UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

WASHINGTON MUTUAL, INC., AS SUCCESSOR IN INTEREST TO H.F. AHMANSON & CO. AND SUBSIDIARIES, Plaintiff-Appellant,

v.
UNITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the United States District Court for the Western District of Washington

REPLY BRIEF FOR PLAINTIFF-APPELLANT

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In the opening brief, WMI described the background and essential components of the unusual public-private transaction that is at the core of this case, and the government takes no issue with that description. See WMI Br. 3-8, 17-24. As a result of the thrift crisis of the early 1980s, FSLIC was faced with an enormous liability to make whole the insured depositors of failed thrifts. That liability would have overwhelmed FSLIC's cash reserves if FSLIC were compelled to liquidate the thrifts. FSLIC sought instead to reduce its liability by arranging "supervisory mergers" in which healthy thrifts would take over the failed thrifts and thereby make a solvent institution, not FSLIC, responsible for the liability. See United States v. Winstar Corp., 518 U.S. 839, 894 (1996) (plurality opinion) (government "entered into supervisory merger agreements to convert some of its financial insurance obligations into responsibilities of private entrepreneurs"). FSLIC was able to facilitate these mergers despite its difficult financial situation by providing non-cash inducements to acquirers, such as rights to special regulatory accounting treatment and the previously unavailable right to branch across state lines. At the same time, Home, a successful and solvent thrift, was eager to expand its business beyond its home state of California and obtain the right to operate branches in other states.

Home and FSLIC were able to help each other advance their respective goals by engaging in the transaction now before this Court. Home agreed to

undertake a supervisory merger in which it acquired three failed thrifts, thereby relieving FSLIC of its obligation to make whole the insured depositors of these thrifts. The merger standing alone was a losing proposition for Home because the acquired thrifts' liabilities exceeded the value of their assets by more than \$200 million. FSLIC was able to induce Home to undertake this otherwise losing proposition without depleting FSLIC's cash position by giving Home in exchange the valuable asset that Home desired – namely, a binding commitment to allow Home to expand its business to Florida and Missouri. Thus, the transaction at issue here has two facets: (1) the overarching Home-FSLIC exchange in which Home agreed to undertake an otherwise uneconomic merger in exchange for the Rights; and (2) the merger itself, in which Home acquired the failed thrifts in a tax-free "G" reorganization.

The government's brief makes clear the parties' agreement on the basic elements of the deal: 1) Home received the Rights from the government in exchange for agreeing to undertake the supervisory merger (*see* Gov't Br. 46 ("inducement to undertake the merger")); 2) Home incurred a substantial cost to undertake the merger because the value of the thrifts' assets was considerably less than the liabilities that Home assumed (*id.* at 13-14); and 3) the merger benefited FSLIC immensely because it was relieved of its immediate deposit insurance liability (*see id.* at 9, 37-38).

The parties differ, however, with respect to the tax consequences of the Home-FSLIC exchange – specifically, whether the exchange gave Home a tax basis in the Rights. WMI argues that applying the Code's basis rules results in Home having a tax basis in the Rights. When an asset is acquired in an exchange, the recipient typically takes basis in the asset in the amount of the acquisition cost – here, the cost Home incurred by acquiring thrifts that had a negative value and thereby extinguishing FSLIC's immediate liability to make the thrifts' depositors whole. Alternatively, if the Rights are not viewed as acquired in an exchange, they should take a fair market value basis under the general rules applicable to property received as compensation for providing a service and the specific rule established in Code section 597 for property received from FSLIC to facilitate a supervisory merger.

By contrast, the government argues that these rules do not apply here. The government focuses on the merger transaction that Home undertook to satisfy its obligation under the broader agreement with FSLIC. The government apparently concludes that the broader Home-FSLIC transaction (in which Home received the Rights in exchange for agreeing to undertake the merger) should simply be ignored for tax purposes, leaving Home with no basis in the Rights. That conclusion is indefensible.

A. The Government Proffers No Tax Law Justification for the District Court's Holding That Home Had Zero Basis in the Rights

Like the district court, the government makes no affirmative effort to explain how the tax law should treat Home's transaction with FSLIC, although it acknowledges that both parties received something of value in the exchange. In particular, the government does not provide any tax law explanation for how the Rights can be assigned a zero basis. Instead, the government is content simply to raise objections to both of WMI's proposed methods of calculating Home's basis in the Rights (that is, cost basis or fair market value basis). But that approach cannot provide a legally sufficient ground for affirmance because the tax law cannot simply ignore the Home-FSLIC transaction and there is no sound theory that yields zero basis in the Rights.

The government's brief provides an accurate primer on the concept of tax basis. Gov't Br. 33-35. While recognizing that most transactions result in the recipient taking a cost basis or fair market value basis in an asset, that primer also notes that a corporation could take a zero basis if the asset received is "a contribution to capital from a nonshareholder." *Id.* at 35. But as explained in the opening brief, Home did not receive the Rights as a non-shareholder contribution to capital. WMI Br. 39 n.4. Assets received in exchange for consideration or as "compensation" are not "contributions" to capital. *See id.* The government cannot and does not dispute WMI's assertion that the Rights cannot be regarded as

a contribution to capital given the Court of Federal Claims' holding that the government provided the Rights in exchange for consideration under the Home-FSLIC contract. *See id.* at 38-39 & n.4.

Accordingly, there is no tax law justification for the district court's holding that Home had zero basis in the Rights. This defect in the government's position provides an independent reason for reversing the judgment below, even apart from the errors in the court's and the government's analysis of the cost basis and fair market value basis issues, to which we now turn.

B. Assigning a Cost Basis to the Rights Is Not Inconsistent with Treatment of the Merger as a "G" Reorganization

The government's response to WMI's cost basis argument rests on two fundamental misunderstandings of WMI's position – namely, that WMI seeks to "recast the transaction Home actually carried out" and that WMI contends that "Home assumed a portion of Southern's liabilities 'outside the mserger' in exchange for the Government's provision of the Rights." Gov't Br. 28-29, 40-41. WMI does not make those arguments, and the government offers little response to the arguments WMI actually makes.

First, WMI does not seek to recast the transaction. It agrees with the government that Home's merger with New Southern satisfied all the requirements of a "G" reorganization, including the requirement that the surviving corporation

assume substantially all of the liabilities of the merged corporation as a result of the merger.

Second, WMI does not argue that "Home obtained [a] cost basis by assuming a portion of Southern's liabilities 'outside the merger.'" Id. at 40. As noted above, WMI and the government agree that the banking agencies provided Home with the Rights in exchange for Home agreeing to undertake the supervisory merger. In the opening brief, WMI pointed out that Home plainly received the Rights "outside the framework of the merger" because the banking agencies were not parties to the merger and the Rights could not have been conveyed in the merger. WMI Br. 31-32. But WMI never asserted that Home's assumption of Southern's liabilities occurred outside the merger. WMI addressed whether the Rights were received "outside the merger" only because it was responding to the district court's erroneous statement that Home could not have basis in the Rights because Home allegedly did not acquire the Rights "as a separate matter from the supervisory merger itself." ER11. Because the government does not purport to defend this aspect of the district court's reasoning, and presumably concedes that Home received the Rights outside the merger, there does not appear to be any

significant dispute between the parties regarding what occurred "outside the merger" and "inside the merger."

What the parties dispute is whether Home could take into account for basis purposes the cost it incurred to obtain the Rights. The consideration that Home gave for the Rights was its agreement to undertake the merger and thereby extinguish FSLIC's immediate liability to make the thrift depositors whole. And the merger had a cost to Home because the amount of the liabilities it assumed as a result substantially exceeded the value of the assets received – the very cost that FSLIC avoided by arranging the merger. That negative value was the price that Home paid for the Rights, and it should provide the amount of Home's basis in the Rights under fundamental cost basis principles.

The government asserts that this method of calculating basis "is inconsistent with the transaction documents and with Home's reporting of the merger as a tax-

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¹ In the opening brief, WMI also pointed to two Revenue Rulings to refute the district court's position that the existence of a tax-free reorganization would prevent the recognition of distinct tax consequences for assets received as an inducement to participate in the reorganization. WMI Br. 35-36. The government responds with a complicated analysis of these rulings, but that analysis does not dispute WMI's basic point that assets received in conjunction with a reorganization, but outside the reorganization, can receive typical tax treatment unaffected by the reorganization provisions. *See* Gov't Br. 42-46. The government's assertion that these rulings support its position appears to rest on the same erroneous premise discussed above – namely, that WMI contends "that Home assumed a portion of Southern's liabilities outside the merger in exchange for the Rights." *Id.* at 43; *see also id.* at 46.

free 'G' reorganization." Gov't Br. 38. The government does not point to any documents or otherwise explain what it means by the first part of this statement. There is nothing in the transaction or other documents that is inconsistent with assigning the Rights a cost basis equal to the amount of Home's cost of undertaking the merger. To the contrary, the contemporaneous documentation made clear that Home incurred the cost of the merger in order to obtain the Rights. The Assistance Agreement provided that receipt of the Rights was a condition of Home's agreement to proceed with the merger. *See id.* at 11-12; ER201. And Home treated the cost of the merger on its books as the cost of acquiring the Branching Rights and reported it that way to the SEC and to its shareholders. *See generally* WMI Br. 7-8, 21-24; ER61; ER218; ER243; ER246.

Nor is affording a cost basis to the Rights inconsistent with treatment of the merger as a "G" reorganization. The government contends that Home's claimed cost basis is incompatible with the merger's satisfaction of the "G" reorganization condition that substantially all of the liabilities of the acquired company must become liabilities of the acquiring company as a result of the transfer. Gov't Br. 39-42; *see* I.R.C. § 368(a)(3)(D)(ii)(II) (1982)). This argument compares apples to oranges.

This "G" reorganization requirement reflects the "continuity of interest" rule that is common to all tax-free corporate reorganizations. Under that rule, a

corporate reorganization is allowed to proceed tax-free only if the stakeholders in the merged corporation see their interests continue in the surviving corporation.

As Congress explained, before 1981 the continuity of interest rule was embodied in "a nonstatutory requirement applicable to tax-free mergers and other reorganizations . . . that the shareholders of the acquired corporation receive stock in the acquiring corporation." H.R. Rep. No. 97-215, at 283 (1981) (Conf. Rep.).

Congress realized, however, that this stock-based continuity of interest requirement was an impediment to affording tax-free reorganization treatment in supervisory mergers – both because stockholders in a failed thrift received no interest in the surviving corporation and because many thrifts were mutual corporations that had no shareholders to begin with. Therefore, Congress amended the "G" reorganization rules to remove the requirement of a continuation of stockholder interests. Id. Recognizing that creditors were the true stakeholders in a failed thrift, Congress substituted a "continuity of interest" requirement that better fit the realities of supervisory mergers – namely, that the acquiring thrift must end up with substantially all of the assets and liabilities of the failed thrifts. Id.; see also Staff of Jt. Comm. on Tax'n, 105th Cong., General Explanation of the Economic Recovery Tax Act of 1981, at 151-53 (Jt. Comm. Print Dec. 29, 1981) ("General Explanation"). This new requirement was particularly pertinent to supervisory mergers because it ensured that FSLIC would be fully relieved of its

immediate liability to the depositors of the failed thrifts. Nothing about the "substantially all" requirement, however, has anything to do with the calculation of basis issue that is before this Court.

Indeed, the legislative history associated with this change shows that there is no inconsistency between obtaining "G" reorganization treatment and assigning a cost basis to assets, like the Rights, that are received outside the framework of the merger. The Joint Committee on Taxation gave the following explanation for why it was necessary to modify the "continuity of interest" requirement in order to make "G" reorganization treatment more readily available for supervisory mergers: "Without tax-free reorganization treatment, the basis of mortgages in the hands of the acquiring organization would be a cost basis; since this basis typically would be substantially below face value where interest rates have risen, repayments of principal would result in taxable income to the acquiring corporation." General Explanation at 152; see also WMI Br. 29-30.

In terms of the numerical example set forth in the opening brief (*id.* at 20-21), the Joint Committee was stating that, under existing law, the \$1,000 acquisition cost would give the acquirer only a \$750 cost basis in the acquired mortgage. That would give the acquirer a \$250 cost basis in whatever other assets it received in order to induce it to agree to an otherwise uneconomic merger. *See, e.g., Winstar,* 518 U.S. at 849 & nn. 4-5 (describing allocation of part of purchase

price to intangible assets acquired); 2 Boris I. Bittker and Lawrence Lokken, Federal Taxation of Income, Estates and Gifts, ¶ 41.6.1 (3d ed. 2000) (general principles of cost basis allocation). Congress found that this result would impede its goal of facilitating supervisory mergers because, when the \$1,000 in outstanding principal of the mortgage was eventually repaid, that \$750 cost basis would yield \$250 in taxable income to the acquirer.

Congress's solution to this problem in 1981 was to make "G" reorganization treatment available for supervisory mergers, thereby ensuring that, instead of a \$750 cost basis, the acquirer would take a \$1,000 carryover basis in the acquired mortgage (that is, basis in the same amount that the mortgage had in the hands of the transferor). *See* I.R.C. § 362(b); Gov't Br. 34-35, 36. Congress was not concerned about the tax treatment of the other \$250 worth of assets received outside the reorganization to induce the merger, and it did nothing in this 1981 statutory change to alter, much less eliminate, the cost basis allocated to those assets. In Home's transaction, those other assets were the Rights, and Home should receive a cost basis in them just as it would have before Congress amended the "G" reorganization rules.

The government's argument here that the existence of a "G" reorganization nullifies this cost basis for the Rights obtained outside the reorganization is basically a roundabout way of undoing Congress's action in 1981. By facilitating

the use of a carryover basis in the "G" reorganization instead of a cost basis,

Congress deliberately allowed an acquirer to obtain a basis in the acquired thrift

assets that exceeded its cost for those assets. Thus, assigning a cost basis to the

Rights and a carryover basis to the mortgages acquired in the "G" reorganization

fully accords with Congress's intent, and there is no foundation for the

government's contention that the two are incompatible. *See* WMI Br. 33-35.

In the opening brief, WMI illustrated the same point – that there is no incompatibility between "G" reorganization treatment and assigning a cost basis to the Rights – by positing a scenario under which Home received cash instead of the Rights as an inducement to undertake the merger. *Id.* at 37. The government's ineffective response to this illustration further highlights the weakness of its fundamental argument against assigning a cost basis to the Rights. See Gov't Br. 45-47. If Home had received a cash payment from FSLIC in exchange for undertaking the merger, all agree that Home would have had a basis in the amount of that cash (and any asset later purchased with that cash) – notwithstanding that the merger qualified as a "G" reorganization and therefore provided a full carryover basis in the mortgages. See WMI Br. 37; Gov't Br. 46. The government's only response is to avoid the question by changing the illustration to one that is not analogous to the instant case – hypothesizing that Home received the cash "in exchange for Home's assuming a portion of Southern's liabilities

outside the merger," which would make the merger ineligible for "G" reorganization treatment. Gov't Br. 46. But that does not respond to the scenario posited in WMI's brief that Home received the cash "as an inducement to undertake the merger" (*id.*) and the merger qualified as a "G" reorganization, which is analogous to the actual transaction here.

In sum, there simply is no inconsistency between "G" reorganization treatment of a merger and assigning a basis to assets received outside the merger as an inducement to undertake the merger. If FSLIC had paid Home cash to undertake the merger, Home would have had a basis in the cash equal to its face value. As it happened, FSLIC was able to use a non-cash asset to induce Home to undertake the merger, which helped FSLIC preserve its precarious cash position. But Home should not be adversely affected by the substitution of the Rights in place of cash to induce the merger. This difference in the type of consideration provided by FSLIC provides no justification for denying Home a basis in the Rights.

C. If the Rights Are Not Afforded a Cost Basis, Home Had a Fair Market Value Basis in the Rights

In the opening brief, WMI alternatively argued that, if this Court concludes that the Rights were not received in an exchange and thus could not be assigned a cost basis, the Rights were received as compensation for undertaking the merger and should accordingly receive a fair market value basis. WMI Br. 38-55. The

government responds by arguing that Code section 597 must be read restrictively to defeat this result, suggesting three different phrases in the statute that could be construed to exclude the Rights. The government's suggested readings are strained, however, and each of them would limit the scope of section 597 in ways that serve no discernible policy interest. Congress did not intend such an unduly narrow construction of the statute, and this Court should reject the government's contention that the Rights are not encompassed by section 597.

1. Home Received the Rights "from [FSLIC]" Within the Meaning of Code Section 597

The government first argues that section 597 is inapplicable because Home allegedly received the Rights from the Federal Home Loan Bank Board ("FHLBB" or "Bank Board"), not from FSLIC. This contention is untenable for two reasons. First, even if one indulges in the fiction that the Bank Board and FSLIC were unrelated entities, Home received the Rights pursuant to the contract it made with FSLIC. Second, the Bank Board was just the decisionmaking entity that operated FSLIC, and it is unreasonable to interpret section 597 as inapplicable simply because the assistance in question was described on Bank Board stationery.

It is undisputed that the broader transaction at issue here – namely, Home receiving the Rights in exchange for agreeing to undertake the merger – was embodied in a binding contract between FSLIC and Home known as the Assistance Agreement. WMI Br. 7-8; Gov't Br. 10-13; *Home Sav. of Am., F.S.B.*

v. *United States* ("*Home I*"), 50 Fed. Cl. 427, 430 (2001). Home's performance obligation was conditioned on securing the Rights, and the government met this condition contractually by issuance of a Bank Board resolution and letter that were formally integrated into the Assistance Agreement. *Id.* at 430-31; ER204; ER207-14; ER215. The Court of Federal Claims held that the promise of the RAP Right was an enforceable contract obligation. See WMI Br. 21-22; Home I, 50 Fed. Cl. at 437-38. Thus, if it is necessary to identify a single government entity as having provided the Rights to Home, that entity must have been FSLIC – the government entity specifically authorized to enter into contracts and the only government signatory to the Assistance Agreement. See 12 U.S.C. § 1725(c)(3) (1982); ER174; ER206. That the Rights *originated* in documents issued by the Bank Board does not change the fact that the Rights were contractually promised to, and provided to, Home by FSLIC in the Assistance Agreement. The government's argument here is no different from contending that a customer did not receive a product from a retailer because the product originated with the manufacturer.

Moreover, even if it could be said that Home in some sense received the Rights from the Bank Board, the close interlocking relationship between FSLIC and the Bank Board makes it unreasonable to read section 597 as inapplicable to such assistance. In 1934, Congress "creat[ed] FSLIC as an arm of the Bank Board" (*Winstar*, 518 U.S. at 890 (plurality opinion)), establishing it as a

corporation that would insure savings and loan deposits with the Bank Board acting essentially as a board of directors for the corporation. FSLIC was "under the direction of the Federal Home Loan Bank Board and operated by it under such bylaws, rules, and regulations as it may prescribe." 12 U.S.C. § 1725(a) (1982). *See also, e.g., id.* §§ 1725(c)(4), (d), (i), 1727(i), 1729(c)(1)(B) (more specifically describing certain relationships between the two entities); ER210 (Bank Board Resolution concerning the RAP Right describes the Bank Board as the "operating head of the FSLIC").

In other words, decisions of the Bank Board were implemented through actions of the FSLIC. Lacking the authority to contract, the Bank Board could not on its own create a contractual obligation to provide the Rights to Home, and thus it could not possibly have provided Home with the necessary inducement to undertake the merger. The Bank Board needed to have FSLIC make the contractual promise, and therefore the Rights cannot be described as having come entirely from the Bank Board. In the words of the Supreme Court in *Winstar*, Home received the Rights in the Assistance Agreement from "FSLIC (and the Bank Board acting through it)." *United States v. Winstar Corp.*, 518 U.S. 839, 891 (1996) (plurality opinion). If the Bank Board had to "act[] through" FSLIC because FSLIC was the only entity that could contract with Home, it necessarily

follows that the Rights were "received from [FSLIC]" within the meaning of section 597.

2. Home Received the Rights Pursuant to Section 1729(f)

The government also argues that section 597 is inapplicable to the Rights because they allegedly do not satisfy the statutory condition of being provided pursuant to section 1729(f). Gov't Br. 51-61. This is a hypertechnical objection as Congress commonly used cross-references to section 1729(f), the section that addresses "[a]ssistance to thrift institutions," as a way of describing FSLIC assistance. *See* 12 U.S.C. §§ 1726(b), 1730a(m)(1)(A)(i) (1982). It is unlikely that Congress would have contemplated that FSLIC could provide assistance to facilitate a supervisory merger without invoking section 1729(f). In any event, the government's contention flies in the face of both Supreme Court precedent and common sense.

a. The Supreme Court's Decision in *Winstar* Establishes That Home Received the Rights Pursuant to Section 1729(f)

As discussed in the opening brief, one of the questions addressed by the *Winstar* Court was whether the banking agencies had statutory authority to enter into the Assistance Agreements that provided the RAP Right. *See* WMI Br. 45-46; *Winstar*, 518 U.S. at 890 (plurality opinion). The Court answered with a resounding yes, stating that there was "ample statutory authority" and "no serious

question" about it. *Id.* at 890, 891. The Court pointed to two statutes. First, it briefly noted that 12 U.S.C. § 1725(c) (1982) "generally empowered [FSLIC] '[t]o make contracts." *Id.* at 890. Second, the Court stated that section 1729(f)(2) "delegated more specific powers in the context of supervisory mergers," quoting extensively from that statute. *Id.* These two statutes covered the two basic concerns about the necessary authority: 1) the power to single out thrifts engaged in supervisory mergers for favorable regulatory treatment not available to other thrifts; and 2) the power to make binding commitments to provide that special regulatory treatment.

The government, however, argues that one cannot conclude from the Court's analysis that FSLIC provided the RAP Right pursuant to section 1729(f). Gov't Br. 53-55. Rather, the government theorizes, "the general grant of contractual authority in § 1725(c) . . . may plausibly be considered the [sole] source of authority to grant the RAP Right." *Id.* at 54. This startling assertion raises the question of why the Supreme Court addressed section 1729(f) at all. The government answers that it is "plausible to conclude that the Court merely viewed § 1729(f)(2) as indicative of Congressional intent to encourage FSLIC-assisted takeovers of troubled thrifts." *Id.* But surely this is not a "plausible" reading of the Court's opinion. The Court's analysis was unquestionably directed at determining whether there existed statutory authority for the contracts at issue, and

it quoted at length from section 1729(f)(2) in order to demonstrate the existence of the authority to provide the promised assistance, not to imply some observation about what conduct Congress wanted to encourage. *See Winstar*, 518 U.S. at 890; *see also id.* at 883 (citing section 1729(f)(2) as having "authorized FSLIC" to incur certain costs).

The government tries to support its reading by noting that section 1729(f)(2) authorizes the provision of FSLIC assistance only to "insured institutions" like Home, yet two of the *Winstar* plaintiffs were not "insured institutions." Since section 1729(f)(2) did not apply to those acquirers, the government reasons, the Court must have concluded that the RAP Right was provided under the sole authority of section 1725(c). Gov't Br. 54-55. But this reasoning is faulty. First, the RAP Right ultimately was provided to the surviving thrifts, which were the entities that had to meet regulatory capital requirements, not to the acquiring holding companies. Therefore, the RAP Right was provided under section 1729(f)(2) even for the non-thrift acquisitions.

Second, even if the RAP Right is viewed as having been directly provided to the acquirers, section 1729(f)(3) to made the provisions of section 1729(f)(2) applicable to entities other than "insured institutions." Thus, the RAP Right was provided to all of the institutions in *Winstar* pursuant to section 1729(f). Although the Court did not specifically mention subsection (f)(3), that provision merely

language, including the "specific powers" on which the Court relied (*Winstar*, 518 U.S. at 890), is found in subsection (f)(2). The government's reading of *Winstar* is untenable; the Court simply did not rule that a general power "[t]o make contracts" was enough to provide "ample statutory authority" for the banking agencies to guarantee novel regulatory treatment to a select group of thrifts. *Id*.

Rather, the only plausible reading of *Winstar* is that the Court ruled that sections 1725(c) and 1729(f) together provided the authority for FSLIC to make a contractual promise to provide the RAP Right. Accordingly, *Winstar* forecloses any argument that the RAP Right was not received by acquirers like Home "pursuant to" section 1729(f). And there is no reason for any different treatment for the Branching Rights that were similarly conveyed by the banking agencies to Home to facilitate supervisory mergers. *See* WMI Br. 46-47; Gov't Br. 58-59 (equating RAP Right and branching rights for section 1729(f) analysis).

Apparently recognizing the implausibility of its reading of *Winstar*, the government urges this Court to disregard the Supreme Court's conclusion as "dictum," arguing that the Court's work was done once it ruled that the contracts had not stripped the government of its legislative sovereignty. *See* Gov't Br. 52-53, 55-56. That argument is premised on an impossibly narrow view of the issues that were before the Court in *Winstar*. In that case, the government specifically

challenged the authority of FSLIC to enter into the Assistance Agreements.

Pointing to the Federal Circuit's conclusion that statutory authority existed in 12

U.S.C. §§ 1725(c) and 1729(f)(2) "to make contracts granting respondents the rights they claim," the government argued that those provisions "do not provide even a hint that Congress intended to grant FSLIC or the Bank Board the authority . . . to immunize particular thrifts from the effects of statutory changes for periods of 25 to 40 years or more." *See* U.S. Br. in *Winstar*, at 40, 41 (Exhibit A).

Contrary to the government's assertion here, that argument was not refuted by the Court's conclusion that the contracts did not implicate the government's sovereign powers. The Supreme Court plurality explained this point directly, stating that its conclusion did not "foreclose the assertion of a defense that the contracts were ultra vires." 518 U.S. at 887. The plurality even cited to the pages of the opinion where it would address that defense – the same pages of the opinion that the government now argues are dictum. *See id.* (*citing id.* at 888-91).

Moreover, the three-justice concurrence also specifically ruled that section 1729(f)(2) was a source of FSLIC's authority to provide the RAP right. *See id.* at 923 (Scalia, J., concurring) ("express delegation" requirement satisfied by "the statutes which the principal opinion identifies as conferring . . . authority," that is, sections 1725(c) and 1729(f)(2)).

Thus, the Court's discussion of the statutory authority for FSLIC to contract to provide the RAP Right in *Winstar* was not "dictum"; it was essential to the decision, not "peripheral," and could not "have been deleted without seriously impairing the analytical foundations of the holding." *See Sarnoff v. American Home Prods. Corp.*, 798 F.2d 1075, 1084 (7th Cir. 1986); *see also Coloma v. Director, Office of Workers Comp. Programs*, 897 F.2d 394, 398 (9th Cir. 1990) (citing *Sarnoff* definition of dictum). This Court is not free to disregard that discussion, but rather must follow the Supreme Court's holding that the RAP Right was provided by FSLIC pursuant to section 1729(f). Therefore, the Rights at issue in this case were provided pursuant to section 1729(f).

b. The 1982 Amendments to the National Housing Act
Do Not Undermine the Conclusion That Home
Received the Rights Pursuant to Section 1729(f)

Assuming that the question remains open after *Winstar*, the government argues that two statutory changes made by the 1982 amendments to the National Housing Act – specifically, the additions of 12 U.S.C. §§ 1729(f)(3) and 1730a(m) – demonstrate that Home could not have received the Rights in December 1981 pursuant to section 1729(f). This convoluted argument is without merit.

As noted earlier, Congress added section 1729(f)(3) to make FSLIC assistance available to acquiring entities other than the "insured institutions" identified in section 1729(f)(2), like holding companies. Because subsection (f)(3)

uses the phrase "financial assistance," the government deduces that no part of section 1729(f) can authorize the Rights, which it regards as not "financial." Gov't Br. 56-58. This argument is essentially another version of the district court's assertion that the term "other property" in section 597 cannot include the Rights because the legislative history describes FSLIC assistance as "financial," and it fails for the same reason. As discussed elsewhere, given the kinds of assistance prevalent at the time, the general term "financial assistance" was sometimes used to describe FSLIC assistance without any specific intent to exclude forms of assistance that do not involve cash or direct loans. *See* WMI Br. 48-53; *infra* p. 28.

Moreover, the use of that term in subsection (f)(3) is entirely understandable because FSLIC regulatory accounting or branching restrictions apply to thrifts, not to holding companies. Therefore, Congress had no reason to worry about including assistance like the Rights within that subsection. Even if the use of the term "financial assistance" in subsection (f)(3) could be read to exclude the Rights from FSLIC's authority respecting non-thrifts, that would be no justification for similarly restricting its authority respecting thrifts like Home under subsection (f)(2). In any event, the courts have repeatedly found the term "financial assistance" broad enough to encompass assistance like the Rights. *See, e.g., Globe Savings Bank. F.S.B v. United States*, 55 Fed. Cl. 247, 259-60 (2003) (section 1729(f)(3) authorizes a "broad variety of assistance," including the RAP Right);

Admiral Fin. Corp. v. United States, 54 Fed. Cl. 247, 258 (2002) ("The Government provided financial assistance in the form of incentives respecting the regulatory treatment of goodwill.").

The second addition identified is 12 U.S.C. § 1730a(m), which generally gives FSLIC broad powers to authorize "emergency thrift acquisitions" without Bank Board action. Gov't Br. 58-59. The government argues that there would have been "no need" for this provision if section 1729(f) already authorized FSLIC to award branching rights, and therefore the Rights could not have been received pursuant to section 1729(f). This argument is incorrect because, as confirmed by the government's own brief, section 1730a(m) made it easier for FSLIC to provide branching rights in certain circumstances. According to the government, section 1730a(m) "authorized FSLIC to grant interstate branching rights" in the "emergency" situations covered by that section (id. at 58); before its enactment, a Bank Board resolution was required before FSLIC could use its authority under section 1725(c) and 1729(f) to contract to provide branching rights. *Id.* at 59 n.20. Indeed, as noted in the opening brief, Congress specifically referenced FSLIC's authority to award branching rights under section 1729(f), notwithstanding section 1730a(m). See WMI Br. 46-47 (quoting H.R. Rep. No. 100-261, at 139 (1987) (Conf. Rep.)); cf. Gov't Br. 58 (incorrectly suggesting that Congress referred only to section 1730a(m), not to section 1729(f)).

Both of the government's arguments share one fundamental flaw. The alternatives that emerge if one rejects the Winstar Court's conclusion that section 1729(f) authorized FSLIC to facilitate supervisory mergers by providing regulatory rights are untenable. One possibility is that FSLIC repeatedly exceeded its authority when it promised RAP Rights to facilitate supervisory mergers throughout the 1980s. That conclusion is inconsistent with the result in *Winstar*, and the government does not endorse it. The other possibility is that the sole authority for FSLIC's actions was 12 U.S.C. § 1725(c)(3), a three-word subsection that gives FSLIC the power "[t]o make contracts." See Gov't Br. 58. If that general grant of authority was enough to authorize FSLIC's extraordinary assistance efforts in the 1980s, then the authority of the numerous agencies that have the power to contract would be almost limitless. And there would have been no need for Congress to enact section 1729(f), section 1730a(m), or any other statute describing FSLIC's authority.

In short, the *Winstar* Court was correct in finding section 1729(f) to be a source for FSLIC's authority to provide the RAP Right. Accordingly, Home received the Rights pursuant to section 1729(f) within the meaning of section 597.

3. The Heading and Legislative History of Code Section 597 Do Not Override the Statutory Language That Broadly Applies to "Money and Other Property"

Finally, the government also briefly addresses the ground relied upon by the district court, describing it as the "real issue" (Gov't Br. 62) – namely, whether the Rights fall within the term "other property" in section 597. In contrast to the district court (*see* ER14 n.2), the government relies on the reference in the heading of section 597 to "financial assistance." But as noted in the opening brief, section 7806(b) of the Code prohibits courts from using the heading of a Code section as a basis for interpretation. WMI Br. 48 n.6.

The government responds to WMI's argument with several citations that do not support its position. Gov't Br. 63. The Supreme Court cases cited do not involve the Internal Revenue Code and merely state the "normal rule" (*id.*) that courts may look to the heading of a statute for guidance. These cases are irrelevant here where section 7806(b) provides a Code-specific rule that departs from the "normal rule." Indeed, the government has so informed the Supreme Court in the past, expressly disclaiming reliance on a Code subtitle heading because of section 7806(b). *United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 222 (1996).

Moreover, headings generally are relevant "only when they shed light on some ambiguous word or phrase . . ., [b]ut they cannot undo or limit that which the

text makes plain." *Bhd. of R.R. Trainmen v. Balt. & Ohio R.R Co.*, 331 U.S. 519, 529 (1947). The government does not attempt to explain what is "ambiguous" about the phrase "money or other property" or why it would not encompass an asset that no one disputes is "property." *See* WMI Br. 25-26, 44. Of particular relevance here, "headings and titles are not meant to take the place of the detailed provisions of the text" and it "is not an unusual fact" that a heading "fails to refer to all the matters which the framers of that section wrote into the text." *Bhd. of R.R. Trainmen*, 331 U.S. at 528.

The court of appeals cases cited involve Code sections, but none of those cases discuss section 7806(b). Rather, it appears that section 7806(b) was not called to those courts' attention and the courts applied the "normal rule."

Accordingly, those cases lend no support to the government's position. This Court has recognized that section 7806(b) establishes a special rule for Code sections (Nordby Supply Co. v. United States, 572 F.2d 1377, 1378 (9th Cir. 1978)), and other courts have uniformly held that it directs courts to draw no inferences from a section heading. See Alcoa, Inc. v. United States, 509 F.3d 173, 181 n.7 (3d Cir. 2007) (section 7806(b) provides that headings of Code sections should be given "no 'legal effect'"); United States v. Juvenile Shoe Corp., 99 F.3d 898, 901 (8th Cir. 1996) (subtitle heading); Grapevine Imports, Ltd. v. United States, 71 Fed. Cl. 324, 331 (2006) ("section 7806(b) of the Code strictly instructs that the heading of

a section is utterly without legal significance"); *Brown-Forman Corp. v. Comm'r*, 94 T.C. 919, 943 (1990) (heading reference to "marginal costing" does not mean that provision is limited to marginal costs). Indeed, the IRS's own internal administrative guidance regards Code section 7806(b) as a prohibition on drawing inferences from Code section headings. *See* G.C.M. 36731 (May 18, 1976).

In addition to the heading, the government points to two references to "financial assistance" in the legislative history and argues that these references demonstrate that Congress did not intend section 597 to apply to FSLIC assistance like the Rights. Gov't Br. 64-65. As discussed in the opening brief, however, cash payments and similar forms of FSLIC assistance were the primary forms of assistance in the early days of the program. Only later, when FSLIC's cash position was threatened by mounting thrift insolvencies, did the provision of regulatory rights become prevalent. When section 597 was enacted, it was natural that the legislative history would mention purely financial forms of assistance, and those references do not demonstrate an intent by Congress to exclude less traditional forms of assistance encompassed by the broad statutory language. *See* WMI Br. 48-49.

The government closes its argument with a couple of observations that are puzzling because they support WMI's position, not the government's. First, the government states: "Had Congress intended § 597(a) to apply to nonfinancial, as

well as financial, forms of FSLIC assistance, it could have done so." Gov't Br. 65. But in fact that is exactly what Congress did. It drafted section 597 expansively, applying to "money and other property." Nothing in the statutory text limits the section to "financial assistance"; indeed, the government does not suggest how the statute could possibly have been drafted more expansively.

Second, the government states that it is not up to the Court "to somehow improve upon the policy choices set forth in the statute." *Id.* (quoting ER17). But as discussed in the opening brief, the evident policy of section 597 was to help FSLIC minimize cash outlays by providing favorable tax treatment for recipients of FSLIC assistance, and that policy is reflected in the statute's broad inclusion of "other property." WMI Br. 43-44, 53-54. The government does not address the policy of the statute, and certainly proffers no reason why Congress would have excluded one type of FSLIC assistance from section 597, which was intended to prevent FSLIC assistance from causing adverse tax consequences because that would force FSLIC to provide more assistance. See Centex Corp. v. United States, 395 F.3d 1283, 1297 (Fed. Cir. 2005) (Congress "did not intend that the extent of the tax benefits would depend – and potentially be substantially reduced – by the particular form in which the assistance payments were made"). As the government states, this Court should respect the policy choices made in the statute. It should

not defeat these policies by arbitrarily excluding the Rights from the coverage of section 597.

CONCLUSION

For the foregoing reasons, and those stated in the opening brief, the judgment of the district court should be reversed.

Respectfully submitted,

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June 21, 2010

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CERTIFICATE OF COMPLIANCE

Pursuant to FRAP 32(a)(7)(C), the undersigned certifies that this brief complies with the type-volume limitations of FRAP 32(a)(7)(B). Exclusive of the exempted portions identified in FRAP 32(a)(7)(B), the brief contains 6,957 words, as calculated by the word-processing system used to prepare the brief. The brief has been prepared in a proportionally spaced typeface using Microsoft Word version 2003, using 14-point Times New Roman font.

June 21, 2010

s/ Thomas D. Johnston

Thomas D. Johnston

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing Reply Brief for

Plaintiff-Appellant with the Clerk of the Court for the United States Court of

Appeals for the Ninth Circuit by using the appellate CM/ECF system on June 21,

2010.

I certify that all participants in the case are registered CM/ECF users and

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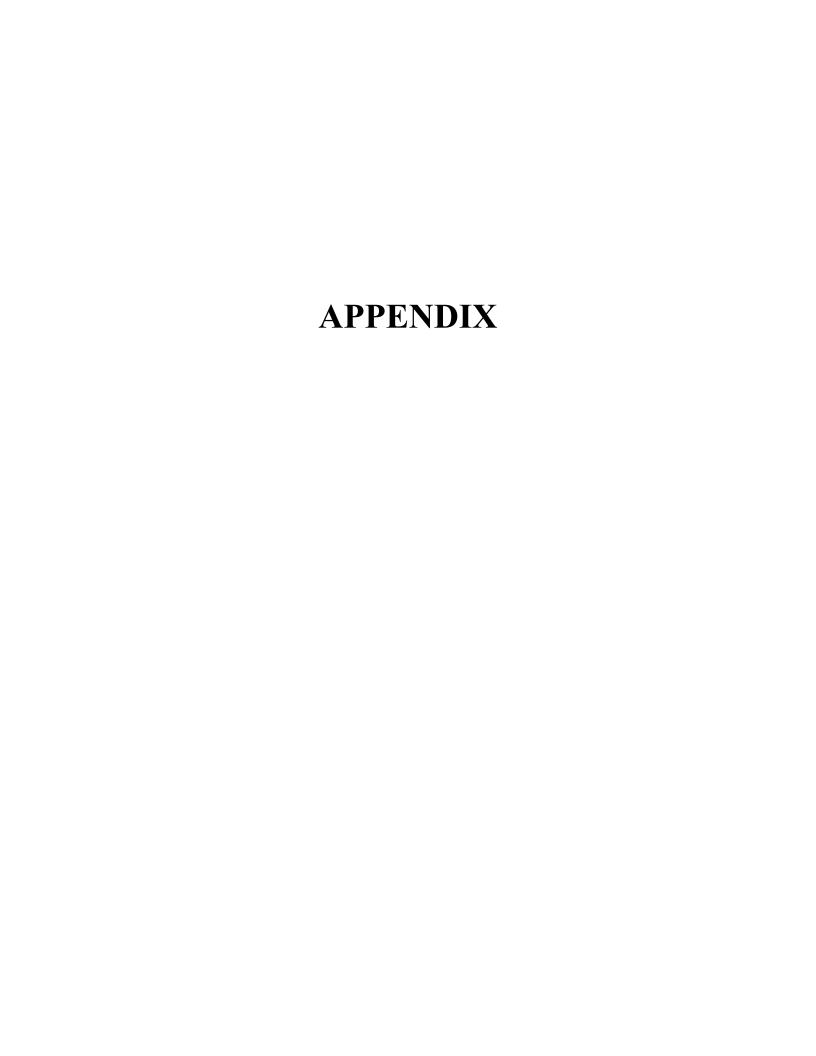


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Exhibit A

In the Supreme Court of the United States

OCTOBER TERM, 1995

United States of America, petitioner

v

WINSTAR CORPORATION, ET AL.

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

BRIEF FOR THE PETITIONER

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with determining whether a showing of such a delegation was made, the Court stated:

The surrender, by contract, of a power of government, though in certain well-defined cases it may be made by legislative authority, is a very grave act, and the surrender itself, as well as the authority to make it, must be closely scrutinized. No other body than the supreme legislature (in this case, the legislature of the State) has the authority to make such a surrender, unless the authority is clearly delegated to it by the supreme legislature. The general powers of a municipality or of any other political subdivision of the State are not sufficient. Specific authority for that purpose is required.

Id. at 273 (emphasis added). Those principles are di-

rectly applicable to this case.82

No specific congressional delegation of authority to enter into contracts limiting Congress's future regulatory power is present in this case. In holding that the federal thrift regulators had the authority to make contracts granting respondents the rights they claim, the court of appeals relied (Pet. App. 39a) on statutes generally granting FSLIC and the Bank Board the power "[t]o make contracts," 12 U.S.C. 1725(c)(3) (1988) (repealed),

The Court added that the effect of the City's contract with the telephone company "is to suspend, during the life of the contract, the governmental power of fixing and regulating the rates." 211 U.S. at 273. In language directly applicable to this case, the Court then stated that, "for the very reason that such a contract has the effect of extinguishing pro tanto an undoubted power of government, both its existence and the authority to make it must clearly and unmistakably appear, and all doubts must be resolved in favor of the continuance of the power." Ibid.

³² These principles have been referred to as the "vertical dimension" of the unmistakability doctrine. See David Toscano, Note, Forbearance Agreements: Invalid Contracts for the Surrender of Sovereignty, 92 Colum. L. Rev. 426, 464 (1992). See also Home Tel. & Tel., 211 U.S. at 276 ("The decisions of this court * * * where a contract of this kind was found and enforced, all show unmistakably legislative authority to enter into the contract.") (emphasis added).

to extend assistance to acquirers of insolvent federally insured thrifts, 12 U.S.C. 1729(f)(2)(A) (1988) (repealed), and the agencies' authority to set minimum capital requirements on a case-by-case basis. The cited provisions, however, do not provide even a hint that Congress intended to grant FSLIC or the Bank Board the authority to commit Congress not to modify the governing statutes, or to immunize particular thrifts from the effects of statutory changes for periods of 25 to 40 years or more.

3. Respondents assert that this Court's decisions in Lynch v. United States, 292 U.S. 571 (1934), and Perry v. United States, 294 U.S. 330, 350 (1935), support their argument. See Glendale Br. in Opp. 19-20. That contention is mistaken.

Lynch and Perry involved government efforts to renege on purely financial contractual obligations—government-issued life insurance contracts in Lynch, the obligation to repay government bonds in gold in Perry. Such contracts do not limit the government's authority to regulate the conduct of private parties or entities for the public good. See Lynch, 292 U.S. at 580 (no suggestion that Congress "abrogate[d] these contracts in the exercise of the police or any other power"). See also David Toscano, Note, Forbearance Agreements: Invalid Contracts for the Surrender of Sovereignty, 92 Colum. L. Rev. 426, 455-456 (1992).

³³ The Court of Federal Claims also relied (Pet. App. 147a) upon statutory language providing that FSLIC could "in its sole discretion and upon such terms and conditions as [FSLIC] may prescribe" guarantee a thrift against loss from a merger. See 12 U.S.C. 1729(f)(2)(A) (1988) (repealed). But that section merely served to exempt such FSLIC determinations from review under the Administrative Procedure Act (5 U.S.C. 701(a)(2)); it did not delegate to FSLIC the authority to make contracts limiting Congress's power to impose regulations on all thrifts.

³⁴ Cf. *POSSE*, 477 U.S. at 55 ("Congress does not have the power to repudiate its own debts, which constitute 'property' to the lender, simply in order to save money.").

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May 26, 2010

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Washington Mutual, Inc. v. United States, Dkt. No. 09-36109 (9th Cir.)

Dear Mr. Catterall:

As we discussed this afternoon, I asked the Court for a two-week extension of the time for filing Appellant's Reply Brief. The extension was granted telephonically. Appellant's Reply Brief is now due June 21, 2010.

Thank you for your cooperation.

Respectfully,

Thomas D. Johnston