No. 98-1966

In the Supreme Court of the United States

SHERMAN PARK APARTMENTS, 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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QUESTION PRESENTED

Whether the enactment of legislation restricting the prepayment of certain loans guaranteed by the Department of Housing and Urban Development, and secured by mortgages on rental housing projects owned by petitioners, breached any contract between petitioners and the government.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-38a) is reported at 162 F.3d 1123. The opinions of the Court of Federal Claims (Pet. App. 39a-91a, 92a-103a, 104a-158a) are reported at 33 Fed. Cl. 196, 37 Fed. Cl. 79, and 38 Fed. Cl. 64.

JURISDICTION

The judgment of the court of appeals was entered on December 7, 1998. A petition for rehearing was denied on March 11, 1999. Pet. App. 159a-160a. The petition for a writ of certiorari was filed on June 8, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Sections 221(d)(3) and 236 of the National Housing Act, 12 U.S.C. 1715*l*(d)(3) and 1715z-1, authorize the Department of Housing and Urban Development (HUD) to insure the payment of mortgages obtained by private developers, thereby enabling private lenders to provide low-interest financing for the construction of housing for low-and moderate-income families. See Pet. App. 3a. Petitioners are owners of rental housing projects in Los Angeles, California, that were developed in the early 1970s with 40-year mortgage loans insured by HUD. See *id.* at 6a-7a.

In each of the transactions at issue in this case, one of petitioners and a private lender sought and received from HUD a commitment to provide mortgage insurance subject to various conditions, including compliance with program rules and the completion of appropriate documentation. See Pet. App. 14a-15a. At the closing of each transaction, the lender and developer entered into a deed of trust (mortgage) and a deed of trust note (mortgage note). The developer also signed a separate "regulatory agreement" with HUD, under which the developer agreed to make timely payments on the mortgage note and to observe various program rules, including limitations on tenant incomes, rental rates, and the permissible rate of return on the developer's investment in the project. In consideration of the developer's promises under the regulatory agreement, HUD endorsed the deed of trust note, thereby agreeing to insure the lender in accordance with the terms of the applicable law and regulations. *Id.* at 15a-18a.[1]

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[1] The terms of the insurance contract between HUD and the lender were set out in regulations at 24 C.F.R. Part 207, Subpart B

HUD's mortgage insurance, and a developer's regulatory agreement, were to remain in effect as long as a given loan remained outstanding. Pet. App. 4a. Prepayment of a loan would therefore terminate both the insurance and the regulatory agreement, allowing the developer to operate its project without regard to HUD's affordability restrictions. *Id.* at 4a-5a. The regulatory agreement between HUD and the developer did not address prepayment of the loan, or incorporate any other agreement on that issue. *Id.* at 19a. The only document that did address prepayment was the deed of trust note. *Id.* at 20a. The note provided, in a rider attached to the printed form of agreement, that the loan could not be prepaid without HUD approval for the first 20 years of its term, but could be prepaid without approval after that time (subject to other conditions not relevant here). *Id.* at 15a-16a.[2]

In the late 1980s, concern arose that owners of many housing projects might soon choose to prepay HUD-insured loans, potentially resulting in a shortage of low-income rental housing. Pet. App. 5a. In 1988, Congress responded by enacting the Emergency Low Income Housing Preservation Act of 1987 (ELIHPA), Pub. L. No. 100-242, Tit. II, 101 Stat. 1877 (12 U.S.C. 1715*l* note), which temporarily prohibited prepayment of

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(1970). See 24 C.F.R. 207.254(c) (1970), as incorporated by 24 C.F.R. 221.751 and 236.251 (1970).

[2] The terms of the rider reflected the prepayment policy set forth in contemporaneous HUD regulations. See 24 C.F.R. 221.524(a)(ii) and 236.30(a)(i) (1970). The Secretary of HUD explicitly reserved the right to amend those regulations (along with others relating to the mortgage insurance program), subject to the proviso that amendments would not adversely affect the interests of a "mortgagee or lender" under an existing contract or commitment. See 24 C.F.R. 221.749 and 236.249 (1970).

insured mortgages without HUD approval. *Ibid.* In 1990, Congress replaced ELIHPA with the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA), 12 U.S.C. 4101 *et seq.* LIHPRHA extended the prohibition on prepayment without HUD approval, and authorized HUD to offer owners certain financial incentives to maintain affordability restrictions on their projects. See 12 U.S.C. 4101, 4109.[3]

2. Petitioners sued the government in the Court of Federal Claims, contending that the prepayment restrictions imposed by ELIHPA and LIHPRHA breached a contractual commitment by HUD that they could prepay their HUD-insured loans, without approval, at any time after 20 years.[4] The trial court

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[3] In 1996, Congress directed HUD to permit prepayment of insured mortgages so long as the owner agreed not to raise rents for 60 days after prepayment. See Pet. App. 6a, 114a; Housing Opportunity Program Extension Act, Pub. L. No. 104-120, § 2, 110 Stat. 834 (referring to provisions of H.R. 2099, 104th Cong., 1st Sess. (1995), as passed by the House of Representatives on Dec. 6, 1995); 141 Cong. Rec. H14112, H14113 (daily ed. Dec. 6, 1995) (relevant provisions as set out in conference report on H.R. 2099 (amendment numbered 16)); 141 Cong. Rec. H14187-H14203 (daily ed. Dec. 7, 1995) (adopting conference report). The court of appeals did not address any issue arising out of the 1996 legislation. See Pet. App. 6a.

[4] The original complaint was filed in 1994 by various plaintiffs, including petitioners Sherman Park Apartments, Independence Park Apartments, and St. Andrews Gardens. Pet. App. 6a n.3. In 1996, 21 additional plaintiffs, including petitioner Pico Plaza Apartments, joined the suit. *Id.* at 10a n.8. In addition to their contract claims, petitioners alleged uncompensated takings of their property and unlawful administrative actions by HUD. *Id.* at 6a. The Court of Federal Claims dismissed the claims based on administrative actions, and petitioners subsequently abandoned those claims. *Id.* at 7a n.4, 11a-12a & n.10. The Fifth Amendment

agreed. Pet. App. 39a-48a, 54a-65a, 91a, 98a. That court concluded that although HUD was not named as a party to the loan agreement, other than through its endorsement with respect to insurance, "when [HUD and petitioners] entered into the regulatory agreement they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note." *Id.* at 58a, 98a.[5] After a trial to determine damages, the court awarded petitioners a total of $3,061,107 in compensation on the theory that, in the absence of ELIHPA and LIHPRHA, after 20 years petitioners would have replaced their HUD-insured loans with uninsured loans, begun to charge market rents for their properties (which would have been permitted, in the court's view, because federal law would have preempted an otherwise applicable local rent control law), and therefore earned a greater return on their investments than they were able to realize under HUD's affordability restrictions. See *id.* at 119a-150a, 158a.

3. The court of appeals reversed. Pet. App. 1a-30a. The court first noted that the Tucker Act, 28 U.S.C. 1491(a)(1), waives sovereign immunity with respect to contract claims only when a suit is based on a contract

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claims remain pending in the trial court. *Id.* at 7a n.4, 10a n.9. Only petitioners' contract claims are at issue before this Court.

[5] Two other judges of the Court of Federal Claims later declined to follow their colleague's decision in this case, instead holding, in substantially similar circumstances, that there was no privity of contract between HUD and project owners with respect to prepayment of mortgage loans. See *Greenbrier (Lake County Trust Co. No. 1391)* v. *United States*, 40 Fed. Cl. 689, 696-700 (1998), appeal pending, No. 98-5111 (Fed. Cir.); *Lurline Gardens Ltd. Housing Partnership* v. *United States*, 37 Fed. Cl. 415, 419-421 (1997).

"between the plaintiff and the government"—that is, when there is "privity of contract between the plaintiff and the United States." Pet. App. 13a (quoting *Ransom* v. *United States*, 900 F.2d 242, 244 (Fed. Cir. 1990)). Assessing the transactions at issue in this case, the court concluded that although the "regulatory agreement" between HUD and each developer was "part of the same transaction" as the loan agreement between the developer and its lender, the documents "evidence[d] separate agreements between distinct parties," and each "stands alone and is unambiguous on its face." *Id.* at 22a. The trial court had therefore "erred in importing requirements [concerning prepayment] from the deed of trust note and the accompanying rider into the regulatory agreement," when "the contract documents simply do not show privity of contract between [petitioners] and HUD with respect to a right to prepay the mortgage loans after twenty years." *Ibid.* Thus, "[b]ecause there was no privity of contract between HUD and [petitioners] with respect to prepayment of the deed of trust notes, HUD could not be liable to [petitioners] for breach of contract by reason of the enactment of ELIHPA and LIHPRHA." *Id.* at 29a.[6] The court accordingly vacated the judgment of the Court of Federal Claims and remanded the case

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[6] Senior Judge Archer dissented. Pet. App. 30a-38a. In his view, the majority failed to take adequate account of "critical factors which support the [trial court's] conclusion that the government intended and in fact did bind itself to the prepayment provisions," including "the overall purpose and nature of the transactions, the intent of the parties, the terms and conditions of HUD's Commitments for Insurance of Advances, and the references in * * * HUD's Commitments and endorsements of the Notes to specific, dated HUD regulations governing these transactions." *Id.* at 31a.

with directions to that court to enter judgment in favor of the government on the contract claims. *Ibid.*[7]

ARGUMENT

1. Petitioners renew in this Court their central argument that a contractual commitment by the government to permit prepayment of insured mortgages after 20 years should be inferred, as "the intent of the parties," by treating the various documents actually signed by any of the parties to the original transaction as "interrelated," and then "considering all of 'the documents and the surrounding facts and circumstances.'" Pet. 16; see Pet. 15-20. That argument concedes at its outset the essential basis of the decision below: No document in the transaction at issue, which involved multiple agreements among commercially sophisticated and amply represented parties (see, *e.g.*, Pet. App. 56a n.9), sets out the alleged promise by the government on which petitioners now seek to rely. See, *e.g.*, *id.* at 22a.

Petitioners' suggestion to the contrary notwithstanding, the court of appeals did not consider each document involved in the mortgage transactions "in isolation," or "refuse[] to look to the realities of the[] transactions." Pet. 16. Indeed, the court explicitly "agree[d] with the Court of Federal Claims that all of the agreements before [the court were] relevant in determining the meaning of each separate contract." Pet. App. 21a-22a. After carefully examining the transaction documents and their "interrelat[ions]" (Pet. 16), however, the court recognized that, in each transaction, separate agreements were used to set out, in unambiguous terms, the

[7] Because its conclusion with respect to privity of contract resolved the appeal, the court of appeals did not address the government's challenges to the trial court's award of damages. Pet. App. 13a.

contractual rights and obligations to be created between HUD and the private lender, between the lender and the developer, and between HUD and the developer. See Pet. App. 14a-22a; see *id.* at 22a ("The documents evidence separate agreements between distinct parties."). Although the documents used cross-references or incorporation clauses where appropriate (see Pet. App. 20a), the regulatory agreement—the only agreement between HUD and project developers (petitioners here)—did not "mention prepayment of the mortgage loan or incorporate any agreement or provision addressing prepayment" (*id.* at 19a).[8] Given the careful structuring of the documents memorializing the transaction, there is little support for petitioners' apparent theory that each document should be read, regardless of its stated parties or terms, to create rights and obligations common to all the participants. To the contrary, as the court of appeals concluded (*id.* at 22a), "[t]he critical point is that the contract documents simply do not show privity of contract between [petitioners] and HUD with respect to a right to prepay the mortgage loans after twenty years."[9]

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[8] Indeed, "it would have been inconsistent for HUD to have entered into the regulatory agreement if the agreement fixed the prepayment rights of [petitioners], in view of the express power to amend the Section 221(d)(3) and Section 236 program regulations [including prepayment restrictions] at any time that was reserved to HUD, subject only to the caveat that *mortgagees*' interests not be adversely affected." Pet. App. 24a (emphasis by the court); see 24 C.F.R. 221.749 and 236.249 (1970).

[9] Petitioners set out at some length in their statement of facts (Pet. 2, 7-11) various statements by HUD officials and individual legislators during the congressional investigation and debate that led to the enactment of ELIHPA and LIHPRHA. See also Pet. 23-24. To the extent those statements reflect an understanding that participating developers likely expected, at the time of the

Petitioners contend that the court of appeals misinterpreted the government's obligations under the transaction documents because it "failed to appreciate" that "the regulatory agreement executed by HUD was to remain in force only while the mortgage loan remained outstanding"; that "the duration of the mortgage loan could in turn be determined only by considering the prepayment provision in Rider A to the deed of trust note"; and that, accordingly, "HUD required the prepayment provision in the * * * note *for its own benefit*, to ensure that it had the right under the regulatory agreement to require Petitioners to remain in the low-income housing program for at least 20 years" (as well as to induce petitioners to enter into the transaction in the first place). Pet. 19. That argument overlooks the fact that some special provision addressing prepayment was necessary to conform the printed

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transactions at issue, that prepayment would be allowed after 20 years—an understanding that is, in any event, directly reflected in the HUD regulations then in force—they are unremarkable, but also irrelevant for present purposes. The question is not whether HUD promulgated regulations stating that, in the absence of an amendment (see 24 C.F.R. 221.749 (1970)), prepayment would be allowed after 20 years, but whether it made a contractual promise, enforceable by petitioners against the government, that it would not revise that aspect of the mortgage insurance program to petitioners' perceived detriment. The materials petitioners cite are of little help in answering that question, which turns primarily on the intent of the parties at the time of the transaction. See Pet. App. 25a ("The after-the-fact views of various parties cannot create a contractual relationship between HUD and [petitioners] with respect to prepayment terms, where the contractual documents themselves fail to evidence such a relationship."); cf. *United States* v. *Price*, 361 U.S. 304, 313 (1960) ("[T]he views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one.").

form of mortgage note used in petitioners' transactions, which gave the borrower an essentially unlimited right of prepayment, to the more restrictive prepayment conditions applicable to these transactions under HUD regulations. Compare C.A. App. 132, 151, 165, 168 (mortgage notes) with 24 C.F.R. 221.524 (1970). Such a conforming change to the form of the loan agreement between developer and lender hardly compels the conclusion that HUD (which was not a signatory) thereby became a party to that agreement.[10]

After carefully considering the documents and circumstances involved, the court of appeals rejected petitioners' argument that HUD intended to bind itself contractually to petitioners and other housing developers on the issue of prepayment rights. Pet. App. 18a, 22a, 29a. Two judges of the Court of Federal Claims independently reached the same conclusion (before the court of appeals had rendered its decision in this case), expressly declining to follow the trial judge's decision in this case. See note 5, *supra*; see also Pet. App. 159a-160a (denying petition for rehearing and declining suggestion for rehearing en banc).[11] The Federal

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[10] Indeed, even if one assumes that the parties to the note intended the prepayment provision to benefit HUD, and to be enforceable by it against either or both of them as a matter of contract law, that would require only that HUD be viewed as an intended third-party beneficiary of the agreement—a conventional contractual status that confers rights, but generally *not* obligations, on a third party who is, by definition, otherwise "a stranger to the [agreement]" (Pet. 19). See generally Restatement (Second) of Contracts §§ 301, 304 (1981).

[11] The decision below is consistent with the decisions in other cases that have rejected contract claims arising out of transactions under the National Housing Act. See *Aetna Cas. & Sur. Co.* v. *United States*, 655 F.2d 1047, 1052-1054 (Ct. Cl. 1981) (HUD's acts in insuring loan under Section 236 of the Act, 12 U.S.C. 1715z-1, to

Circuit's resolution of that fact-bound controversy, with respect to a matter within its core jurisdiction, does not warrant further review by this Court.

2. Petitioners argue (Pet. 20-25) that the decision below conflicts with this Court's decision in *United States* v. *Winstar Corp.*, 518 U.S. 839 (1996), aff'g 64 F.3d 1531 (Fed. Cir. 1995). The court of appeals properly rejected that contention. Pet. App. 27a-29a. In *Winstar*, the plaintiffs and federal regulators had entered into express contracts providing for government assistance in the acquisition of three thrifts. See 518 U.S. at 858, 861-868. The plaintiffs alleged that those contracts included terms dealing with the "regulatory treatment of supervisory goodwill and capital credits." *Id.* at 860. Although the central agreements did not address those issues, each explicitly incorporated certain other materials, and this Court accepted the Federal Circuit's conclusion that those materials included regulatory documents permitting the accounting treatments at issue. See *id.* at 860-868; 64 F.3d at 1540-1544.

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construct a low-income housing project, including its intimate involvement in all phases of the project, did not create privity of contract between HUD and construction contractor); *Brookside Ltd. Partnership* v. *United States*, 231 Ct. Cl. 944, 948 (1982) (owner of housing project with mortgage loan insured under Section 221(d)(4) of the Act, 12 U.S.C. 1715*l*(d)(4), did not have contractual relationship with HUD where owner and HUD were not both parties to any written agreements owner claimed were evidence of contract between them), cert. denied, 459 U.S. 1204 (1983); *H.A. Ekelin & Assocs.* v. *United States*, 225 Ct. Cl. 561, 563-564 (1980) (HUD's approval of loan for insurance under Section 231 of the Act, 12 U.S.C. 1715v, did not create privity of contract between HUD and alleged third-party beneficiary of loan agreement).

Petitioners argue that in deciding this case the Federal Circuit "fundamentally misread" its own prior decision in *Winstar*, and used an "approach" to contractual interpretation "flatly inconsistent" with that endorsed by this Court in that case. Pet. 20-21. Petitioners assert that the relationship between the regulatory agreement and the deed of trust note in this case is akin to the relationship between the instruments that contained the integration clauses and the various documents permitting the accounting treatment at issue in the thrift merger transactions in *Winstar*. Pet. 21. But, as the court of appeals noted, "[t]he plaintiffs in *Winstar* had contracts with integration clauses that expressly incorporated contemporaneous documents that allowed them to use supervisory goodwill," whereas the regulatory agreements in petitioners' case "do not adress prepayment and do not contain integration clauses that incorporate any document addressing prepayment." Pet. App. 28a.[12]

Petitioners' real complaint is that, after applying settled precepts of contract interpretation to different facts, the court of appeals in this case reached a

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[12] Petitioners also argue that, although the documents containing the integration clauses were relevant in *Winstar*, this Court would have reached the same result absent the integration clauses, based upon "the overall facts and circumstances" of those transactions. Pet. 22-23. However, in *Winstar*, this Court only stated that, to the extent the integration clauses were *ambiguous*, the "realities" of the transaction "favored" reading those documents as contractual commitments. 518 U.S. at 863. Similarly, while the Federal Circuit in *Winstar* noted that its interpretation of the integration clauses was "supported" by other evidence and by the circumstances surrounding the transactions, that court did *not* hold that it would have reached the same result if the contracts had not contained the integration clauses.

different *conclusion* from the one it reached in *Winstar*. That circumstance, however, is not a basis for review by this Court. Pet. App. 28a.

3. Finally, petitioners contend (Pet. 25-26) that the mortgage insurance commitment issued by HUD to petitioners and their lenders "incorporat[ed] the regulations *then in effect* into [HUD's] offer to the developers," and that HUD thereby "relinquished its right to change the terms of the contract by amending those regulations."[13] That argument, which petitioner raised for the first time in the court of appeals, is without merit.

To begin with, it is far from clear that the "Regulations" to which the insurance commitment refers include the regulatory prepayment provisions on which petitioners rely. The commitment was concerned with the conditions upon which HUD would insure a loan, not the particular terms of the loan so insured; and it would therefore be most natural to read the commitment to refer to the specific regulations that prescribed (indeed, constituted) the insurance contract, between HUD and the lender, that was brought into force by HUD's endorsement of a mortgage note. See 24 C.F.R. 207.254(c) (1970) ("From the date of initial endorsement, [HUD] and the mortgagee or lender shall be bound by the provisions of this subpart to the same extent as if they had executed a contract including the provisions of this subpart and the applicable sections of

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[13] The insurance commitments stated that HUD would "endorse for insurance under the provisions of Section [221(d)(3) or 236] of the National Housing Act, and the Regulations thereunder now in effect, a mortgage note in the amount of [a stated amount], to be secured by a mortgage, on [stated] property." C.A. App. 122, 142.

the Act."). Those regulations were incorporated by reference, for purposes of the programs at issue here, by 24 C.F.R. 221.751 and 236.251 (1970), which adopted (with some exceptions) the regulations governing a similar program, set out at 24 C.F.R. 207.251-207.499 (1970). They did not include the prepayment rules applicable to the programs at issue, which appeared at 24 C.F.R. 221.524(a)(ii) and 236.30(a) (1970). Compare 24 C.F.R. 207.14 (1970) (setting out different prepayment rule for the program from which the terms of the insurance contract, but not other provisions, were borrowed for purposes of the programs at issue); see also *Lurline Gardens Limited Housing Partnership* v. *United States*, 37 Fed. Cl. 415, 420 n.7 (1997).

In any event, even if the insurance commitment's reference to regulations "now in effect" were read to embrace all regulations applicable to the relevant statutory program, petitioners' attempt to infer a contract guaranteeing them the perceived benefit of those provisions would still fail. If the reference to regulations in HUD's commitment included the prepayment regulations, then it also included the regulations specifying the effect of regulatory amendments, which were included in the same subpart as the prepayment regulations. The amendment regulations provided that any regulation in that subpart might be "amended * * * at any time and from time to time, in whole or in part," subject to the proviso that such amendments should not "adversely affect the interests of a *mortgagee or lender* under the contract of insurance on any mortgage or loan already insured." 24 C.F.R. 221.749 and 236.249 (1970) (emphasis added). Thus, if the commitment included any promise concerning changes in the prepayment (or similar) regulations, it was one made expressly to petitioners' *lenders* (who were the

primary counterparties to the commitment), not to petitioners. Indeed, as the court of appeals observed (Pet. App. 24a), it would have been quite inconsistent for HUD to limit any protection against regulatory changes so carefully to "mortgagee[s] or lender[s]" when drafting the regulations themselves, but then to enter into contracts extending the same protection to developer mortgagors. Analysis of the regulations in effect at the time of the transactions here thus cuts against, rather than in favor of, petitioners' contractual argument.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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