IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF KENTUCKY
SOUTHERN DIVISION AT PIKEVILLE

ARNETIA JOYCE ROBINSON, *Plaintiff*, v. FEDERAL HOUSING FINANCE AGENCY, *et al.*, *Defendants.*	Civil Action No. 7:15-cv-109-ART

PLAINTIFF'S RESPONSE TO SUPPLEMENTAL BRIEF OF FHFA AND MELVIN L. WATT IN FURTHER SUPPORT OF THEIR MOTION TO DISMISS

FHFA belatedly argues that Plaintiff's suit is barred by 12 U.S.C. § 4623(d), which provides, in relevant part, that "[e]xcept as provided in this section, no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or effectiveness of any classification or action of the Director under this subchapter." There is good reason why FHFA did not raise this argument before and that Treasury does not join it now—the argument is wholly meritless. Section 4623(d) has no application whatsoever to actions taken by FHFA as *conservator*. Rather, it applies only to certain specific classifications and supervisory actions taken by FHFA in its capacity as *regulator*. FHFA does not—and could not—contend that the Net Worth Sweep falls within the scope of this provision. Instead, FHFA argues that Plaintiff's suit would somehow affect FHFA's 2008 decision to suspend the Companies' capital classifications during the conservatorships. FHFA's belated argument can be easily refuted for the simple reason that Plaintiff has not challenged FHFA's 2008 decision. In addition, that

decision falls outside the scope of Section 4623(d). Finally, in any event, this lawsuit will have no effect on that decision.[1]

ARGUMENT

I. Section 4623(d) Applies Only to Certain Classifications and Supervisory Actions Taken by FHFA in Its Regulatory Capacity.

HERA assigns FHFA separate roles as supervisor and regulator, on the one hand, and as conservator or receiver, on the other hand. There is a fundamental distinction between the powers that FHFA may exercise and the nature of its actions in these distinct roles. As regulator and supervisor, FHFA is charged with overseeing and examining regulated entities; as conservator or receiver, it is charged with either rehabilitating the Companies by preserving and conserving their assets and returning them to a sound and solvent condition (as conservator), or winding up the affairs of the Companies and liquidating their assets (as receiver). These dual but separate roles are modeled on those assigned to the FDIC under the Federal Deposit Insurance Act. *See, e.g.*, *Sierra Club, Lone Star Chapter v. FDIC*, 992 F.2d 545, 549 n.4 (5th Cir. 1993) (discussing these separate roles). "The separateness of these dual identities . . . has been well respected by federal courts." *Texas American Bancshares, Inc. v. Clarke*, 954 F.2d 329, 335 (5th Cir. 1992).

The distinction between these separate roles is carefully reflected in the text of HERA. *Compare* 12 U.S.C. § 4511(b)(2) (providing that "[t]he Director shall have general regulatory authority over" Fannie and Freddie), *and* 12 U.S.C. § 4513(a) ("Duties and authorities of Director" as regulator and supervisor), *with* 12 U.S.C. § 4617(b) ("Powers and duties of the Agency as conservator or receiver"). In the "subchapter" to which Section 4623(d) refers, for

[1] Even if Section 4623(d) did somehow apply (and it does not), it would not bar review in this case because FHFA has exceeded its delegated powers and plainly violated HERA. *See Dart v. United States*, 848 F.2d 217, 221–22 (D.C. Cir. 1988).

example—subchapter II of chapter 46 of Title 12, comprising 12 U.S.C. §§ 4611 through 4624—HERA repeatedly refers to actions that may be taken by FHFA in its regulatory capacity as actions of "the Director," while referring to actions that may be taken by FHFA in its capacity as conservator or receiver as actions of "the Agency as conservator or receiver."[2] Further reflecting this dichotomy, HERA provides separate limitations on judicial action "to affect . . . the issuance or effectiveness of any classification or action of the *Director* under this subchapter," on the one hand, 12 U.S.C. § 4623(d) (emphasis added), and of judicial "action to restrain or affect the exercise of powers or functions of *the Agency as a conservator or a receiver*," on the other hand, *id.* § 4617(f) (emphasis added).

Although FHFA now invokes Section 4623(d), this provision plainly applies only to actions taken by the Director in his supervisory or regulatory capacity, not to actions taken by the Agency as conservator or receiver. Any other reading of this provision would conflict with the consistent usage of the statute and render Section 4617(f) superfluous. FHFA does not dispute this limitation here, and in other litigation it has expressly acknowledged that Section 4623(d) applies only to "FHFA *in its regulatory capacity*." Defs.' Mot. to Dismiss & Supporting Mem. of P. & A. at 26, *California ex rel. Harris v. FHFA*, No. 10-CV-3084 (N.D. Cal. Oct. 14, 2010), ECF No. 49 (emphasis added).

The scope of Section 4623(d) is further limited to actions seeking review of the specific capital classifications and supervisory actions authorized "under" other provisions of the same

[2] *See, e.g.*, 12 U.S.C. § 4611(a)(1) ("The Director shall, by regulation, establish risk-based capital requirements . . ."); *id.* § 4612(f) ("The Director shall periodically review the amount of core capital maintained by the enterprises . . ."); *id.* § 4614(a) ("For purposes of this subchapter, the Director shall classify the enterprises according to the following capital classifications . . . ."); *id.* § 4617(a)(1) ("[T]he Director may appoint the Agency as conservator or receiver . . . ."); *id.* ("All references to the conservator or receiver under this section are references to the Agency acting as conservator or receiver.").

"subchapter." Specifically, Section 4614 requires "the Director" to "classify the enterprises" as "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized." 12 U.S.C. § 4614(a). Sections 4615 and 4616, in turn, authorize various "supervisory actions" for "undercapitalized regulated entities" and "significantly undercapitalized regulated entities," respectively. *Id.* §§ 4615–4616. ("Critically undercapitalized" entities are subject to conservatorship or receivership. *See* 12 U.S.C. § 4617(a)(3)(K).) Section 4623 provides a specific mechanism for judicial review of "a classification under section 4614 of this title" or of "a discretionary supervisory action taken under this subchapter"—a plain reference to the "supervisory actions" authorized under Sections 4615 and 4616. *Id.* § 4623(a)(1). Section 4623(d) makes clear that this avenue of review is exclusive: "*[e]xcept as provided in this section*, no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or effectiveness of any classification or action of the Director under this subchapter . . . ." *Id.* § 4623(d) (emphasis added).

The statutory structure thus makes clear that Section 4623(d)'s reference to "classification[s]" or "action[s]" refers to the same "classification[s]" and "discretionary supervisory action[s]" addressed by Section 4623(a). *See also id.* § 4623(a) (using the phrase "classification or action" as shorthand for "a classification under section 4614 of this title or a discretionary supervisory action taken under this subchapter"). This reading is confirmed by Section 4623(d)'s reference to "classification[s] or action[s] . . . *under this subchapter*." To read this reference to refer to something other than the classifications and supervisory actions referenced in Section 4623(a) and detailed in Sections 4614 through 4616 would divorce this phrase from context and violate the familiar interpretive principle that words are known by the company they keep. *See Yates v. United States*, 135 S. Ct. 1074, 1085 (2015).

II. Section 4623(d) Has No Application to this Case.

FHFA "is not asserting" that adoption of the Net Worth Sweep was "a regulatory action," but rather freely admits that "the Third Amendment was executed by FHFA in its capacity as Conservator." Suppl. Br. of Defs. FHFA and Watt in Further Supp. of Their Mot. to Dismiss at 4 n.2 (June 16, 2016), Doc. 53 ("Suppl. Br."). FHFA hardly could argue otherwise, as it signed the amendment to the stock agreements on behalf of each Company "by Federal Housing Finance Agency, its Conservator." Exhibit D to Treasury's Mem. in Support of Its Motion to Dismiss at 9, 17 (Jan. 11, 2016), Doc. 22-5. Accordingly, the Net Worth Sweep is not a "classification or action of the Director" subject to Section 4623(d), and even FHFA does not contend otherwise.

Nor was FHFA's decision to temporarily suspend the Companies' existing regulatory capital requirements such a "classification or action." As an initial matter, suspending capital requirements is not one of the supervisory actions authorized under Section 4615 or Section 4616.[3] Whatever authority FHFA may or may not have to take such action under *other* statutes, suspending capital requirements is certainly not a "classification or action of the Director *under this subchapter*." More fundamentally, FHFA's own regulations make clear that "the authority to suspend capital classifications [for] the duration of the conservatorship" is one of FHFA's "powers *as conservator*." 12 C.F.R. § 1237.3(c) (emphasis added). The decision to suspend capital requirements, accordingly, was not a regulatory "classification or action *of the Director*" at all.

[3] The Companies' minimum and critical capital requirements are prescribed by 12 U.S.C. § 4612(a) and 12 U.S.C. § 4613(a), respectively. Although 12 U.S.C. §§ 4612(c) & (d) give the Director power to *increase* minimum capital requirements, nothing in this provision or Sections 4614 through 4616 gives the Director power to *decrease*, *suspend*, or altogether *eliminate* these requirements.

In all events, Plaintiff is not challenging the decision to temporarily suspend the Companies' capital classifications and related regulatory capital requirements. She has not argued that that decision was unlawful. She has not asked this Court to vacate or reverse that decision, or even to address its legality in any way. And the relief she does seek—vacating the Net Worth Sweep—would not reinstate the capital requirements or affect the suspension of those requirements in any way. FHFA's decision to suspend the capital requirements was wholly distinct from the decision to strip the Companies of their entire net worth on a quarterly basis. Indeed, Plaintiff seeks simply to *restore* the terms of the conservatorship and stock agreements that existed for nearly four years from the time FHFA placed the Companies in conservatorship and suspended their capital classifications until the Net Worth Sweep was adopted.

In arguing that Plaintiff's claims would nevertheless somehow "affect" the decision to suspend the Companies' capital classifications, FHFA highlights Plaintiff's argument that stripping the Companies of all of their capital cannot be reconciled with FHFA's duty to put the Companies in a sound and solvent condition. *See* Suppl. Br. 5. But it certainly does not follow from this obvious, practical point that the capital classifications and regulatory capital requirements should be reinstated, and Plaintiff has not requested such relief.

FHFA's apparent claim that the decision to suspend capital classifications somehow amounted to a judgment that the Companies should operate with zero capital and instead rely solely on potential funding from Treasury's standby commitment as their "operating capital" is simply untenable. To the contrary, the decision to suspend the capital classifications itself made clear that FHFA would "continue to closely monitor capital levels," while instructing the Companies "to focus on managing to a positive stockholder's equity." News Release, FHFA, FHFA Announces Suspension of Capital Classifications During Conservatorship at 1 (Oct. 9,

2008) (filed as Doc. 53-1). After all, aiming to operate a company with absolutely no capital is antithetical to the basic premise of modern financial regulation. Indeed, FHFA has elsewhere acknowledged that "zero capital" is *not* a "new capital paradigm." Defs.' Mot. to Dismiss the First Am. Compl., with Supporting Mem. of Law at 19, *Samuels v. FHFA*, No. 1:13-cv-22399 (S.D. Fla. Dec. 6, 2013), ECF No. 38. And FHFA's Director has himself recently acknowledged that the Companies' "lack of capital" remains their "most serious risk." Melvin L. Watt, Dir., FHFA, Prepared Remarks at the Bipartisan Policy Center (Feb. 18, 2016), http://tinyurl.com/jryfjzq; *see also* Letter from Thirty-Two Members of Congress to Secretary Lew and Director Watt (June 1, 2016), http://tinyurl.com/gmk5gw4 (expressing concern about policy of Treasury and FHFA "of requiring Freddie Mac and Fannie Mae . . . to operate without adequate capital").

Further, the PSPAs themselves make clear that Treasury's funding commitment would *not* be viewed as capital, expressly excluding "the Commitment" from the Companies' "total assets." Exhibit A to Treasury's Mem. in Support of Its Motion to Dismiss at 3, 17 (Jan. 11, 2016), Doc. 22-2.[4] In all events, as Plaintiff has previously explained, Pl.'s Sealed Consol. Resp. in Opp'n to Defs.' Mots. to Dismiss 10, 35 (Feb. 12, 2016), Doc. 32, the option of paying dividends in kind rendered the Net Worth Sweep entirely unnecessary to preserve Treasury's funding commitment, and vacating that unlawful action would thus not undermine that commitment. Indeed, the relief Plaintiff seeks—treating excess dividends unlawfully paid pursuant to the Net Worth Sweep as repayments of previous draws or returning the excess dividends to the Companies—would further buttress the funding commitment, either by (1) substantially reducing the total draw outstanding, and thus decreasing future dividend payments

[4] No external funding commitment can be equated with a company's own capital, and Treasury's standby commitment is no exception.

to Treasury, or (2) creating a substantial capital buffer that would make any further draws less likely.

FHFA's decision to permanently consign the Companies to a "zero capital" position, was not, as FHFA has so recently imagined, an action of the agency as regulator. To the contrary, as FHFA observed in a brief it submitted to this Court three months ago, "there is no dispute FHFA acted in its capacity as conservator (not regulator) in executing the Third Amendment." Reply of FHFA and Melvin L. Watt in Support of Their Motion to Dismiss at 15 (Mar. 14, 2016), Doc. 37. That is alone a sufficient basis to conclude that Section 4623(d) does not apply to Plaintiff's challenges.

CONCLUSION

This Court should deny Defendants' motions to dismiss.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was served upon all counsel of record on this 30th day of June, 2016, via the Court's Electronic Case Filing system.

s/ Robert B. Craig