero, since the possibility still existed that Statesman would fail (whether or not as a result of a future government breach). Therefore, the true value in economic terms of the acquisition by Statesman was somewhat less than $50 million; this amount can be thought of as the present value in 1981 of the product of the probability that the thrift's depositors would later have to be bailed out and the amount that such a bailout would cost. Overall, then, Statesman is correct in its general point that squandered benefits should not reduce Statesman's recovery; more specifically, however, Statesman has overstated the value to the government of the acquisition.

300 Restatement (Second) §370.
3015 Corbin, supra note 74, at §1112.
V. CONCLUSION

We have seen above the main arguments regarding damages in the Winstar-related cases, and discussed how the Court of Federal Claims and other courts that may face these questions should analyze them. Ultimately, however, the court must come to a conclusion as to the proper measure of damages in each case. While the facts differ and the outcomes in many of the cases will ride upon certain factual questions, the following prescriptive framework suggests how the court should come down on the various issues.

First, lost profits seems to be the correct measure of damages. Both the economic motivations of the thrifts and common sense regarding FSLIC's understanding of the savings and loan industry militate towards the conclusion that lost profits were a foreseeable consequence of a breach. The government can hardly gainsay with a straight face that it so misunderstood the economics of the thrift industry as not to realize either the motivation which inspired thrifts to engage in supervisory mergers or the ramifications of disallowing the treatment of supervisory goodwill as regulatory capital. To any knowledgeable observer of the savings and loan industry, the impact of removing supervisory goodwill was clear and foreseeable. Moreover, the fact that such a consequence need only be probable, not certain, further supports lost profits recovery here.

Whether or not the plaintiff in each individual case can prove that lost profits were recoverable with probable certainty is a different question, and some thrifts may indeed be unable to prove such a claim. Of course, this assumes that the anterior question, whether a valid contract existed mandating the continuation of supervisory goodwill treatment, is answered in the affirmative. In some cases, this may not be true. Even in the Statesman case, the Supreme Court had to resort to the incorporation rule in order to find the existence of such an agreement; in other cases, a contract may be less evident. Even if contracts are found to exist, some plaintiffs may face a large obstacle in the causation requirement. We have not addressed causation in this paper because in all three of the leading cases, it is clear that the government's breach was a proximate
cause of the plaintiffs' injury. However, in other cases to come, plaintiff thrifts may have a
difficult time proving that the government's breach directly caused the thrifts' failure or losses.
The Supreme Court found that the parts of FIRREA which simply raised reserve ratios were
non-breaching. Thus, for thrifts that even with the use of supervisory goodwill were
unprofitable or only marginally profitable, it will be difficult to prove that the breach, not the
higher reserve ratios, was the proximate cause of their injuries.

Assuming that plaintiffs overcome the hurdles of foreseeability, causation, and certainty,
they nonetheless must face the doctrine of avoidable consequences. The heart of the
government's case is that the plaintiff thrifts failed to mitigate damages, and under the doctrine of
avoidable consequences should have their recoveries reduced accordingly. While the plaintiffs'
argument that the government had an equal opportunity to mitigate damages is unconvincing,
their contention that the thrifts were under no obligation to put substantial additional funds at
risk is somewhat more credible. It seems, however, like there ought to be a sliding standard
taking both risk and size of further investment into account, because the two criteria are often
conflated into one test by courts. That is, courts may require for recovery that an injured party
invest a more substantial amount if it can be shown that such an investment was relatively
riskless; the less risk involved, the more substantial an amount must the injured party contribute.
In most of these cases, the plaintiffs maintain that they would have earned high profits in the
future, yet claim that an attempt to cover their losses by raising additional funds would have
meant undertaking substantially greater risks. Perhaps the best way to look at this is to measure
substantiality in a relative sense: The savings and loan industry inherently contains some risk,
due to the volatility of interest rates and other factors. In order to judge whether a thrift should
have mitigated, the court should ask whether the additional capital would have been more at risk
than the thrift's other assets: Would the further investment in the thrift be substantially more
risky than the investment they had already made? If the answer is yes, then no cover should be
required. This would be the case, for instance, when a marginally profitable thrift might well
have been forced under by the increased reserve ratios, irrespective of the removal of supervisory
goodwill. If the answer is no, and the thrift irrationally passed up relatively certain profits by failing to raise funds or shrink its balance sheet, then its recovery should be reduced accordingly.

If the mitigation doctrine does apply, however, the key question is whether closed thrifts like Statesman made a good faith, reasonable effort to obtain additional funds. The best way to look at this, given the legal presumption that money is always available in the market, albeit perhaps at a prohibitively high price, is to allow thrifts recovery under the following system: Plaintiffs should recover lost profits damages so long as their return on equity was less than their cost of capital immediately after the breach. Thus, the cost of capital should provide a ceiling for recovery by the plaintiff thrifts.

This is illustrated in Exhibit A. In the diagram, the curve S represents the supply of capital available to an individual thrift.\(^{302}\) The S curve is assumed to be flat over the quantity covered in the diagram, so that in the exhibit the thrift could raise either $10 million or $20 million at a 12 percent cost of capital. The demand curve for capital, D, is downward-sloping, which reflects the fact that some projects or investments will be more profitable than others. For the purposes of this diagram, each firm is assumed to have as its set of projects available the profits that it could earn from the loans made relying on supervisory goodwill. Each firm will sit at some point along this curve. For example, Thrift A can earn a return on equity of 18 percent on its investments, and can raise capital at 12 percent. On the other hand, Thrift B is less profitable than Thrift A and can earn only 10 percent on its equity. Thrift B can raise capital 12 percent. Using this diagram, we can evaluate whether each thrift should have mitigated its damages by raising additional capital. Here, Thrift A would be better off if it raised additional funds at 12 percent and invested them to earn 18 percent; by not raising additional funds, it gives up the profits on $10 million of additional equity. Thus, a choice not to raise more money costs it $600,000.\(^ {303}\) In asking for damages, however, Thrift A bases its lost profits on the 18 percent

\(^{302}\) In reality, of course, different savings and loans institutions will be able to raise capital at different rates, based on a variety of factors. Consequently, they will face differently shaped supply curves. Each savings and loan will have available a certain set of projects which it may be able to undertake, so each institution will also face its own demand curve for capital. Basically, then, each thrift will have its own specific diagram, though a diagram for the entire market could be obtained by summing all of the individual diagrams.

\(^{303}\) \((\text{ROE} - \text{Cost of capital}) \times Q = (0.18 - 0.12) \times ($10,000,000) = $600,000\)
ROE figure, despite the fact that it did not avail itself of the opportunity to prevent the loss of $600,000. Under the commonly accepted principles of the avoidable consequences doctrine, Thrift A should therefore not be able to recover the $600,000 that it wasted. On the other hand, Thrift B’s ROE is below its cost of capital. Thrift B could raise money at 12 percent, but could only invest it at 10 percent. If Thrift B were to raise $20 million, its net loss would be $400,000.\(^{304}\) Therefore, it would be foolish for Thrift B to mitigate by accessing the capital markets.

Extrapolating from these results, a glance at the curve will demonstrate that any thrift to the left of Q* should have raised additional capital, while thrifts to the right of Q* should not have raised additional funds. If we apply the mitigation doctrine, those thrifts to the right of Q* which should not have covered should receive their full ROE as damages; they have not contributed in any way to the amount of losses and thus their damages should not be reduced. However, thrifts to the left of Q* have increased their losses by failure to cover, so their damages should be reduced accordingly. Consequently, we reach the result depicted in Exhibit B. The green line is the damages awarded line; reading from right to left, it follows the ROE curve up to the supply curve, then plateaus at the supply curve. Thus, this diagram is merely a diagrammatic representation of the following two proposals: First, if a thrift’s ROE was greater than its cost of capital, it should have covered, and its damages should equal its cost of capital. That is, the thrift should absorb those additional losses that it could have prevented. Second, if a thrift’s cost of capital exceeded its ROE, it should not have covered (or, perhaps, could not have covered), and its damages should equal its ROE.

This method has the added benefit of not favoring closed or open thrifts -- open thrifts should recover the cost of capital for the additional financing they obtained; this may be either the yield or expected return they offered to investors, or the opportunity cost of those funds if taken from their other internal operations such as affiliates or other related companies. Similarly, closed thrifts should receive the lesser of their return on equity (a lost profits measure) or the rate

\[304(ROE - \text{Cost of capital}) \cdot Q = (0.10 - 0.12) \cdot (20,000,000) = -400,000\]
at which that they would have been able to raise capital had they made a reasonable effort. It may be, of course, that capital was not available to some of these thrifts at any rate -- but theoretically that is the same result as saying that the thrift's position on the return on equity curve was below the cost of the alternative capital line. Either way, this proposal allows damages to be calculated in a consistent way across all thrifts and provides a logically coherent framework for their valuation.

A further issue not explored to date in the parties' briefs but of vital importance regarding the overall sum total of damages in each case is that of amortization. Recall that the contracts between the savings and loans and the government specified that supervisory goodwill would not last forever, but would be amortized at a straight-line rate, usually over 40 years. The value of supervisory goodwill would decline commensurately over time, as the amount available for leveraging decreased. Consequently, assuming that the leverage the thrift could obtain remained constant over time, the thrift's earnings from supervisory goodwill should also fall as the amount of supervisory goodwill is depleted.

We see this illustrated in Exhibit C and Table 1. The table assumes a supervisory acquisition that takes place in 1981. The "Leverage Factor" in Table 1 is simply the amount of additional assets (loans) that the thrift can create from each additional dollar of goodwill. Because the reserve ratio before FIRREA was 3 percent, this meant that for each additional dollar of equity, a thrift could make $33 more in loans. Thus, the leverage factor was equal to 33. As can be seen in the table, the leverage factor increases in year 9. This occurs because FIRREA raised the capital reserve ratio for thrifts to 8 percent, which meant that for each additional dollar of equity, a thrift could make only $12 in loans. Multiplying the amount of supervisory goodwill remaining times the leverage factor gives us the amount of assets which supervisory goodwill helped create. A constant ROA of 120 basis points has been assumed. The earnings figure, then, is simply the amount of assets multiplied by the ROA.

In order to determine the amount of lost profits damages that a thrift ought to receive, we need to take the present value of the future earnings at the time of the breach -- in this model,
year 8. We exclude the earnings from years 0–8 because the thrift has already received them. The present value of the future earnings has been calculated using both a 10 percent and 12 percent discount rate. Presumably, the discount rate used should be equal to the thrift’s cost of capital, because that is the rate that the market would use in valuing these future cashflows. Exhibit C provides a graphical rendition of this same information.

This paper has supported the use of expectancy damages as the preferred method of recovery in the *Winstar*-related cases. However, in some cases, plaintiffs may be unable to prove the sufficient certainty and foreseeability of lost profits. In these cases, the court must look to a reliance or restitution measure of damages. As we have seen, under the Court of Federal Claims’ jurisprudence, both of these measures dictate the same result: Both seek to return the injured party to his *status quo ante*. Therefore, reliance damages should be construed broadly, and incidental as well as essential reliance should be included in the calculation. However, reliance recovery must be reduced by the benefits from partial performance that the plaintiffs enjoyed; in these cases, the pre-1989 earnings attributable to supervisory goodwill. Similarly, the restitution measure should reflect the amount of plaintiffs’ costs that served to benefit the government, but must also be offset by the government’s partial performance.
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