ORAL ARGUMENT HELD ON APRIL 15, 2016

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

PERRY CAPITAL LLC, Appellant, v. JACOB J. LEW, et al., Appellees.	Nos. 14-5243 (L), 14-5254 (con.), 14-5260 (con.), 14-5262 (con.)

PLAINTIFFS-APPELLANTS' REPLY IN SUPPORT OF THEIR MOTION FOR FURTHER JUDICIAL NOTICE AND SUPPLEMENTATION OF THE RECORD

Defendants' oppositions are consistent with their broader litigation strategy, designed to obscure the true purpose and effect of the Net Worth Sweep while claiming that no court may question their self-serving and demonstrably false account of the relevant facts. Despite Defendants' best efforts to ensure that this case is decided on the basis of an incomplete and misleading administrative record, discovery in related litigation has revealed a much more accurate picture of the information Defendants considered when they decided on the Net Worth Sweep, at precisely the point when the Companies became fabulously profitable. This is no mere coincidence. The materials Plaintiffs ask the Court to judicially notice reveal that Defendants never considered conservatorship principles and knew that the Net

Worth Sweep would be tremendously lucrative for Treasury, adopting the Sweep to prevent the Companies from returning to a sound and solvent financial condition as mandated by the Housing and Economic Recovery Act of 2008 (HERA). Defendants' arguments for why the Court should blind itself to those facts are unpersuasive.

1. Defendants complain that Plaintiffs waited too long to make their latest motion, with Treasury telling the Court that "[t]he Fairholme Funds plaintiffs had access to these additional materials before they filed their first motion," Treasury's Opp'n to Pls.' Mot. for Further Judicial Notice & Suppl. of the Record at 1(June 8, 2016) ("Treas. Opp."), and FHFA stating that "Fairholme plainly had the opportunity to submit any additional documents under seal as part of its original motion for judicial notice," Opp'n of Appellees FHFA & Melvin L. Watt to Appellants' Mot. for Further Judicial Notice & Suppl. of the Record at 2–3 (June 9, 2016) ("FHFA Opp."). These statements are false. Several of the most significant documents identified in Plaintiffs' recent filing were only produced to Fairholme *after* it made its earlier motion. The Government initially withheld these documents on the basis of groundless privilege assertions that it subsequently abandoned when it became clear that Fairholme was preparing to file a motion to compel in the Court of Federal Claims. Included among these belatedly produced documents are the Treasury Q&A document that lists the Companies' "improv[ed] operating

performance" and the "potential for near-term earnings to exceed the 10% dividend" as among the reasons for the Net Worth Sweep, App. to Mot. for Further Judicial Notice & Suppl. of the Record (May 31, 2016) ("App."), Exhibit 4 at A014 (UST00554583), A021 (UST00554590); a meeting agenda that shows that Treasury was discussing "[r]eturning the deferred tax asset to the GSE balance sheets" months before the Net Worth Sweep was announced, UST00405880 (App. Exhibit 6, A029); a briefing memorandum that reveals that Treasury's first question for the Companies' management on August 9, 2012 was "how quickly they forecast releasing credit reserves," UST00556835 (App. Exhibit 8, A035); and an email in which White House official James Parrott explained to a "fellow traveler" at a Washington think tank that the Net Worth Sweep would ensure that the Companies "can't repay their debt and escape." UST00061068 (App. Exhibit 2, A007).

The handful of other documents that Fairholme was unable to identify in its earlier motion were only produced to Fairholme between April and July 2015, a period during which the Government dumped approximately 144,000 pages of materials on Fairholme's document review team after months of foot dragging. It is Defendants, not Plaintiffs, who remain responsible for any delays: after all, Defendants failed to produce complete and accurate administrative records when this suit was filed in 2013, and Defendants have repeatedly attempted to prevent the courts from considering materials in a timely manner—information that never

should have been withheld in the first place. In any event, Defendants have not identified any legal basis for excluding relevant documents from consideration by this Court based on a purported delay in their submission.[1]

2. Defendants urge the Court to deny Plaintiffs' motion on the theory that the facts of this case do not matter because HERA allows them to do whatever they want with the Companies for any reason that suits them. Treas. Opp. 2; FHFA Opp. 3. HERA's text and the longstanding history of conservatorship operations fully rebut Defendants' position. *See* Final Reply Br. for Inst. Pls.' at 10–15 (Feb. 25, 2016) ("Institutional Plaintiffs' Reply Br."). Moreover, FHFA concedes, at least for "present purposes," that the facts are undisputed—that the Net Worth Sweep "was intended to wind down and not rehabilitate the [Companies]" and "foreseeably resulted in 'windfall profits' to Treasury." FHFA Opp. at 3–4. Treasury argues to the contrary, that "[p]rotecting Treasury's commitment by ending the draws to pay dividends cycle was a real and important concern for Treasury." Treas. Opp. at 3. Thus, while the Court can find for Appellants on the undisputed record, Institutional Plaintiffs' Reply Br. 15–37, it certainly cannot rule against them without first consulting a complete administrative record.

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[1] Moreover, regardless of when Fairholme first obtained these documents, there is no question that other appellants, movants here, did not have access to these documents until after the Court of Federal Claims entered an order making them available to the public long after Fairholme's first motion for judicial notice was filed in July 2015.

3. Treasury says that it is entitled to a "presumption of regularity" in how it compiled its administrative record, Treas. Opp. 2, but that presumption has been rebutted by clear evidence that the Government omitted relevant documents from the records produced below. *See American Wildlands v. Kempthorne*, 530 F.3d 991, 1002 (D.C. Cir. 2008) (court may supplement the administrative record if "[t]he agency deliberately or negligently excluded documents that may have been adverse to its decision"); *Walter O. Boswell Memorial Hosp. v. Heckler*, 749 F.2d 788, 792 (D.C. Cir. 1984) (examining on appeal materials that agency improperly failed to include in administrative record submitted to district court). The key elements of Defendants' submissions to the district court included a sworn statement from a declarant who, when later questioned under oath, contradicted or disclaimed personal knowledge of the statement's most important points, Institutional Plaintiffs' Reply Br. 6 n.1, and a set of financial projections that Treasury attempted to pass off as having been created in mid-2012 but that in fact were based on data from 2011, nearly a year before adopting the Net Worth Sweep, *id.* at 5. Indeed, FHFA did not even purport to submit a complete administrative record. Final Opening Br. for Inst. Pls.' at 69–70 (June 29, 2015) ("Institutional Plaintiffs' Opening Br.").

The evidence from the Court of Federal Claims that Plaintiffs have submitted to this Court demonstrates that Defendants considered more recent and far more

positive financial projections that Defendants improperly withheld from the district court. Institutional Plaintiffs' Reply Br. 5–6; *see also* Mot. for Further Judicial Notice & Suppl. of the Record at 5–6 (May 25, 2016) ("Mot."). It requires no small amount of audacity for Treasury to describe *Plaintiffs'* evidence as "a selective sliver of untested discovery materials." Treas. Opp. 2.

4. Treasury focuses on snippets of the materials identified in Plaintiffs' motion that demonstrate its early efforts to promote the false "death spiral" narrative, but it ignores the most important facts that emerge from these documents.

First, Treasury does not and cannot dispute that the documents demonstrate that Treasury's intention in entering the Net Worth Sweep was to ensure that the Companies could never rebuild capital, return to a sound financial condition, and emerge from conservatorship. *See, e.g.*, UST00503987 (App. Exhibit 3, A010) (White House official explaining that commentator was "exactly right on substance and intent" that the Net Worth Sweep would prevent the Companies from "com[ing] back to life because their profits will enable them to re-capitalize themselves," *see* Mot. 2–3). Treasury never attempts—because it is impossible—to reconcile this aim with the mandates of conservatorship.

Second, Treasury never disputes that these documents show that Defendants anticipated that the Companies' foreseeable profits would exceed the then-10% dividend that the Companies could, but were not required, to declare under the terms

of the original contract. *See, e.g.*, UST00554590 (App. Exhibit 4, A021) (Net Worth Sweep was adopted in light of "[p]otential for near-term earnings to exceed the 10% dividend").[2] Indeed, Treasury's reference to the Companies' performance in "five of the last six quarters" is nothing but mere (and belated) hindsight. Treas. Opp. 3–4. This gives the lie to Defendants' "death spiral" explanation for the Net Worth Sweep, for if they were truly concerned about preserving the funding commitment they would not have imposed the Net Worth Sweep at a time when they knew that its near-term effect would be to prevent the Companies from accumulating a substantial capital buffer. But for the Net Worth Sweep, the Companies today would have $125 billion in additional capital that they could use to avoid any further draws on Treasury's funding commitment in the future.

To be clear, this $125 billion represents the amount of capital that has been swept to Treasury *in excess* of what the Companies would have paid had the original

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[2] Treasury's assertion that Fannie's CEO questioned the "credibility" of the new projections, or that someone within Fannie Mae suggested a "conservative approach" is taken out of context. *See* Treas. Opp. at 7–8 (quoting App. Exhibit 12, A064). The email chain at issue recounted preparation for a July 2012 meeting of Fannie Mae's board of directors at which the revised financial projections would be presented. *See* App. Exhibit 12, A064. But any of these concerns must have been addressed during the meeting because these revised projections were presented to the Treasury Department on August 9, 2012. App. Exhibit 11, A058–059. Moreover, the person who allegedly suggested a "conservative" approach—John Greenlee—was not a Fannie Mae official, but rather was a FHFA employee at the time, App. Exhibit 12, A063 ("jon.greenlee@fhfa.gov" listed as an email recipient), so Treasury's assertion that "others within the organization [Fannie]," held that view, Treas. Opp. 7–8, is not supported by the record.

agreement remained in place and had the Companies elected to continue paying 10% *cash* dividends. Treasury's assertion that "the GSEs have failed to earn sufficient income to pay what they would have owed Treasury under the original 10% dividend obligation in five of the last six quarters" thus *highlights* the perverse nature of the Net Worth Sweep. Treas. Opp. 3–4. For rather than having an additional $125 billion as protection from quarterly fluctuations in earnings, Fannie and Freddie are forced to operate on the edge of insolvency and could be forced to take an additional draw from Treasury on the basis of a single down quarter. Rather than protecting Treasury's commitment, the Net Worth Sweep has dramatically *enhanced* the likelihood that Fannie and Freddie will need to draw from Treasury's commitment in the future by transferring in perpetuity the Companies' net worth to the government, rather than paying the fixed dividend in-kind or with accumulated capital.

Third, Treasury cannot dispute that the documents demonstrate that the White House and Treasury viewed the Net Worth Sweep as "a policy change of enormous importance." UST00503985 (App. Exhibit 5, A027). That upends Treasury's litigation position that the Net Worth Sweep was a mere "modification" to the dividend terms of its securities. The United States recently argued to the Federal Circuit that "an 'interest in residual profits' is the defining feature of an equity interest in a corporation." Reply Brief for the United States at 24, *Starr Int'l Co. v.*

United States, No. 2015-5103 (Fed. Cir. June 1, 2016). The Net Worth Sweep transformed Treasury's stock from debt-like preferred shares with a fixed-rate dividend term into securities that entitle Treasury to *all* of the Companies' residual profits and retained capital in perpetuity and thus effectively makes Treasury the Companies' exclusive equity investor. This is no less a "purchase" of the Companies' securities than if Treasury had directly acquired Plaintiffs' shares and all of the common stock—after its authority to do so expired in 2009. *See* Institutional Plaintiffs Opening Br. 57–60.

5. Finally, in an analytically bankrupt passage of its opposition that conflates its overall profits from its investment in the Companies with its proceeds from the Net Worth Sweep, Treasury claims that its investment has not been especially profitable and that it has only received "an annual rate of return of around 7.5%." Treas. Opp. 6–7. One might reasonably wonder how this figure was calculated given the undisputed fact that Treasury has to date received $125 billion *more* than it would have received under the original terms of a deal that *already* gave it at least a 10% annual dividend. The answer appears to be that Treasury's figure incorrectly ignores any residual value of its investment, which under the Sweep, encompasses all future profits and retained capital plus a claim for the full liquidation preference of the Government's securities, and penny warrants for 79.9% of the Companies' common stock. But while Treasury offers a misleading figure to the Court that assumes that

it will never receive another cent from either Company, the Office of Management and Budget's most recent estimate is that the Companies will pay Treasury under the Net Worth Sweep an additional $151.5 billion in "dividends" from January 1, 2016 through federal fiscal year 2026 (on top of the $241 billion that the Companies had already paid to Treasury through 2015). OFFICE OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2017 312, https://goo.gl/JU1dtX. The Court should not permit this latest abuse of basic financial concepts to help Treasury defend the Net Worth Sweep—an action that unlawfully enriches Treasury while condemning the Companies to forever operate in an unsafe and unsound state and extinguishing the rights of other shareholders who contributed tens of billions of dollars of capital to the Companies.

June 15, 2016

Respectfully submitted,

/s/ Charles J. Cooper

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CERTIFICATE OF SERVICE

I hereby certify that, on this 15th day of June 2016, I electronically filed the original of the foregoing document with the clerk of this Court by using the CM/ECF system. I certify that the participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

Dated: June 15, 2016

/s/ Charles J. Cooper
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