No. 07-1234

In the Supreme Court of the United States

THE LONG ISLAND SAVINGS BANK, FSB, ET AL.,
PETITIONERS

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals correctly held that petitioners' fraud rendered their contract with the United States unenforceable.

2. Whether the court of appeals correctly held that petitioners' prior material breach of the contract precluded their claims.

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OPINIONS BELOW

The opinions of the court of appeals (Pet. App. 1a-37a, 38a-68a) are reported at 503 F.3d 1234, and 476 F.3d 917, respectively. The opinions of the Court of Federal Claims (Pet. App. 69a-169a, 170a-198a) are reported at 67 Fed. Cl. 616, and 54 Fed. Cl. 607, respectively.

JURISDICTION

The judgment of the court of appeals was entered on September 13, 2007. The petitions for rehearing were denied on December 28, 2007 (Pet. App. 199a-200a, 201a-202a). The petition for a writ of certiorari was filed on March 27, 2008. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This is one of the breach-of-contract cases that were filed after the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183. See *United States* v. *Winstar Corp.*, 518 U.S. 839 (1996) (*Winstar*). Of the approximately 122 *Winstar*-related cases that were originally filed, only approximately 17 remain pending, and most of those cases, like this one, have nearly completed the litigation process.

1. a. Petitioners are the Long Island Savings Bank, FSB (LISB) and the Long Island Savings Bank of Centereach FSB (Centereach). This case arises from LISB's acquisition of Centereach, a federally insured thrift that had been created by the government's merger of two troubled thrifts by the Federal Savings and Loan Insurance Corporation (FSLIC). Pet. App. 2a, 72a-73a.

In connection with the acquisition, LISB, Centereach, and FSLIC entered into an Assistance Agreement in 1983. Pursuant to the Assistance Agreement, LISB acquired Centereach as a wholly-owned subsidiary by purchasing 100% of Centereach's stock for $100,000. The Assistance Agreement required FSLIC to make infusion of cash to Centereach that totaled $122 million. Pet. App. 3a, 76a-77a, 172a. The Assistance Agreement also permitted Centereach to account for $625.4 million of goodwill to be amortized over 40 years. *Id.* at 3a, 76a. LISB thereafter was able to dramatically expand its asset size, "increas[ing] its branch network fourfold, from twelve to forty-eight branches, and * * * its assets more than threefold, from approximately $1.2 billion to $4.1 billion." *Id.* at 80a.

The soundness and integrity of LISB's management were critical to the government's decision to enter into

the Assistance Agreement. Pet. App. 3a. The Assistance Agreement thus provided, as a condition precedent to FSLIC's entering into the transaction, that the Chairman of the Board of LISB certify that it was being operated in a safe and sound manner with no violations of federal statutes or regulations that could materially and adversely affect the operations or condition of the bank. Specifically, Section 2(c)(7) of the Agreement required a certification that LISB's "representations and warranties * * * set forth in § 11(b) are true and substantially correct as of the Purchase Date [August 17, 1983]" and that "[n]o event has occurred and is continuing on the Purchase Date which would constitute * * * a Breach." *Id.* at 3a-4a. Section 11(b)(5) of the Agreement in turn provided that:

> *LISB is not in violation of any applicable statutes, regulations* or orders of, or any restrictions imposed by, the United States of America * * * regarding the conduct of its business * * *, including, without limitation, all applicable statutes, regulations, orders and restrictions relating to savings and loan associations * * * where such violation would materially and adversely affect LISB's business, operations or condition, financial or otherwise.

Id. at 4a-5a. LISB also represented and warranted in Section 11(b)(9) that it would not make "any untrue statement of a material fact or omit to state a material fact necessary to be stated in order to make the statements contained therein not misleading," and that the Assistance Agreement contained every fact materially adversely affecting LISB. *Id.* at 5a.

When LISB acquired Centereach, regulations required LISB to maintain safe and sound management,

including by complying with the Real Estate Settlement Procedures Act of 1974, (RESPA), 12 U.S.C. 2601 *et seq.* 12 C.F.R. 563.17, 571.7 (1983). Regulations of the Federal Home Loan Bank Board also prohibited directors and officers of insured institutions from receiving fees, kickbacks, or anything of value, directly or indirectly, in connection with any institution loan for real property. 12 C.F.R. 563.40 (1983).

At the time of contract formation, LISB's Chairman of the Board and Chief Executive Officer (CEO), James Conway (Conway), signed the required certification of the Assistance Agreement. Pet. App. 5a. That certification was false, as Conway at the time was involved in an illegal kickback scheme related to fees associated with LISB's real-estate loan closings. *Id.* at 12a-14a, 22a-26a, 187a-188a. Pursuant to that scheme, all of LISB's loan closings were directed to a law firm controlled by Conway. Although he did not practice law, the firm kicked back millions of dollars to Conway, either directly or through family members who Conway placed at the firm. *Id.* at 6a-7a, 12a-14a, 22a-26a. Conway also repeatedly misrepresented his relationship with the law firm in a series of questionnaires the banks submitted to regulators during the 1980s. *Id.* at 7a-9a, 173a-174a.

b. In August 1989, Congress enacted FIRREA to address widespread problems in the savings and loan industry. FIRREA created the Office of Thrift Supervision (OTS) and charged it with examining, supervising, and regulating federally insured thrifts. 12 U.S.C. 1462a, 1463. FIRREA also imposed new capital requirements on thrifts and restricted their ability to count goodwill toward those capital requirements. Pet. App. 10a. FIRREA thus restricted Centereach's ability to count its $625 million in goodwill toward regulatory cap-

ital requirements and altered the period over which LISB could amortize its goodwill.

c. After the enactment of FIRREA, Conway hired an outside law firm to advise the banks. In the course of that representation, the law firm discovered Conway's compensation arrangement with his former firm. Petitioners thereafter disclosed Conway's arrangement to OTS, which in turn banned Conway from holding any position in an insured financial institution. Pet. App. 10a-12a. In February 1998, Conway pleaded guilty to a criminal violation of 18 U.S.C. 215, admitting that he "knowingly, intentionally and corruptly solicit[ed], demanded, accepted and agreed to accept . . . funds from the law firm paid directly to him, . . . intending to be influenced and rewarded in connection with . . . the assignment of the LISB residential mortgage closing work to the law firm." Pet. App. 13a (brackets in original). Conway was also disbarred by the New York Supreme Court, which found that he "engaged in a scheme of illegal kickbacks, using his daughter and daughter-in-law as conduits to circumvent Federal law prohibiting him from receiving compensation from his former law firm." *Id.* at 13a-14a (quoting *In re Conway*, 712 N.Y.S.2d 610, 611 (App. Div. 2000)).

2. Meanwhile, in August 1992, petitioners filed this suit in the Court of Federal Claims, alleging that, by enacting FIRREA, the government breached the Assistance Agreement's provision stating that LISB could count the goodwill created by its acquisition of Centereach toward its regulatory capital computations. Pet. App. 12a. In February 2001, the government filed its answer, including its counterclaims and defenses, based upon petitioners' fraud and prior material breach of the contract. *Id.* at 14a. Defendant's answer was filed pur-

suant to the schedule agreed upon by the parties and set forth in the case management order governing this and other *Winstar*-related actions, which expressly stated that "no defenses or arguments of any kind should be deemed waived" because the answer had not been filed previously. *Ibid*.

3. The Court of Federal Claims denied the government's summary judgment motion with respect to the counterclaim for fraud and its defense of prior material breach. Pet. App. 170a-198a. The trial court recognized that Conway had engaged in an illegal scheme to receive kickbacks from his law firm with respect to LISB loan closings. *Id*. at 172a-175a. The court nonetheless rejected the fraud counterclaims based on its conclusions that LISB itself had not acted fraudulently and that Conway's conduct could not be imputed to LISB. *Id*. at 194a-198a. The trial court further found that LISB had not committed a prior material breach of the Assistance Agreement. *Id*. at 177a-184a. In reaching that conclusion, the trial court held that LISB did not violate RESPA because it did not pay the kickback charges to Conway; rather, Conway's law firm paid the kickbacks. *Id*. at 183a. The trial court then reasoned that, because LISB was not violating RESPA, LISB was not operating in an unsafe and unsound manner, and therefore did not violate the Assistance Agreement's warranty and disclosure provisions. *Ibid*.

The government subsequently moved for summary judgment seeking to dismiss petitioners' claims for $474 million in restitution damages. The trial court granted the government's motion, holding that petitioners' claim was "both speculative and indeterminate." 60 Fed. Cl. at 96 (quoting *Glendale Fed. Bank FSB* v. *United States*, 239 F.3d 1374, 1382 (Fed. Cir. 2001)).

Following a trial, the Court of Federal Claims issued its decision holding the government liable for breach of the Assistance Agreement. Pet. App. 107a-120a. The court awarded petitioners expectancy damages of more than $252 million, incidental damages of almost $18 million, and a tax gross-up of more than $165 million, for a total of approximately $435 million. *Id.* at 168a-169a.

4. The court of appeals reversed, holding that petitioners' claims were forfeited under the special plea in fraud statute, 28 U.S.C. 2514. Pet. App. 38a-68a. Following petitioners' petition for panel rehearing and rehearing en banc, the court of appeals, acting en banc, returned the case to the panel, which withdrew and vacated its original opinion. *Id.* at 2a. The court of appeals then held that the trial court erred in denying the government's summary judgment based upon fraud and prior material breach. *Id.* at 1a-37a.

The court of appeals observed that, pursuant to the Restatement (Second) of Contracts § 163 (1981) (Restatement), a misrepresentation may prevent the formation of contract, thus making the contract void. Pet. App. 19a-20a. The court of appeals then recognized that "the general rule is that a Government contract tainted by fraud or wrongdoing is void *ab initio*." *Id.* at 20a (quoting *Godley* v. *United States*, 5 F.3d 1473, 1476 (Fed. Cir. 1993)). The court held that rule was satisfied here because LISB obtained the contract by knowingly making a false statement that LISB was operating in a safe and sound manner at the time of the Centereach acquisition. *Id.* at 21a-24a. The court of appeals further held that Conway's knowledge of the certification's falsity should be imputed to LISB. *Id.* at 26a-29a. The court of appeals explained that Conway's arrangement to funnel LISB's mortgage closing transactions to his

law firm benefitted LISB because it obtained the legal services required for the closings, *id.* at 28a-29a, and because "by signing the false certification under the Assistance Agreement, Conway enabled LISB to acquire Centereach," *id.* at 29a. The court of appeals further found that the government had "contracted for full disclosure of any conflicts-of-interest in order to assure the safe and sound management of LISB," and had justifiably relied upon Conway's misrepresentations. *Id.* at 29a-30a. The court of appeals explained that "the only reasonable inference is that had [petitioners] stated the truth about Conway, they would not have received the contract." *Id.* at 31a.

The court of appeals further held that, "[e]ven if the contract were not void, the doctrine of prior material breach precludes [petitioners'] breach of contract claim for damages." Pet. App. 31a. The court of appeals concluded that "because the Assistance Agreement explicitly conditioned the government's obligations" upon the "representations and warranties of LISB set forth in § 11(b)" of the Assistance Agreement, "the falsity of LISB's certification * * * represents a failure of performance." *Id.* at 32a-33a. The court of appeals explained that petitioners' failure of performance was material because, without the false certification, petitioners would not have received the contract. *Id.* at 33a. The court of appeals similarly determined that, because the government relied upon the certification, LISB's failure of performance preceded the government's breach and was never cured. *Ibid.* The court of appeals accordingly concluded that "LISB's false certification constitutes an uncured material failure of performance that provides

an independent basis for precluding [petitioners'] claim for damages." *Id.* at 36a.[1]

ARGUMENT

The court of appeals correctly held that petitioners' knowingly made false material statements, both at the formation of the contract with the United States, and during the contract's performance, preclude petitioners' breach of contract claim. That fact-bound decision does not warrant further review by this Court.

1. Petitioners contend (Pet. 16-24) that the court of appeals erred by failing to hold that petitioners' fraud in inducing the Assistance Agreement merely rendered that contract voidable, and not, as the court of appeals held, void ab initio. Petitioners thus argue that the court of appeals' decision conflicts with precedents of this Court recognizing the distinction between the two concepts and that the court "did not attempt to reconcile its holding with generally applicable principles of contract law, and did not rely for its rule on the Restatement or the decisions of any other court." Pet. 19; see Pet. 23-24. That contention is incorrect and would not warrant this Court's review in any event.

a. Contrary to petitioners' statement (Pet. 16-17) the court of appeals cited the Restatement §§ 163-164, and expressly recognized that "a misrepresentation may prevent the formation of a contract or may make a con-

[1] The court of appeals did not address the government's challenges to the trial court's award of damages. The government argued that any costs resulting from the merger were not caused by the breach; that the merger entailed no new capital costs; that the trial court erred in imputing costs to LISB's contributed capital; that the trial court used an improper methodology for calculating any imputed costs of LISB's retained earnings; and that the trial court erred by awarding tax gross-up damages. Gov't C.A. Br. 36-62.

tract voidable." Pet. App. 19a. Section 163 states that, if a misrepresentation concerns an essential term of the contract, so that the opposing party does not have a reasonable opportunity to know of the character or the essential terms of the contract, "there is no effective manifestation of assent and no contract at all." Restatement § 163 cmt. a.

The court of appeals correctly determined in this case that LISB's representations that it was operating in a safe and sound manner and that it had not failed to disclose material information were essential terms of the contract. Pet. App. 30a-33a. The fraud here thus "relates to the very nature of the proposed contract itself." Restatement § 163 cmt. a.

Through the Assistance Agreement, the government contracted primarily for LISB's safe and sound management, an essential concern of the government, given that Centereach's financial condition was deteriorating and its acquisition was funded from the outset by $75 million of government-infused cash, with the government's assistance totally $122 million. The government's concern for safe and sound management was further based upon its desire to maintain the public's trust in the banking system, a trust that depends to a large degree on the integrity of bank management. A meeting of the minds as to the integrity and truthfulness of LISB's representations was therefore essential—and a condition precedent—to any agreement by the government with the petitioners. Pet. App. 3a-4a.

The evidence was uncontested that there would have been no contract if the government had known that the certification—a central tenet of the contract itself—was false and if petitioners instead had truthfully set forth the facts concerning the safety and soundness of LISB's

management. Pet. App. 9a-10a, 30a-31a. Accordingly, there was no effective manifestation of assent by the government to the essential terms of the contract concerning safety and soundness of LISB's management. In other words, petitioners understood that the contract itself actually did not set forth true and accurate representations concerning safety and soundness and full disclosure of material facts, while the government understood the contract's essential terms as setting forth truthful representations concerning these matters.

b. Petitioners also contend (Pet. 19-23) that the court of appeals' finding that the Assistance Agreement was void ab initio conflicts with *United States ex rel. Siewick* v. *Jamieson Science & Engineering, Inc.*, 214 F.3d 1372, 1377 (D.C. Cir. 2000) (*Jamieson*), and *Hayes International Corp.* v. *McLucas*, 509 F.2d 247, 263 n.26 (5th Cir.), cert. denied, 423 U.S. 864 (1975). That is not correct, as those decisions are clearly distinguishable from the court of appeals' decision in this case. *Jamieson* was a qui tam action in which the United States was not a party, and the court addressed the distinction between void and voidable contracts only in what is essential dictum, as the court of appeals concluded that the relator had not shown that the government was defrauded. 214 F.3d at 1376-1378. Moreover, *Jamieson* acknowledged that "contracts that are seen as being in fundamental violation of public policy" are void (rather than merely voidable). *Id.* at 1377. *Jamieson* did not involve conduct remotely resembling that at issue here, where petitioners made an express certification in the contract that was both essential to contract formation and false.

Hayes is even further removed from this case. That case did not even discuss the difference between con-

tracts that are void and those that are voidable. The court, in a concluding footnote, merely declined to invalidate a government contract based on an asserted "general public policy against conflicts of interest," unanchored to specific penal prohibitions. 509 F.2d at 263 n.26. Here, by contrast, petitioners made false representations in the *contract itself*, and Conway was convicted of a criminal offense for conduct underlying the false representations.

c. This Court's review is also not warranted because even if the contract was not void ab inito, the Assistance Agreement was voidable at the government's election, and petitioners thus are not entitled to relief in any event. As petitioners acknowledge, as a result of petitioners' fraud, the government is entitled to renounce the contract and be returned to its pre-contract position, as long as the government does not continue to keep the benefits of the contract. Pet. 18. Here, contrary to petitioners' suggestion (Pet 29 n.10) the trial court properly denied petitioners' restitution claim for benefits allegedly conferred on the government, 60 Fed. Cl. at 96, and petitioners did not appeal that holding. Indeed, far from retaining any benefit of the bargain, the government never received *from petitioners* the $122 million in cash that the government provided to petitioners, or the value of the Centereach franchise. Accordingly, any distinction between a contract being void and being voidable is not critical to the outcome of this case.[2]

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[2] The government's election to regard the contract as void was timely. By the time the government discovered LISB's fraud, at the earliest in 1992 (Pet. App. 12a), "all of the government's obligations under the Assistance Agreement were completed." Pet. App. 35a. As the court of appeals correctly concluded, moreover, the government did not continue to accept performance under the Assistance Agreement after dis-

2. In all events, this Court's review of the court of appeals' holding that the contract was void ab initio is unwarranted because the court alternatively held that petitioners' prior material breach provided an independent basis for rejection of petitioners' damages claims. Pet. App. 2a, 31a, 36a, 37a. That fact-bound conclusion too does not warrant further review.

Petitioners contend (Pet. 24-27) that the court of appeals erred in stating that "any degree of fraud is material as a matter of law." Pet. App. 33a (quoting *Christopher Village, L.P.* v. *United States*, 360 F.3d 1319, 1335 (Fed. Cir. 2004), cert. denied, 543 U.S. 1146 (2005)). Petitioners further argue (Pet. 27-29) that the court's statement in that respect conflicts with decisions of other courts of appeals that hold that materiality turns on the extent to which a contract breach deprives the non-breaching party of the benefit of the bargain. The court of appeals' actual holding, however, is entirely faithful to that principle. The court of appeals' passing statement that "any degree of fraud is material" was unnecessary to the court's disposition of the issue, as the court's specifically held that petitioners' breach was material because the government did not receive the benefits of its bargain under the contract, *i.e.*, sound management of the bank. Pet. App. 33a.

Specifically, the court of appeals thus held that petitioners' misrepresentations were material "based on [the court's] discussion of causation in *supra* Part III.A.3." Pet. App. 33a. Part III.A.3 of the court of ap-

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covery of the fraud. *Id.* at 35a-36a. Finally, pursuant to the case management order governing this case, petitioners agreed that the government waived no counterclaim or defense by following the procedural order whereby the government was not obligated to file an answer to petitioners' 1993 complaint until 2001. *Id.* at 14a, 34a-36a.

peals' opinion in turn held that there was a direct and substantial causal link between petitioners' fraud and the government's decision to enter into the contract. *Id.* at 29a-31a. The court of appeals thus concluded that "the only reasonable inference is that had the plaintiffs stated the truth about Conway, they would not have received the contract. The plaintiffs have set forth no affirmative evidence such that a reasonable jury could conclude otherwise." *Id.* at 31a. Indeed, the government's supervisory agent responsible for negotiating and recommending the acquisition averred that, had LISB revealed the nature of the kickback scheme, the government would not have gone forward with the Agreement. *Id.* at 9a-10a. The trial court thus found that Conway's fraud was material and induced the agreement, explaining that the "Government contracted for full disclosure of any conflicts-of-interest in order to assure the safe and sound management of LISB, and it relied on Conway's statements. The Government thus justifiably relied on Conway's misrepresentation." *Id.* at 192a.[3]

Petitioners therefore err in arguing that the court of appeals held that a contracting party can be absolved of liability "if a contracting party made *any misstatement at all* that caused the other party to enter into the contract, even if the misstatement was not 'wil[l]ful or even negligent.'" Pet. 25 (emphasis added) (brackets in original). Nowhere did the court of appeals state that "any misstatement at all" that causes a party to enter into a contract can absolve a party of liability. The court of

[3] The trial court concluded that Conway's fraud could not be imputed to LISB, Pet. App. 194a-198a, but the court of appeals reversed that conclusion, *id.* at 26a-29a, and petitioners do not seek review of that issue in this Court.

appeals merely noted in a footnote, that the knowledge element required for rendering a contract void based on fraud is not a requirement under the prior material breach doctrine. Pet. App. 33a n.4 (quoting Restatement § 235 cmt. a). Petitioners' argument here, too, does not address the court of appeals stated bases for finding the false statements and omissions material: that the certification was an express condition precedent for the government's performance and that there would have been no contract but for the false certification.[4]

In short, petitioners deprived the government of the benefit of safe and sound management for which it had contracted as a fundamental purpose of the Assistance Agreement. LISB's fraud was neither minor nor insignificant, but rather tainted the very essence of LISB's performance. The acquisition approved by the government enabled LISB to obtain 36 branches and $122 million in cash, the benefits of which LISB would not have received but for the fraud, Pet. App. 29a-30a, while "LISB paid nothing for the franchise," and contributed only $100,000 to Centereach. *Id.* at 172a. LISB was required in turn to supply (1) honest and full disclosure, and (2) safe and sound management. LISB breached those obligations at the contract's inception, depriving the government of the expected benefit of its bargain.

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[4] For the same reasons, the court of appeals did not, as petitioners argue, establish a "*per se* test[] of materiality that completely disregard[s] the effect of the breach on the performance promised by the breaching party." Pet. 25-26. Again, the court of appeals specifically concluded that petitioners' certification was an express condition precedent for the government's performance and that, but for the misstatements and omissions, petitioners would not have received the contract. Pet. App. 29a-31a.

The court of appeals' fact-bound conclusion in this regard does not warrant plenary review by this Court.

3. Petitioners finally contend that the court of appeals' decision will discourage citizens from entering into commercial contracts with the government, Pet. 31-32, and "greatly unsettle the government contracting process." Pet. 15. That contention, too, is incorrect. For over half a century, the law has been settled—in a decision by the Federal Circuit's predecessor, the Court of Claims—that, if a plaintiff commits material fraud "in regard to the very contract upon which the suit is brought," all claims under the contract will be forfeited. *Little* v. *United States*, 152 F. Supp. 84, 87 (Ct. Cl. 1957). The contracting process has fared well because, contrary to petitioners' contention, it is not, in fact, unduly burdensome to require contractors to refrain from fraud in the inducement of government contracts.

Furthermore, as the Federal Circuit has correctly observed, *Winstar* claims frequently turn on their particular facts and circumstances, and each case must be considered on its individual merits. See, *e.g., California Fed. Bank, FSB* v. *United States*, 245 F.3d 1342, 1347 (Fed. Cir. 2001), cert. denied, 534 U.S. 1113 (2002). In this case, petitioners were unable to make out their claim for breach of contract because of the material fraud they perpetrated in connection with the formation and performance of the contract, and because of their prior material breach of the contract.

The petitioners' hypothetical, where the government confiscates a $436 million airplane without paying for it (see Pet. 30-31), is not remotely analogous to the facts

here.[5] This is not a case in which a contractor supplied goods or services and the expected payments from the government were forfeited. As discussed above, petitioners have failed to return more than $100 million in government funds they procured by fraud, and they are hardly well-positioned to complain that the court of appeals' decision undermines public confidence in government contracts. Contrary to the petitioners' apparent belief (Pet. 34), the court of appeals' decision thus respects this Court's admonition that ordinary principles of contract construction and breach should be applied to government contracts. *United States* v. *Winstar Corp.*, 518 U.S. 839, 870-871, 895 (1996). Moreover, as the Court explained in *United States* v. *Mississippi Valley Generating Co.*, 364 U.S. 520, 565 (1961), non-enforcement of government contracts tainted by fraud is meant to "guarantee the integrity of the federal contracting process and to protect the public from the corruption which might lie undetectable beneath the surface of a contract conceived in a tainted transaction."

[5] Moreover, as noted, the plaintiff's claimed damages, at a minimum, were significantly inflated. See *supra*, n.1.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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