IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
CEDAR RAPIDS DIVISION

THOMAS SAXTON, IDA SAXTON, BRADLEY PAYNTER, Plaintiffs, vs. THE FEDERAL HOUSING FINANCE AGENCY, in its capacity as Conservator of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, MELVIN L. WATT, in his official capacity as Director of the Federal Housing Finance Agency, and THE DEPARTMENT OF THE TREASURY, Defendants.	Civil Action No. 1:15-cv-00047

PLAINTIFFS' RESPONSE TO DEFENDANTS' MOTIONS TO DISMISS

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INTRODUCTION

This action challenges the "Net Worth Sweep"—a truly unprecedented administrative action that has destroyed Plaintiffs' property rights. In August 2012, just as the Federal National Mortgage Association ("Fannie") and the Federal Home Loan Mortgage Corporation ("Freddie," and together with Fannie, the "Companies") had entered a period of sustained, record-breaking profitability, two agencies of the federal government—the Federal Housing Finance Agency ("FHFA") and the Department of the Treasury ("Treasury," and together with FHFA, the "Agencies")—conspired together to expropriate the entire economic value of the Companies, including the value held by private shareholders, for the exclusive benefit of the federal government. The Net Worth Sweep was without warrant in the Agencies' statutory authorities, usurped the property rights of private shareholders such as the Plaintiffs in this action, and has enabled one stockholder—the Treasury—to unlawfully seize nearly $125 billion and counting for its coffers.

FHFA and Treasury accomplished their objective by "amending" the terms of Fannie and Freddie equity securities held by Treasury. Before the Net Worth Sweep, Treasury's equity securities had a stated dividend rate of 10% of the outstanding liquidation preference of Treasury's stock, if paid in cash, or 12% if paid in kind by adding to the liquidation preference. The Net Worth Sweep fundamentally changed Treasury's securities by replacing this dividend structure with one that requires Fannie and Freddie to *forever* pay their *entire* net worth to Treasury *every quarter*.

As anticipated, the Net Worth Sweep has been tremendously profitable for the federal government. In less than four years, through the most recently reported quarter, the Companies have paid Treasury *$192 billion*—approximately $125 billion *more* than they would have paid under the prior arrangement. Because the Agencies treat these payments as mere "dividends," not

pay downs of principal, the face value of Treasury's stock has not, and will not, decrease by one cent. Fannie's and Freddie's private shareholders, by contrast, are guaranteed to *never* receive *any* return *of* their investments nor any return *on* their investments (i.e., in the form of dividends).

When it entered the Net Worth Sweep, FHFA purported to be acting in its capacity as conservator of Fannie and Freddie. But Congress has *never* granted FHFA, or any other conservator, the authority to take an action even remotely comparable to the Net Worth Sweep. To the contrary, Congress has charged FHFA as conservator with the statutory responsibility of rehabilitating Fannie and Freddie, and it has empowered FHFA *only* to take action "necessary to put [Fannie and Freddie] in a *sound* and *solvent* condition" and "appropriate to carry on the business of [Fannie and Freddie] and *preserve* and *conserve* [their] assets and property." 12 U.S.C. § 4617(b)(2)(D) (emphasis added).

The Net Worth Sweep is designed to *thwart* these statutory directives, not to comply with them. It is now clear that FHFA had no intention of *rehabilitating* Fannie and Freddie; rather, it was determined to *prevent* them from exiting conservatorship under their current charters. The Net Worth Sweep does not *preserve and conserve* assets, but rather strips those assets on a quarterly basis and siphons them over to Treasury. And the Net Worth Sweep prevents Fannie and Freddie from *ever* being sound and solvent, because it prohibits them from building *any* capital, which is the essence of soundness and solvency for all financial institutions—particularly mortgage insurers like Fannie and Freddie.

Treasury, for its part, purported to be exercising authority to "amend" the securities it had purchased from Fannie and Freddie at the outset of the conservatorship in 2008. But Treasury had no such authority; its temporary authority to purchase Fannie's and Freddie's securities expired on December 31, 2009. *See id.* §§ 1455(*l*), 1719(g). After that date, it only had authority "to hold,

exercise any rights received in connection with, or sell" its securities. *Id*. §§ 1455(*l*)(2)(D); 1719(g)(2)(D). The Net Worth Sweep did none of these things. Indeed, it fundamentally altered Treasury's equity securities to such a significant degree that it amounted to an exchange of those securities for new securities, an exchange Treasury had no authority to make in 2012.

Any uncertainty that existed about the Agencies' true objective in entering the Net Worth Sweep has now been eliminated. As early as 2010, Treasury had secretly determined that the potential for Fannie's and Freddie's existing common shareholders to share in the Companies' profitability should be destroyed. By mid-2012, however, it became apparent that, despite FHFA's and Treasury's best efforts, the existing dividend structure of Treasury's stock would not accomplish that objective. As explained above, Treasury's stock provided for a 10% cash or 12% in kind dividend payment, keyed to the value of the stock's liquidation preference. The liquidation preference had started at $1 billion for each company (a so-called "commitment fee"), and it had increased dollar-for-dollar with every draw the Companies made from the Treasury funding commitment. At the time of the Net Worth Sweep, Treasury's liquidation preference stood at $189 billion. That amount, however, was artificially and unnecessarily inflated by overly pessimistic accounting decisions made shortly after FHFA placed Fannie and Freddie in conservatorship, resulting in paper losses that temporarily decreased the Companies' net worth by hundreds of billions of dollars and thus required them to draw corresponding amounts from the funding commitment to maintain positive net worth. To make matters worse, the terms of Treasury's stock did not allow Fannie and Freddie to pay down the liquidation preference.

Nevertheless, Treasury's and FHFA's attempt to drown Fannie and Freddie with a *concrete* life-preserver was threatened to be undone by an improving housing market and the Companies' improving financial prospects. By mid-2012, it was clear to the Agencies that the accounting

decisions resulting in Fannie's and Freddie's outsized losses would soon have to be reversed, resulting in correspondingly outsized profits dwarfing the Companies' dividend obligations to Treasury. Indeed, in early August 2012, the Companies reported significant profits that enabled them to pay Treasury's dividend with billions of dollars to spare. And Treasury and FHFA knew that there was much more to come. Both Agencies were in possession of financial projections indicating that Fannie and Freddie were entering "golden years" of earnings that would result in net payments to Treasury exceeding net draws by 2020 and that would leave each Company (i) in strong financial condition and (ii) with over $100 billion remaining on Treasury's funding commitment by 2022. And on August 9, 2012, just days before the Net Worth Sweep agreement, Fannie's Chief Financial Officer (CFO) told senior Treasury officials that Fannie was likely to make an accounting adjustment within the next year that would immediately add $50 billion to its balance sheet.

Treasury and FHFA were thus forced to act if they wanted to succeed in their goal of preventing Fannie and Freddie from building up capital and putting themselves in a position to potentially exit conservatorship and benefit private shareholders. The Net Worth Sweep was the Agencies' solution. Indeed, the same day that Fannie's CFO told senior Treasury officials that Fannie anticipated making accounting adjustments that would cause it to report an additional $50 billion in profits within the next year, an FHFA official wrote that Treasury was making a "renewed push" to finalize the deal. And after the agreement was signed, a senior White House advisor involved in the development of the Net Worth Sweep wrote to a Treasury official that "we've closed off [the] possibility that [Fannie and Freddie] ever[ ] go (pretend) private again." Likewise, Edward DeMarco, FHFA's Acting Director at the time of the Net Worth Sweep, has testified that he had no intention of allowing the Companies to emerge from conservatorship under

what he viewed as flawed charters.

In sum, there can be no question that the purpose and effect of the Net Worth Sweep was to place Fannie and Freddie into a permanent financial coma and to eliminate the economic bundle of rights held by their private shareholders so that the entire value of the Companies—all of their capital plus immense profits—would exclusively benefit the federal government.

The Net Worth Sweep is one of the most brazenly lawless acts ever taken by executive branch agencies. Yet, FHFA and Treasury argue that Congress has deprived this Court of the power even to *review* the legality of their action. Congress has done no such thing.

The Agencies first point to 12 U.S.C. § 4617(f), which provides that "no court may take any action to restrain or affect the powers or functions of [FHFA] as conservator." But the relief Plaintiffs seek here would not affect or restrain FHFA's conservatorship powers or functions *at all* because entering the Net Worth Sweep was *entirely outside* of those powers and functions. Indeed, the Net Worth Sweep was the act of an *anti*-conservator, not a conservator, and it is diametrically opposed to FHFA's conservatorship authorities. What is more, Section 4617(f) says *nothing* about limiting the Court's power to enjoin *Treasury* from exceeding *its own* statutory authorities. Thus even if Section 4617(f) barred relief against FHFA (and it certainly does not), it would have absolutely no effect on Plaintiffs' claims against Treasury.

The Agencies also point to 12 U.S.C. § 4617(b)(2)(A), which states that as conservator FHFA "succeed[s] to . . . all rights, titles, powers, and privileges of . . . any stockholder . . . of [Fannie and Freddie] with respect to [Fannie and Freddie] and [their] assets." This language has never been interpreted to transfer to FHFA direct causes of action asserted on behalf of shareholders themselves, as opposed to derivatively on behalf of an entity in conservatorship or receivership. Plaintiffs' causes of action, which arise under the Administrative Procedure Act, are

their own and not those of the Companies.

FHFA and Treasury also attempt to create the impression that Plaintiffs' claims have been widely rejected by the courts. In truth, however, there has been only *one* opinion that ruled on any of the defenses raised in the motions to dismiss: that of the district court in *Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208 (D.D.C. 2014), in a judgment that is pending on appeal before the D.C. Circuit. The district court's reasoning in *Perry Capital* is utterly bankrupt, and this Court should reject it. For example, essentially ignoring whether FHFA's actions were consistent with its statutory mandates to "preserve and conserve" Fannie's and Freddie's assets while returning them to a "sound and solvent" condition, *Perry Capital* instead held that the Net Worth Sweep was within FHFA's conservatorship authority because Fannie and Freddie "maintain an operational mortgage finance business and are . . . profitable." *Id*. at 228. This superficial analysis ignores the central issue, because the key question is not *whether* Fannie and Freddie are generating profits, but *what they are directed to do with* those profits. Being forced to pay out all profits in the form of "dividends" to a controlling shareholder plainly does not preserve and conserve assets and it is the antithesis of sound operations.

Perry Capital's analysis of Treasury's actions is similarly misguided. Despite acknowledging that, as a matter of substance, "Treasury agreed to a net worth sweep *in exchange for* eliminating the cash dividend equivalent to 10% of the [Companies'] liquidation preference," *id*. at 224 (emphasis added), the court reasoned that the transaction nevertheless did not transgress the expiration of Treasury's purchase authority because, as a matter of form, Treasury was not "providing an additional funding commitment or receiving new securities from [the Companies]," *id*. The *Perry Capital* court's reasoning eviscerates the statutory limitations Congress placed on FHFA and Treasury and grants the agencies free rein to raid the coffers of two of the Nation's

most profitable companies and to destroy the property rights and contractual claims of their shareholders. This is not what Congress intended, and this Court must not allow it.

In addition, the allegations in *Perry Capital* were materially different from the allegations in the Amended Complaint (hereinafter, the "Complaint") in this case. Since *Perry Capital* was decided, additional evidence has come to light regarding the actions of Treasury and FHFA, and in particular, the knowledge that they possessed about the Companies' significantly improved financial circumstances when the Agencies embarked upon their scheme to impose the Net Worth Sweep. The allegations in the Complaint, which must be accepted as true for purposes of the Defendants' motions to dismiss, compel a different result from that of the *Perry Capital* case.

FHFA and Treasury also argue that the *Perry Capital* decision precludes Plaintiffs from litigating their claims before this Court, but that is incorrect. Plaintiffs are not bound by a decision entered against different shareholders in an action in which they played no part. This Court is free to, and should, reject the Agencies' attempt to eviscerate Plaintiffs' private property rights.

Finally, FHFA (but not Treasury) belatedly argues in a supplemental brief that Plaintiffs' 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." But Section 4623(d) applies only to certain specific classifications and supervisory actions taken by FHFA in its *regulatory* capacity; it has no application to actions taken by FHFA as *conservator*. Neither the Net Worth Sweep (which Plaintiffs do challenge) nor FHFA's 2008 decision to *entirely suspend* the Companies' capital classifications (which Plaintiffs do not challenge) falls within the scope of Section 4623(d). FHFA concedes as much with regard to the Net Worth Sweep, and even if the statute did apply to the 2008 decision, FHFA's argument that this lawsuit will somehow affect that

decision is wholly meritless.[1]

STATEMENT OF FACTS

In August 2012, at a time when the housing market was recovering from the financial crisis and Fannie and Freddie had returned to stable profitability, the federal government took for itself the entire value of the rights held by Plaintiffs and Fannie's and Freddie's private shareholders by forcing these private, shareholder-owned Companies to turn over *all* of their capital and profits to the federal government on a quarterly basis *forever*—an action the government called the "Net Worth Sweep."

Fannie and Freddie are two of the largest privately owned financial institutions in the world. They insure trillions of dollars of mortgages and provide essential liquidity to the residential mortgage market. The Companies operate for profit, and their debt and equity securities are privately owned and publicly traded. Plaintiffs own Fannie and Freddie common stock and Freddie preferred stock. *See* Pls.' Am. Compl. for Declaratory & Injunctive Relief & Damages ¶¶ 1, 2, 34–38 (Feb. 9, 2016), Doc. 61 ("Compl."). Plaintiffs have been shareholders since before imposition of the conservatorship in 2008. *Id.* ¶¶ 37–38.

Throughout the financial crisis, Fannie and Freddie were capable of meeting all of their obligations to insureds and creditors and were capable of absorbing any losses that they might reasonably incur as a result of the downturn in the financial markets. As mortgage insurers, Fannie and Freddie are designed to generate ample cash to cover their operating expenses—and indeed this was the case for the Companies throughout the financial crisis. In contrast to the nation's largest banks, the Companies took a relatively conservative approach to investing in mortgages

[1] Defendants also seek dismissal of Plaintiffs' common law claims. Although Plaintiffs do not concede the validity of Defendants' arguments, in the interest of judicial economy they consent to dismissal of Counts IV and V of their Complaint.

during the national run up in home prices from 2004 to 2007. As a result, the Companies remained in a comparatively strong financial condition during the financial crisis. Despite the Companies' relative financial health, Treasury implemented a deliberate strategy to seize the Companies and operate them for the exclusive benefit of the federal government. *See id.* ¶¶ 3, 40–41, 75.

On September 6, 2008—despite prior public statements assuring investors that the Companies were in sound financial shape, FHFA, at Treasury's urging, abruptly forced Fannie and Freddie into conservatorship. Indeed, former Treasury Secretary Hank Paulson has stated that "seizing control" of Fannie and Freddie was an action "I took." *Id.* ¶ 113. Under the Housing and Economic Recovery Act of 2008 ("HERA"), and as acknowledged by FHFA at the time, the purpose of the conservatorship was to restore confidence in and stabilize the Companies with the objective of returning them to normal business operations. *Id.* ¶¶ 7, 45. As FHFA confirmed in its public statements, conservatorship is necessarily temporary, and FHFA may only act as conservator for the Companies until they are stabilized. *Id.* ¶ 50. At the time, neither of the Companies was experiencing a liquidity crisis, nor did they suffer from a short-term fall in operating revenue. *Id.* ¶¶ 7, 40, 75. Nevertheless, Treasury coerced the Companies into conservatorship to further the government's unspoken policy objectives. *See id*. ¶¶ 7, 41.

Immediately after the Companies were forced into conservatorship, Treasury exercised its temporary authority under HERA to enter into agreements with FHFA to purchase equity securities of Fannie and Freddie ("Preferred Stock Purchase Agreements" or "PSPAs"). *Id.* ¶¶ 52–53. Under these PSPAs, Treasury designed an entirely new class of securities in the Companies, known as Senior Preferred Stock ("Government Stock"), which came with very favorable terms. Treasury received $1 billion of Government Stock (via one million shares) in each Company and warrants to purchase 79.9% of the common stock of each Company at a nominal price in return for its

commitment to acquire Government Stock in the future. *Id.* ¶¶ 57–58. Treasury's PSPAs with Fannie and Freddie are materially identical. Exercising these warrants would entitle Treasury to 79.9% of all future profits of the Companies, subject to the Companies' obligation to share the remaining 20.1% of those profits with private common shareholders. Treasury's Government Stock in each Company had an initial liquidation preference of $1 billion. This liquidation preference increases by one dollar for each dollar the Companies receive from Treasury pursuant to the PSPAs. In the event the Companies liquidate, Treasury is entitled to recover the full liquidation value of its shares before any other shareholder receives anything. *Id.* ¶¶ 8, 58.

The Government Stock enabled Treasury to receive dividends at an annualized rate of 10% if paid in cash or 12% if paid in kind. The Government Stock was only permitted to receive cash dividends from the Companies to the extent declared by the Board of Directors "in its sole discretion, from funds legally available therefor." If the Companies did not wish to—or legally could not—pay a cash dividend, the unpaid dividends on the Government Stock could be capitalized (or paid "in kind") by increasing the liquidation preference of the outstanding Government Stock—an option Treasury acknowledged in the fact sheet it released upon entry into the PSPAs and numerous other documents. Therefore, the Companies were *never* required to pay cash dividends on Government Stock. There was *never* any threat that the Companies would become insolvent by virtue of making cash dividend payments, both because dividends could be paid with stock and because state law prohibits the payment of dividends if it would render a company insolvent. *See id.* ¶¶ 9, 59–62.

The Government Stock diluted, but did not eliminate, the economic interests of the Companies' private shareholders. The warrants to purchase 79.9% of the Companies' common stock gave Treasury "upside" via economic participation in the Companies' profitability, but this

upside would be *shared* with private preferred shareholders (who were contractually entitled to dividend and liquidation payments before common shareholders) and common shareholders (who retained rights to 20.1% of the Companies' residual value). James Lockhart, the Director of FHFA, accordingly assured Congress shortly after imposition of the conservatorship that Fannie's and Freddie's "shareholders are still in place, both the preferred and common shareholders have an economic interest in the companies" and that "going forward there may be some value" in that interest. *See id.* ¶¶ 10, 49.

Under FHFA's supervision—and, on information and belief, at the insistence and direction of Treasury—the Companies were forced to excessively write down the value of their assets, primarily due to FHFA's wildly pessimistic assumptions about potential future losses. At Treasury's behest, FHFA caused the Companies to incur substantial non-cash accounting losses in the form of loan loss provisions and write-offs of deferred tax assets.[2] Tens of billions of dollars of these provisions—recognized by the Companies as expenses—were completely unnecessary. Nonetheless, by June 2012, the Agencies had forced Fannie and Freddie to issue $161 billion in Government Stock to make up for the balance-sheet deficits caused by the Agencies' unrealistic and overly pessimistic accounting decisions, even though there was no indication that the Companies' actual cash expenses could not be met by their cash receipts. The Companies were further forced to issue an additional $26 billion of Government Stock so that Fannie and Freddie would be able to pay *cash* dividends to Treasury even though, as explained above, the Companies were never required to pay cash dividends. Finally, because (i) the Companies were forced to issue Government Stock to Treasury that they did not need to continue operations and (ii) the structure

[2] Loan loss reserves reduce a company's reported net worth to reflect anticipated future losses. *Id.* ¶ 72. Deferred tax assets reflect the value of the company's right to avoid paying taxes on future income. *Id.* ¶ 71.

of Treasury's financial support did not permit the Companies to repay and redeem the Government Stock outstanding, the amount of the dividends owed on the Government Stock was artificially—and permanently—inflated. *See id.* ¶¶ 11, 71–73.

As a result of these transactions, Treasury amassed a total of $189 billion in Government Stock. But based on the Companies' performance in the second quarter of 2012, it was apparent that there was still value in the Companies' private shares. The Companies were thriving and paying 10% annualized cash dividends on the Government Stock without drawing additional capital from Treasury. And based on the improving housing market and the high quality of the newer loans backed by the Companies, it was apparent that Fannie and Freddie would enjoy stable profitability for the foreseeable future. The Agencies had specific information from the Companies demonstrating that this stable profitability was inevitable because the Companies would soon be reversing many of the non-cash accounting losses imposed upon them under FHFA's supervision. In light of that information and the broad-based recovery in the housing industry that had occurred by the middle of 2012, the Agencies fully understood that the Companies were on the precipice of generating huge profits, far in excess of the dividends owed on the Government Stock. *See id.* ¶¶ 12, 76–88.

Treasury, however, was not content to share the value of the Companies with private shareholders and was committed to ensuring that the Companies would be operated for the exclusive benefit of the federal government. Indeed, unbeknownst to the public, Treasury had secretly resolved "to ensure existing common equity holders will not have access to any positive earnings from the [Companies] in the future." *Id.* ¶¶ 13, 118 (alteration in original). Therefore, on August 17, 2012, just days after the Companies announced their robust second quarter earnings, the Agencies unilaterally imposed the Net Worth Sweep to expropriate for the federal government

the entire value of Fannie and Freddie shares held by private investors. Treasury itself said that the Net Worth Sweep was intended to ensure that "every dollar of earnings that Fannie Mae and Freddie Mac generate will benefit taxpayers." With the stroke of a pen, the Agencies had nationalized the Companies and taken all the value of the Companies for Treasury, thereby depriving the private shareholders of all of their economic rights, well in excess of the authority granted to FHFA as conservator. *See id.* ¶¶ 14, 93.

Despite the transparent fact that the Net Worth Sweep was designed to expropriate private property rights, the government has claimed both in public and before the courts that the Net Worth Sweep was necessary to prevent the Companies from falling into a "death spiral" in which the Companies' increasing dividend obligations to Treasury would consume Treasury's remaining funding commitment to the Companies. *See id.* ¶ 15. This factual account for the Net Worth Sweep is belied by an inconvenient truth: the Net Worth Sweep was imposed just days after the Companies disclosed that they had returned to stable profitability, and senior government officials knew that the Companies were on the verge of reporting tens of billions of dollars in profits that would far exceed their dividend obligations under the original terms of the PSPAs. *See id.* ¶ 15. It is thus clear that the government's death spiral narrative is false and was not the true reason for the Net Worth Sweep. Indeed, discovery in related litigation has revealed that the Net Worth Sweep was adopted not out of a concern that the Companies would earn too little, but rather out of concern that the Companies would earn *too much* and thus would complicate the Administration's plans to hold Fannie and Freddie hostage in a perpetual conservatorship and to prevent their private shareholders from ever recouping their investment principal, let alone any incremental return in the form of dividends.

Extensive evidence supports this understanding of the purpose and effect of the Net Worth

Sweep. Perhaps the most striking evidence pertains to a meeting that occurred on August 9, 2012 (just eight days before the sweep), between senior Treasury officials and Fannie's executive management team. At that August 9 meeting, Treasury was given very specific information about Fannie's deferred tax assets: Fannie CFO Susan McFarland told Treasury Under Secretary for Domestic Finance Mary Miller that release of the valuation allowance on Fannie's deferred tax assets was likely in mid-2013 and would generate profits in the range of $50 billion—a prediction that proved remarkably accurate. It thus is no surprise that Ms. McFarland also testified that she did not think that Fannie was in a death spiral when the Net Worth Sweep was announced in mid-August 2012. *See id.* ¶¶ 17–18, 83.

The Agencies knew in advance of Treasury's August 9 meeting with Fannie that the company was likely entering a period of "golden years" of earnings. Indeed, in July 2012 the minutes of a Fannie executive management meeting during which that precise sentiment was expressed were circulated broadly within FHFA, including to Acting Director Edward DeMarco. Projections attached to those minutes showed that Fannie expected that its cumulative dividend payments to Treasury would exceed its total draws under the PSPAs by 2020 and that over $115 billion of Treasury's commitment would remain after 2022. Fannie management shared similar projections with Treasury in advance of the August 9 meeting. *See id.* ¶¶ 17, 84.

Fannie's July 2012 projections did not even reflect the dramatically positive near-term increase in net worth that would occur upon reversal of the Company's massive deferred tax assets valuation allowance. As Ms. McFarland predicted, that item alone would soon add over $50 **billion** to Fannie's balance sheet. Treasury was keenly aware of this impending addition to earnings. Indeed, by late May 2012, Treasury was discussing with its financial consultant the topic of returning the deferred tax asset to Fannie's and Freddie's balance sheets, and a key item on

Treasury's agenda for the August 9 meeting was how quickly Fannie forecasted releasing its reserves. *See id.* ¶¶ 18, 103.

In light of these facts, it is utterly implausible for the Agencies to claim that there was imminent concern of a "death spiral" when the Net Worth Sweep was announced. Indeed, in an internal document finalized the day before the sweep was announced, Treasury specifically identified the Companies' "improving operating performance" and the "potential for near-term earnings to *exceed* the 10% dividend" as reasons for imposing the Net Worth Sweep. *Id.* ¶¶ 19, 91.

The Net Worth Sweep agreement also provides that the Companies will not have to pay a periodic commitment fee under the PSPAs while the Net Worth Sweep is in effect. But Treasury had consistently waived the periodic commitment fee before the Net Worth Sweep was imposed, and it could only set the amount of such a fee with the agreement of the Companies and at a market rate. And that rate likely would have been, at most, a small fraction of the outstanding amount of Treasury's commitment. Freddie forecasted its "sensitivity" to imposition of a periodic commitment fee as follows: "Our sensitivity to a commitment fee based on remaining commitment available beginning in 2013 of $149 billion shows that a 25 bps fee results in a $0.4 billion annual impact on Stockholders' Equity." *Id.* ¶ 100. Further, the purpose of the fee was to compensate Treasury for its ongoing support in the form of the commitment to invest in the Companies' Government Stock. By the time of the Net Worth Sweep, the 10% return on the Government Stock and the warrants for 79.9% of the common stock provided a more than adequate return on the government's stand-by commitment, and thus any additional fee would have been inappropriate. Given the Companies' stable profitability and positive outlook in August 2012, the market rate for the periodic commitment fee in 2012, 2013, and 2014 would have been zero. Finally, even if a market-rate fee had been agreed upon between Treasury and FHFA and imposed pursuant to the

PSPAs, the Companies had sufficient market power to pass the entire amount of this fee through to their customers—as the Companies do for other operating and financing costs—without affecting profitability or the value of the Companies' equity securities. *Id.*

For the foregoing reasons, the sworn declaration by Mario Ugoletti that FHFA submitted to the court in *Perry Capital* stating that the value of the periodic commitment fee was "incalculably large" is wholly inaccurate. Indeed, Mr. Ugoletti subsequently gave testimony that was not available to the *Perry Capital* court that he could not recall discussing his idea that the value of the fee was incalculably large with anyone at FHFA or Treasury, that he did not know whether anybody shared that view, that he is neither "an expert on periodic commitment fees," nor "in the business of calculating" such fees, and that he did not know whether anyone at FHFA or Treasury ever tried to calculate the value of the periodic commitment fee. Mr. DeMarco also testified that he could not recall anyone at FHFA attempting to quantify what the periodic commitment fee would have been in the absence of the Net Worth Sweep. *See id*. ¶ 101.

As the Agencies expected at the time of their announcement, *see id*. ¶¶ 76–88, the Net Worth Sweep has resulted in massive and unprecedented profits for the federal government. From the fourth quarter of 2012, the first fiscal quarter subject to the Net Worth Sweep, through the first quarter of 2016, the most recently reported fiscal quarter, Fannie and Freddie generated $191 billion in comprehensive income through significantly increased revenue and the reversal of earlier, overly pessimistic accounting decisions. But rather than using its revenue to prudently build capital reserves and prepare to exit conservatorship, Fannie and Freddie instead have been forced to pay almost $192 billion in "dividends" to the federal government under the Net Worth Sweep—approximately $125 billion more than the government would have received under the original PSPAs. *See* Compl. ¶ 21; *Treasury and Federal Reserve Purchase Programs for GSE and*

Mortgage-Related Securities, FHFA (May 5, 2016), http://goo.gl/jlMw81. Adding Net Worth Sweep dividends to the dividends Fannie and Freddie had already paid, Treasury has now recouped nearly $60 billion *more* than it invested in the Companies. Yet, according to Treasury, the amount of outstanding Government Stock remains firmly fixed at $189 billion, and Treasury continues to insist that it has the right to all of Fannie's and Freddie's future earnings *in perpetuity*.

ARGUMENT

I. Section 4617(f) Does Not Bar Plaintiffs' Claims.

Treasury and FHFA contend that HERA's limitation on judicial remedies, 12 U.S.C. § 4617(f), bars all claims for equitable relief that in any way touch on the Net Worth Sweep. It does not. Courts embrace a "strong presumption that Congress intends judicial review of administrative action." *Bowen v. Michigan Acad. of Family Physicians*, 476 U.S. 667, 670 (1986); *Kenney v. Glickman*, 96 F.3d 1118, 1124 (8th Cir. 1996); *see also* 5 U.S.C. § 702 ("A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof."). Indeed, the Court should only conclude that judicial review of administrative action is unavailable "if presented with clear and convincing evidence" that this was Congress' intent. *Reno v. Catholic Soc. Servs. Inc.*, 509 U.S. 43, 63–64 (1993) (quotation marks omitted). As demonstrated below, Plaintiffs' claims establish that the Net Worth Sweep *grossly exceeded* FHFA's "powers" and "functions" under HERA, and Section 4617(f)'s instruction that courts not "restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver" poses no barrier to relief that simply enforces HERA's limits on FHFA's authority. Nor does Section 4617(f) preclude Plaintiffs' claims against Treasury, for insisting that Treasury honor its own legal obligations does not "restrain or affect" FHFA's exercise of its conservatorship powers.

A. Section 4617(f) Does Not Bar Plaintiffs' Claims Against FHFA.

Section 4617(f) does not bar this Court from enjoining FHFA from acting in excess of or contrary to its statutory authority as conservator. By imposing the Net Worth Sweep, FHFA blatantly exceeded the limits Congress has placed on its authority in at least five ways. First, Congress specifically directed that FHFA as conservator cannot be subject to the direction or supervision of any other government agency, *see* 12 U.S.C. § 4617(a)(7), but FHFA entered the Net Worth Sweep at the direction and under the supervision of Treasury. Second, FHFA failed to act as a "conservator"—and, indeed, acted as an "anti-conservator"—because conservators are not allowed to use the companies under their care as ATM machines. Third, FHFA is required to put Fannie and Freddie in a sound and solvent condition, *see id.* § 4617(b)(2)(D)(i), but the Net Worth Sweep forces the Companies to operate on the edge of insolvency in perpetuity. Fourth, FHFA is required to conserve and preserve Fannie's and Freddie's assets, *id.* § 4617(b)(2)(D)(ii), but the Net Worth Sweep requires the dissipation of assets by forcing the Companies to pay their net worth to Treasury on a quarterly basis. Finally, FHFA is charged with rehabilitating Fannie and Freddie and seeking to return them to private control, *see id.* § 4617(a)(2); 76 Fed. Reg. at 35,727, 35,730, but the Net Worth Sweep makes any such outcome impossible. Each one of these violations independently removes this case from the ambit of Section 4617(f).

1. Section 4617(f) Does Not Insulate Conduct that Exceeds or Contravenes FHFA's Authority Under HERA.

By its terms, Section 4617(f) applies only to actions that would "restrain or affect *the exercise of powers or functions of [FHFA] as conservator or receiver.*" Although this statute insulates FHFA's "lawful exercise of its authority as conservator of the Enterprises," it "is inapplicable when FHFA acts beyond the scope of its conservator power." *County of Sonoma v. FHFA*, 710 F.3d 987, 992 (9th Cir. 2013) (emphasis added). Courts uniformly agree on this point.

See id.; *Leon Cty. v. FHFA*, 700 F.3d 1273, 1278 (11th Cir. 2012); *Town of Babylon v. FHFA*, 699 F.3d 221, 228 (2d Cir. 2012); *Suero v. Federal Home Loan Mortg. Corp.*, 123 F. Supp. 3d 162, 174 (D. Mass. 2015); *Massachusetts v. FHFA*, 54 F. Supp. 3d 94, 99–100 (D. Mass. 2014); *Gail C. Sweeney Estate Marital Tr. v. United States Treasury Dep't*, 68 F. Supp. 3d 116, 125–26 (D.D.C. 2014). Indeed, even the district court opinion in *Perry Capital*, upon which Defendants repeatedly rely, acknowledged that Section 4617(f) does not bar injunctive relief if FHFA " 'has acted or proposes to act beyond, or contrary to, its statutorily prescribed, constitutionally permitted, powers or functions.' " 70 F. Supp. 3d at 220 (quoting *National Tr. for Historic Pres. in United States v. FDIC*, 21 F.3d 469, 472 (D.C. Cir. 1994)[3]); *accord County of Sonoma*, 710 F.3d at 992.

These interpretations mirror the uniform judicial treatment of 12 U.S.C. § 1821(j), the virtually identical provision of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) on which Section 4617(f) was modeled—as illustrated by *Perry Capital*'s quotation from *National Trust for Historic Preservation*, a leading case interpreting Section 1821(j). *Sharpe v. FDIC*, 126 F.3d 1147 (9th Cir. 1997), is illustrative. In that case, the Ninth Circuit concluded that "the FDIC did not act within its statutorily granted powers" when it breached a contract and therefore held that Section 1821(j) did not bar equitable relief redressing that breach. *Id*. at 1155; *see also id.* (Section 1821(j) "does not extend to situations in which the FDIC as receiver asserts authority beyond that granted to it as a receiver."); *Bank of Manhattan, NA v. FDIC*, 778 F.3d 1133, 1136–37 (9th Cir. 2015) (same).

This interpretation, in turn, tracks the Supreme Court's interpretation of FIRREA's

[3] FHFA invokes another passage from the same page of *National Trust* stating that Section 1821(j) "would appear to bar a court from acting in virtually all circumstances." 21 F.3d at 472. As is evident from the language quoted in the text, this is only true when the conservator or receiver does not "act beyond, or contrary to, its statutorily prescribed, constitutionally permitted, powers or functions." *Id.*

predecessor. In *Coit Independence Joint Venture v. Federal Savings & Loan Insurance Corp.*, 489 U.S. 561 (1989), the Court held that a provision similar to Section 4617(f) posed no obstacle to judicial review where a federal receiver had purported to adjudicate a claim the statute did not authorize it to adjudicate. *Id.* at 572–79; *see also* H.R. REP. NO. 101-54, at 130 (1989), *reprinted in* 1989 U.S.C.C.A.N. 86 (Section 1821(j) prevents courts, "to the same extent as the Home Owners' Loan Act does now under existing law, from restraining or affecting the exercise of the powers or functions of the FDIC as conservator or receiver.").

This Court thus cannot simply accept FHFA's *ipse dixit* that the Net Worth Sweep was an exercise of its statutory authority: "FHFA cannot evade judicial scrutiny by merely labeling its actions with a conservator stamp." *Leon County*, 700 F.3d at 1278; *see also County of Sonoma*, 710 F.3d at 994 ("FHFA cannot evade judicial review . . . simply by invoking its authority as conservator."); *Chemical Futures & Options, Inc. v. RTC*, 832 F. Supp. 1188, 1192–93 (N.D. Ill. 1993) ("[S]ection 1821(j) does not elevate the FDIC to the position of a sacred cow which may graze upon the rights of others at will, unchecked by the courts."). Rather, the Court "must consider all relevant factors pertaining to the [Net Worth Sweep] to determine whether it was [implemented] pursuant to the FHFA's powers as conservator," including "its subject matter, its purpose, [and] its outcome." *Leon County*, 700 F.3d at 1278.

The Eighth Circuit's precedents are consistent with this analysis. As that Court made clear in the context of the analogous provision of FIRREA, in determining whether Section 4617(f) applies to Plaintiffs' claims, the federal courts' task is simply to "determine whether the challenged action is within [FHFA]'s power or function." *Dittmer Props., LP v. FDIC*, 708 F.3d 1011, 1017

(8th Cir. 2013).[4]

To be sure, *Gross v. Bell Savings Bank PaSA*, 974 F.2d 403 (3d Cir. 1992), stated, in the course of addressing Section 1821(j)'s application to the Resolution Trust Corporation (RTC) acting as conservator or receiver pursuant to FIRREA, that "federal courts have the ability to restrain the RTC where the Corporation is acting *clearly outside its statutory powers*." *Id.* at 407 (emphasis added). The Third Circuit made this statement in the course of explaining that "where the RTC performs functions assigned it under the statute, injunctive relief will be denied even where the RTC acts in violation of *other* statutory schemes" or "exercises judgment under one of its enumerated powers." *Id.* at 407–08 (emphasis added). While *Gross* thus makes clear that Section 1821(j)—and thus, by analogy, Section 4617(f)—bars equitable relief in actions based solely on the conservator's violations of *other* laws or disagreements with the wisdom of the conservator's *lawful, statutorily authorized* choices, it cannot reasonably be understood to suggest that FHFA may violate HERA or exceed its authority under that statute so long as its conduct is not *too obviously* unlawful. After all, FHFA either violated HERA when it executed the Net Worth Sweep, or it did not. And conduct that violates HERA is clearly beyond the scope of FHFA's powers and functions under HERA. Indeed, the Supreme Court has squarely rejected the notion

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[4] The Eighth Circuit's observation in *Hanson v. FDIC* that an analogous provision of FIRREA "effect[s] a sweeping ouster of courts' power to grant equitable remedies" is not to the contrary. 113 F.3d 866, 871 (8th Cir. 1997) (alteration in original) (quoting *Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995)). The Eighth Circuit quoted this statement in the course of holding that Section 1821(j) applies not merely to injunctions but also to the equitable remedy of a constructive trust. *Id.* The D.C. Circuit, in turn, made this statement in holding that Section 1821(j) applies to the remedy of rescission and to declaratory relief, as well as to injunctions. *See Freeman*, 56 F.3d at 1399. The fact that the set of *remedies* that Section 1821(j) forecloses is "sweeping" does not mean that a conservator may violate or exceed its statutory authority with impunity. Nor does it imply that a conservator's *powers* are likewise "sweeping." To the contrary, the unavailability of most remedies when a conservator is exercising, rather than exceeding or violating, its statutory powers is a reason to construe those powers narrowly.

that any meaningful distinction can be drawn between an agency acting unlawfully and an agency acting beyond the scope of its powers, explaining that agencies' "power to act and how they are to act is authoritatively prescribed by Congress, so that when they act improperly, no less than when they act beyond their jurisdiction, what they do is ultra vires." *City of Arlington v. FCC*, 133 S. Ct. 1863, 1869 (2013). Any suggestion that a federal court may not enjoin FHFA from violating the very statute from which it derives its authority cannot be reconciled with *City of Arlington*. Thus, before the Court can determine whether Section 4617(f) has any applicability to the claims in this lawsuit, it must first determine whether the Net Worth Sweep was within FHFA's authority as conservator. *See, e.g.*, *County of Sonoma*, 710 F.3d at 994 ("Analysis of any challenged action is necessary to determine whether the action falls within the broad, but not infinite, conservator authority."). Any other reading of Section 4617(f) would render meaningless the enumerated and carefully circumscribed list of conservatorship powers that appears in 12 U.S.C. § 4617(b).[5]

2. FHFA Exceeded Its Statutory Authority When It Entered the Net Worth Sweep.

Although the scope of judicial review allowed under Section 4617(f) is contested, the Court need not resolve that dispute to reject Defendants' motions to dismiss. That is because FHFA acknowledges, and Treasury appears to agree, that a court may intervene when FHFA acts "clearly outside" its statutory powers. *See* Mem. in Supp. of Mot. to Dismiss by Defs. FHFA as Conservator

[5] Defendants invoke isolated language from *Ward v. RTC*, 996 F.2d 99 (5th Cir. 1993), and a handful of similar cases suggesting that Section 1821(j) applies even when the conservator or receiver acts unlawfully. *See* FHFA Br. 20, 25 n.16; Treas. Br. 12–13. For example, in *Ward*, the court purported to distinguish "between the exercise of a function or power that is clearly outside the statutory authority of the [conservator or receiver] on the one hand, and improperly or even unlawfully exercising a function or power that is clearly authorized by statute on the other." 996 F.2d at 103. *Ward* and other, similar cases are best understood to mean only that Section 1821(j) applies even when a conservator or receiver violates some law *other* than FIRREA. Any other reading of these cases cannot be reconciled with *City of Arlington* or with FIRREA's (and HERA's) careful delimitation of the powers of conservators and receivers.

for Fannie Mae and Freddie Mac, and FHFA Director Melvin L. Watt at 24 (Mar. 18, 2016), Doc. 76-1 ("FHFA Br.") (quoting *Gross*, 974 F.2d at 407); *see also* Dep't of the Treasury's Mem. in Supp. of Its Mot. to Dismiss the Am. Compl. at 12–13 (Mar. 18, 2016), Doc. 77-1 ("Treas. Br."). The facts alleged in Plaintiffs' Amended Complaint, which must be assumed to be true, amply satisfy even that artificially high standard.

The Complaint alleges that Defendants seized control of the Companies when they were financially healthy, Compl. ¶¶ 40–41, that Defendants used a series of accounting manipulations to cause the Companies to unnecessarily write down assets, thereby forcing them to report artificial paper losses, *id.* ¶¶ 70–73, that by the time of the Net Worth Sweep Defendants knew that the Companies had returned to sustained profitability and were on the verge of reporting massive profits as a result of reversing the earlier erroneous accounting decisions, *id.* ¶¶ 76–87, that the Net Worth Sweep "effectively nationalized the Companies" and ensured that all of their anticipated profits would flow to Treasury rather than being used to rebuild capital and return the Companies to a sound financial condition, *id.* ¶ 93, and that "[t]he Companies did not receive any meaningful consideration" in return for permanently forfeiting the ability to build their capital reserves, *id.* ¶ 99.[6] The Complaint also cites specific instances in which Defendants acknowledged their intention to ensure that "every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers," *id.* ¶¶ 93, 117, while guaranteeing that the Companies would not be able to recapitalize and emerge from conservatorship, *id.* ¶ 92 (describing emails from White

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[6] Suspension of the periodic commitment fee, which under the original terms of the PSPAs was to be set by mutual agreement of the Companies and Treasury at a market rate, cannot plausibly be viewed as reasonable consideration for the Net Worth Sweep. *See supra* 15–16. At any rate, relief from the periodic commitment fee is no more adequate consideration for the Companies giving up their entire net worth than relief from property taxes is adequate consideration for the government seizing someone's home.

House official). The Complaint also alleges that on the eve of the Net Worth Sweep, Fannie's CFO told senior Treasury officials that her company anticipated that it would soon report approximately $50 billion in profits as a result of recognizing previously written down deferred tax assets. *Id.* ¶ 83. The gravamen of Plaintiffs' Complaint is thus that Defendants placed the Companies in a financial coma and prevented them from prudently rebuilding their capital reserves in order to harvest all of their capital and sizable future profits and residual capital for the Treasury to the exclusion of all other shareholders. Whatever the precise scope of FHFA's statutory powers as conservator, looting the Companies and expropriating private shareholders' investments is "clearly outside" of it.

a. FHFA Exceeded Its Statutory Authority by Agreeing to the Net Worth Sweep at Treasury's Direction.

To ensure that FHFA would exercise its best *independent* judgment in protecting the interests of *all* creditors and shareholders of the Companies, Congress mandated that FHFA as conservator "shall not be subject to the direction or supervision of any other agency of the United States." 12 U.S.C. § 4617(a)(7). FHFA violated that provision of HERA by agreeing to the Net Worth Sweep at Treasury's explicit direction. Compl. ¶¶ 11, 112–115, 133, 139, 149. Defendants respond by disputing the facts alleged in the Complaint, and FHFA urges the Court to adopt an exceedingly cramped understanding of the "zone of interests" that Section 4617(a)(7) protects. FHFA Br. 26–28; Treas. Br. 21. Neither argument is persuasive.

FHFA acknowledges that Section 4617(a) bars it "from being *involuntarily* subjected to legally binding directives of other federal agencies," but it seeks to controvert Plaintiffs' allegations, claiming that in acceding to the Net Worth Sweep it "*voluntarily*" negotiated and executed an agreement with Treasury that it determined was in the "best interests of the

[Companies] or the [a]gency." FHFA Br. 27.[7] Treasury likewise resists Plaintiffs' claim as if it rested on nothing more than the fact that FHFA and Treasury "engag[ed] in negotiations over the terms of an agreement." Treas. Br. 21.

But, contrary to Defendants' arguments, the Complaint alleges that the Net Worth Sweep was not the product of arms-length negotiations between two independent agencies. Rather, "FHFA agreed to the Net Worth Sweep only at the insistence and under the direction and supervision of Treasury" and "subject[ed] itself to Treasury's will." Compl. ¶¶ 112, 139. Specific facts support this allegation. Treasury has exerted significant influence over FHFA throughout the conservatorships, *id.* ¶ 113, and the Net Worth Sweep transfers to Treasury, in perpetuity, every penny that the Companies earn while leaving the principal of the Companies' obligation to Treasury untouched, *id.* ¶ 21. Furthermore, the Net Worth Sweep was entered into almost immediately after the Companies announced their return to substantial profitability, *id.* ¶¶ 89–90, was adopted with specific knowledge that it would result in massive profits for Treasury, *id.* ¶¶ 76–88, 103–107, and provides the Companies with no relief from their obligation to pay cash dividends that they did not already enjoy, *id.* ¶ 119. FHFA would no doubt have understood all this had it exercised its independent judgment, for it was clear that the recognition of deferred tax assets, the release of loan loss reserves, and monetary recoveries from legal settlements with big banks would all soon make enormous contributions to the Companies' net worth. *Id.* ¶¶ 79–88. And that is to say nothing of the real and very substantial profits the Companies were poised to earn from their core businesses of guaranteeing and securitizing mortgages as the housing market recovered. *Id.* ¶¶ 76–78. Only a conservator that has given up the will to exercise its independent

[7] *Gail C. Sweeney Estate Marital Trust*, which Defendants cite in support of this argument, did not involve a challenge to the Net Worth Sweep and did not consider the facts and circumstances surrounding that transaction.

judgment could agree to forfeit so much under such circumstances. Further reinforcing the conclusion that Treasury was the driving force behind the Net Worth Sweep, it was entered into against the backdrop of the Administration's previously undisclosed policy decision to exclude Fannie's and Freddie's common equity holders from having access to any of the Companies' positive earnings, and Treasury trumpeted the Net Worth Sweep as making "sure that every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers." *Id.* ¶¶ 117–118. And a White House official closely involved in the development of the Net Worth Sweep hailed it for achieving the Administration's policy objectives. *Id.* ¶ 92. These well-pleaded allegations contradict Defendants' assertion that FHFA independently agreed to the Net Worth Sweep after concluding that it was "in the best interests of the [Enterprises] or the Agency," FHFA Br. 27 (alteration in original), and the Court must accept Plaintiffs' allegations as true when ruling on Defendants' motions to dismiss.[8]

FHFA is also wrong when it suggests that Plaintiffs may not complain of FHFA's violation of Section 4617(a)(7) because Plaintiffs are not within the "zone of interests" protected by this provision. FHFA Br. 27 n.18. Section 4617(a)(7) is intended to preserve the integrity of conservatorships and receiverships by barring other agencies from interfering with FHFA's decisions. And one of the principal purposes of a conservatorship or receivership is to protect the interests of an entity's creditors and shareholders. Indeed, as conservator, FHFA owes fiduciary duties to Fannie's and Freddie's shareholders. *See, e.g.*, 12 U.S.C. § 1831f(d)(3); *id.*

[8] FHFA relies on *Perry Capital*, which rejected the argument that FHFA had acted at Treasury's direction on the ground that plaintiffs in that case relied on what the court called "subjective, conclusory allegations" rather than "objective facts." 70 F. Supp. 3d at 226. But Plaintiffs here have no obligation to prove "objective facts" to defeat Defendants' motions to dismiss. And the detailed and specific allegations in Plaintiffs' Complaint differ significantly from the allegations in the *Perry Capital* case, which was decided without the benefit of evidence produced through discovery in the Court of Federal Claims concerning the Net Worth Sweep.

§ 1823(d)(3)(A), (C); *Golden Pac. Bancorp v. FDIC*, 273 F.3d 509, 519 (2d Cir. 2001); *Suess v. FDIC*, 770 F. Supp. 2d 32, 38 (D.D.C. 2011); *Gibralter Fin. Corp. v. Federal Home Loan Bank Bd.*, 1990 WL 394298, at *3 (C.D. Cal. June 15, 1990); *In re Franklin Nat'l Bank Sec. Litig.*, 445 F. Supp. 723, 731, 733–34 (E.D.N.Y.), *supplemented by* 449 F. Supp. 574 (E.D.N.Y. 1978). In all events, it is well-settled that "[t]he zone of interests adequate to sustain judicial review is particularly broad in suits to compel federal agency compliance with law, since Congress itself has pared back traditional prudential limitations by the Administrative Procedure Act, which affords review to any person 'adversely affected or aggrieved by [federal] agency action within the meaning of a relevant statute.' " *FAIC Sec., Inc. v. United States*, 768 F.2d 352, 357 (D.C. Cir. 1985) (alteration in original) (citation omitted) (quoting 5 U.S.C. § 702).

e. The Net Worth Sweep Violated FHFA's Statutory Duties To Preserve and Conserve the Companies' Assets and To Place Them in a Sound and Solvent Condition.

i. As Conservator, FHFA Is Obligated To Preserve and Conserve Assets with the Aim of Rehabilitating the Companies.

When Congress enacts a statute using "a well-established term," courts presume that "Congress intended the term to be construed in accordance with pre-existing . . . interpretations." *Bragdon v. Abbott*, 524 U.S. 624, 631 (1998). "Conservatorship" is among those "well-established term[s]," familiar to anyone even remotely acquainted with financial regulation. As the Congressional Research Service has explained, "[a] conservator is appointed to operate the institution, conserve its resources, and restore it to viability." DAVID H. CARPENTER & M. MAUREEN MURPHY, CONG. RESEARCH SERV., RL34657, FINANCIAL INSTITUTION INSOLVENCY: FEDERAL AUTHORITY OVER FANNIE MAE, FREDDIE MAC, AND DEPOSITORY INSTITUTIONS 5 (2008), http://goo.gl/ecEI4H. This stands in contrast to a "receiver," which "is appointed to liquidate the institution, sell its assets, and pay claims against it to the extent available funds allow." *Id.*

Courts, and regulators, including FHFA itself, have emphasized that a conservator's purpose is to revive a troubled entity. The Eighth Circuit, for example, has explained that "[t]he conservator's mission is to conduct an institution as an ongoing business" while restoring it "to a solvent position." *RTC v. CedarMinn Bldg. Ltd. P'ship*, 956 F.2d 1446, 1453–54 (8th Cir. 1992), and other courts uniformly agree.[9] The FDIC also understands the defining purpose of conservatorship. *See* FDIC, MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 216 (1998), *available for download at* https://goo.gl/qjIjTh ("A conservatorship is designed to operate the institution for a period of time in order to return the institution to a sound and solvent operation."). And commentators explain that the "intent of conservatorship is to place the insured depository institution in a sound and solvent condition." Donald Resseguie, *Banks & Thrifts: Government Enforcement & Receivership* § 11.01 (2013); *see also* 3 Michael P. Malloy, *Banking Law and Regulation* § 11.3.4.2 (2011) (a conservatorship's "basic statutory assumption is that the institution may well return to the transaction of its business").

Outside the context of litigation challenging the Net Worth Sweep, FHFA has expressed the same view. When FHFA placed the Companies in conservatorship, it stated that its purpose was to stabilize the Companies with the objective of returning them to normal business operations.

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[9] *See, e.g.*, *Delaware Cty. v. FHFA*, 747 F.3d 215, 219 (3d Cir. 2014) ("[A] conservator . . . tries to return the bankrupt party to solvency, rather than liquidating it."); *DeKalb Cty. v. FHFA*, 741 F.3d 795, 798 (7th Cir. 2013) (same); *Elmco Props., Inc. v. Second Nat'l Fed. Sav. Ass'n*, 94 F.3d 914, 922 (4th Cir. 1996) ("[A] conservator's function is to restore the bank's solvency and preserve its assets."); *James Madison Ltd. by Hecht v. Ludwig*, 82 F.3d 1085, 1090 (D.C. Cir. 1996) ("The principal difference between a conservator and receiver is that a conservator may operate and dispose of a bank as a going concern, while a receiver has the power to liquidate and wind up the affairs of an institution."); *Del E. Webb McQueen Dev. Corp. v. RTC*, 69 F.3d 355, 361 (9th Cir. 1995) (A conservator "operates an institution with the hope that it might someday be rehabilitated," while a receiver "liquidates an institution and distributes its proceeds to creditors."); *1185 Ave. of the Americas Assocs. v. RTC*, 22 F.3d 494, 497 (2d Cir. 1994) ("A conservator . . . is empowered to take action to restore the thrift to a solvent position and to carry on the business of the institution.") (quotation marks omitted).

Compl. ¶ 7; *see also id.* ¶¶ 45, 47. And it has often repeated this understanding of its goal as a conservator. *E.g.*, 76 Fed. Reg. at 35,727 (The conservator "has a statutory charge to work to restore a regulated entity . . . to a sound and solvent condition."); Joint Status Report, Attachment A at .pdf 7, *McKinley v. FHFA*, No. 10-1165 (D.D.C. Sept. 16, 2011), Doc. 18-1 ("The goal of a conservator is to return the entity to a sound and solvent condition, carry on the business of the entity and preserve/conserve the entity's assets and property."); Compl. ¶ 116 ("[T]he only [post-conservatorship option] that FHFA may implement today under existing law is to reconstitute [Fannie and Freddie] under their current charters." (quoting DeMarco Letter to Chairmen and Ranking Members at 7)); FHFA, STRATEGIC PLAN 2009–2014, at 33, http://goo.gl/UjCxf6 (FHFA as conservator "preserves and conserves the assets and property of the Enterprises . . . and facilitates their financial stability and emergence from conservatorship."); Letter from Edward DeMarco, Acting Director, FHFA to Senators at 1 (Nov. 10, 2011), http://goo.gl/hbBe25 ("By law, the conservatorships are intended to rehabilitate [Fannie and Freddie] as private firms."). An internal Treasury document from 2011 likewise recognized that "the path laid out under HERA" was for Fannie and Freddie to "becom[e] adequately capitalized" and "exit conservatorship as private companies." Compl. ¶ 118.

This defining purpose—rehabilitation and a return to viability as a going concern—informs the scope of a conservator's power. For example, in *CedarMinn* the Eighth Circuit concluded that the RTC was not required to exercise its statutory authority to repudiate contracts immediately upon its appointment as conservator because this would put the conservator "in the untenable position of trying to operate the business as an ongoing concern with one hand, while at the same time calculating the . . . repudiation issue as if it were shutting the business down." *CedarMinn*, 956 F.2d at 1454; *see also MBIA Ins. Corp. v. FDIC*, 816 F. Supp. 2d 81, 97 (D.D.C. 2011) (same).

The Fifth Circuit has explained that "a conservator *only* has the power to take actions necessary to restore a financially troubled institution to solvency" and that it cannot "as a matter of law" take actions reserved to a receiver. *See McAllister v. RTC*, 201 F.3d 570, 579 (5th Cir. 2000) (emphasis added); *see also id.* ("Expenses of liquidation cannot be incurred by a conservator as a matter of law, as liquidation is not a function of the conservator."). Thus, when exercising its powers as conservator, FHFA must always act consistent with the overarching purpose of rehabilitation and the need to conserve the assets of the estate for all stakeholders.

A conservator's "mission . . . to conduct an institution as an ongoing business" contrasts with that of a receiver, "whose interest, by definition, is shutting the business down." *CedarMinn*, 956 F.2d at 1454. Unlike conservators, receivers act to "liquidat[e] [an] institution and wind[ ] up its affairs." *See* CARPENTER & MURPHY, *supra*, at 6. During this process of liquidation a receiver gathers and sells the financial institution's assets and distributes the proceeds to creditors and others with claims against the failed entity in accordance with the statutory priority scheme. *See Freeman*, 56 F.3d at 1401 (Receivership "ensure[s] that the assets of a failed institution are distributed fairly and promptly among those with valid claims against the institution."). As this distribution process leaves the receivership entity with no remaining assets, receivership requires a "determination . . . that the institution is not viable." *See* CARPENTER & MURPHY, *supra*, at 6. Indeed, "[p]lacing a bank in receivership acknowledges that restoration is impossible." John W. Head, *Lessons from the Asian Financial Crisis: The Role of the IMF and the United States*, 7 KAN. J.L. & PUB. POL'Y 70, 77 (1998).

The fundamental distinction between a conservator and a receiver was well understood by Congress in enacting HERA and by FHFA in promulgating regulations implementing its conservatorship powers. HERA requires FHFA as conservator to "put the [Companies] in a sound

and solvent condition" and "carry on the business of the [Companies] and preserve and conserve [their] assets and property." 12 U.S.C. § 4617(b)(2)(D). FHFA's regulations explain that these statutory powers "charge[ ] [FHFA] with rehabilitating the regulated entity," that "the essential function of a conservator is to preserve and conserve the institution's assets," and that "[a] conservator's goal is to continue the operations of a regulated entity, rehabilitate it and return it to a safe, sound and solvent condition." 76 Fed. Reg. at 35,727, 35,730. Indeed, FHFA's regulations generally prohibit distributions of capital such as dividends precisely because they would "deplete the entity's conservatorship assets" and therefore "would be inconsistent with the agency's statutory goals, as they would result in removing capital at a time when the Conservator is charged with rehabilitating the regulated entity." *Id.* at 35,727.

In other litigation, FHFA has argued that, contrary to the well-established concept of conservatorship and its own regulations, HERA *empowers* it to conserve and preserve the Companies' assets but does not *require* it to do so. This argument rests entirely on HERA's use of "may" in the following statutory text: "The Agency may, as conservator, take such action as may be . . . appropriate to . . . preserve and conserve the assets and property of the regulated entity." 12 U.S.C. § 4617(b)(2)(D). But while the word "may" often "implies some degree of discretion," that assumption can be "defeated by . . . obvious inferences from the structure and purpose of the statute." *United States v. Rodgers*, 461 U.S. 677, 706 (1983). Here, FHFA's reading of "may" is inconsistent with the statutory design, which constitutes a limited delegation of authority from Congress. The fact that Congress, in describing FHFA's "[p]owers as conservator," spelled out that the conservator "may" operate the Companies in a manner that preserves and conserves their assets means that it may not operate the Companies in any other manner. *See Halverson v. Slater*, 129 F.3d 180, 184–87 (D.C. Cir. 1997) (language that "Secretary may delegate" authority to

specific entity prohibits delegation to any other entity).

For decades, it has been well-established that a bank conservator's "*duties* are to conserve the assets of the bank for the purpose of rehabilitation." *Bicknell v. Central Hanover Bank & Trust Co.*, 6 N.Y.S.2d 704, 705 (N.Y. Spec. Term) (emphasis added), *aff'd*, 8 N.Y.S. 2d 668 (N.Y. App. Div. 1938). HERA accordingly must be construed as imposing on FHFA as conservator the obligation—not merely the option—of managing the Companies in a way that is plausibly in conformance with what FHFA itself describes as its statutory mission: to preserve and conserve assets to rehabilitate the Companies to a sound and solvent condition.

ii. The Net Worth Sweep Failed To Preserve and Conserve the Companies' Assets and To Put Fannie and Freddie in a Sound and Solvent Condition.

The Net Worth Sweep contravenes FHFA's obligations under HERA and its regulations to "preserve and conserve the [Companies'] assets and property," 12 U.S.C. § 4617(b)(2)(D)(ii), and to "put the [Companies] in a sound and solvent condition," *id.* § 4617(b)(2)(D)(i).

First, the Net Worth Sweep depletes the Companies' capital, a consequence that FHFA has elsewhere determined is "inconsistent with [its] statutory goals." 76 Fed. Reg. at 35,727. Indeed, former Director Lockhart emphasized that, "[a]s the conservator, FHFA's *most important goal* is to preserve the assets of Fannie Mae and Freddie Mac over the conservatorship period. That is our statutory responsibility." *The Present Condition and Future Status of Fannie Mae and Freddie Mac: Hearing Before the H. Comm. on Fin. Servs., Subcomm. of Capital Markets, Ins. & Gov't Sponsored Enters.* 111th Cong. (2009) (written statement of James B. Lockhart, III, Director, FHFA) (emphasis added), http://goo.gl/nVaYYE. Rather than allow the Companies to build up their capital, the Net Worth Sweep siphons off every dollar belonging to the Companies into Treasury's coffers, precluding them from strengthening along with the improving housing market.

Indeed, Treasury made clear in publicly announcing the Net Worth Sweep that its purpose was to prevent the Companies from "retain[ing] profits" or "rebuild[ing] capital." Compl. ¶ 117 (quoting Treasury Net Worth Sweep Press Release). This perpetual and complete giveaway to Treasury is certainly more detrimental to the Companies' chances of rehabilitation than other capital distributions that FHFA has prohibited altogether. *See* 12 C.F.R. § 1237.13 (prohibiting payment of securities litigation claims). Accordingly, the Net Worth Sweep is antithetical to FHFA's duty to "preserve and conserve the assets and property" of the Companies. 12 U.S.C. § 4617(b)(2)(D)(ii).

The Net Worth Sweep's effect on the Companies' capital retention also violates FHFA's obligation to "put the [Companies] in a sound and solvent condition." *Id.* § 4617(b)(2)(D)(i). At the core of American regulation of financial institutions are capital requirements, with capital defined as the excess of assets over liabilities. Such capital serves as a buffer against the inevitable vicissitudes of the economic cycle that affect all financial institutions. Institutions with sufficient capital are deemed safe, and those without capital are deemed unsound. The Net Worth Sweep, however, has the perverse effect of prohibiting Fannie and Freddie from "retain[ing] capital to withstand a sudden, unexpected economic shock," Press Release, Statement by Kelli Parsons, Senior Vice President and Chief Communications Officer, on Stress Test Results (Apr. 30, 2014), http://goo.gl/g4pSNB, condemning the Companies into the ranks of the undercapitalized on a permanent basis. It is difficult to imagine a regulatory action more calculated to undermine the "soundness and solvency" of a financial institution than the Net Worth Sweep.

Treasury impermissibly contradicts the factual allegations in the Complaint (and reality) when it suggests that the Net Worth Sweep actually *improved* the Companies' capital position by preserving Treasury's funding commitment. Treas. Br. 16. But for the Net Worth Sweep, the

Companies would have approximately $125 billion in capital that they have instead been forced to turn over to Treasury. *See* Compl. ¶ 21; *Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities*, FHFA (May 5, 2016), http://goo.gl/jlMw81. Without this capital, the Companies are *more*, not less, likely to need to draw on Treasury's commitment in the future.

Furthermore, the original terms of Treasury's stock posed no threat to the funding commitment because the Companies always had the ability to pay Treasury's dividends "in kind"—with additional stock at a 12% rate—rather than in cash, and doing so would not have reduced the size of Treasury's funding commitment. *See* Compl. ¶¶ 59–62. Treasury contends that this argument "misread[s] the stock certificates," Treas. Br. 17, but it does not quote the relevant language from the certificates, which says that dividends shall be paid "when, as and if declared by the Board of Directors, in its sole discretion, out of funds legally available therefor," Fannie Stock Certificate § 2(a), and defines "Dividend Rate" to mean "10.0%; provided, however, that if at any time the Company shall have for any reason failed to pay dividends in cash in a timely manner as required by this Certificate," then "the 'Dividend Rate' shall mean 12.0%," *id.* § 2(c). Although Treasury now disputes that this language gave the Companies the option not to declare cash dividends they could not afford, it has repeatedly acknowledged the availability of that option outside the context of litigation. *See, e.g.*, Compl. ¶ 60 ("The senior preferred stock shall accrue dividends at 10% per year. The rate shall increase to 12% if, in any quarter, the dividends are not paid in cash . . . ." (quoting U.S. TREASURY DEP'T OFFICE OF PUB. AFFAIRS, FACT SHEET: TREASURY SENIOR PREFERRED STOCK PURCHASE AGREEMENT (Sept. 7, 2008))); *id.* (acknowledging that dividend rate of the PSPAs would be 12% "if elected to be paid in kind" (quoting Treasury Presentation to SEC, GSE Preferred Stock Purchase Agreements (PSPA),

Overview and Key Considerations at 9 (June 13, 2012))); *id.* ¶ 119 (recounting testimony from Treasury official stating that he could not identify any "problems of the circularity [in dividend payments that] would have remained had the [payment-in-kind] option been adopted" (first alteration in original)); *id.* ¶ 61 (Treasury's consultant asked "whether we expect [the Companies] to pay the preferred stock dividends in cash or to just accrue the payments").

Second, the Net Worth Sweep guarantees that the Companies will never resume "normal business operations." "Normal" companies recovering from financial distress save their profits to withstand the next downturn. But today the Companies cannot operate as normal, private companies because the Net Worth Sweep depletes every dollar of their net worth, depriving them of the "future income flows" that represent a company's "fundamental value." *See Tennessee Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1208 n.2 (D.C. Cir. 1991). Indeed, the Companies themselves have described the Net Worth Sweep as a "risk factor" because it does not allow them to build capital reserves. *See* Fannie Mae 2012 Annual Report at 46–47 (Form 10-K) (Apr. 2, 2013), http://goo.gl/rGVpQq. FHFA has clearly and impermissibly abandoned its conservatorship duty to "rehabilitate" the Companies and has instead converted them into a permanent government revenue stream, prohibited from "retain[ing] profits" or "rebuild[ing] capital." *See* Compl. ¶ 117; 76 Fed. Reg. at 35,727, 35,730.

Third, the Net Worth Sweep has caused the Companies to incur tens of billions of dollars in additional debt to finance unlawful dividends. Because many of the Companies' assets are valued based on assumptions about future financial performance or marked to market (i.e., valued according to fluctuating market prices), increases in the Companies' net worth are not necessarily associated with corresponding increases in cash on hand. Recognition of deferred tax assets, for example, is an accounting decision that does not generate any cash. The result is that a cash

dividend linked solely to net worth may need to be financed through new borrowing. Indeed, the Companies incurred substantial additional debt in 2013 in order to pay cash dividends under the Net Worth Sweep. *See* Compl. ¶¶ 124–25. Ordering the Companies to pay debt-financed dividends when they are in conservatorship is inimical to FHFA's statutory duties to "preserve and conserve" the Companies' assets, 12 U.S.C. § 4617(b)(2)(D)(ii), and to place them in a "sound and solvent" condition, *id.* § 4617(b)(2)(D)(i). Such forced borrowing for Companies operating under federal conservatorship is financially reckless and clearly exceeds the authority granted to FHFA as conservator.

Fourth, the government has openly vowed that, far from rehabilitation, the Net Worth Sweep is aimed specifically at winding down the Companies' operations. At the time of the Net Worth Sweep, Treasury proclaimed that it would "expedite the wind down of Fannie Mae and Freddie Mac" and make "sure that every dollar of earnings that [each firm] generate[s] will be used to benefit taxpayers," such that the Companies "will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." Compl. ¶ 117 (quoting Treasury Net Worth Sweep Press Release). FHFA similarly told Congress that its goal was to "move the housing industry to a new state, one without Fannie Mae and Freddie Mac." *Id.* ¶ 120 (quoting FHFA, 2012 REP. TO CONG. at 13). FHFA's Acting Director Edward DeMarco tied the Net Worth Sweep to this goal, telling Congress that it "reinforce[d] the notion that the [Companies] will not be building capital as a potential step to regaining their former corporate status." *Id.* (second alteration in original) (quoting DeMarco Statement Before S. Comm. on Banking, Hous. & Urban Affairs). That statement is consistent with Mr. DeMarco's testimony in other litigation concerning the Net Worth Sweep, during which he stated that he had no intention of returning Fannie and Freddie to private control and that FHFA's objective "was not for Fannie

and Freddie Mac to emerge from conservatorship" because he perceived the Companies' charters to be "flawed." Compl. ¶ 95. It also is consistent with statements by a key White House official who said that the Net Wort Sweep "closed off [the] possibility that [Fannie and Freddie] ever[ ] go (pretend) private again." *Id.* ¶ 92.

These actions—agreeing to pay "every dollar of earnings" to the Treasury, depleting capital, eliminating the possibility of rehabilitation and a return to normal business operations, borrowing money to pay cash dividends on paper profits, and doing so with the intent to slowly wind down the Companies—neither "preserve and conserve" the Companies' assets, 12 U.S.C. § 4617(b)(2)(D)(ii), nor "put the [Companies] in a sound and solvent condition," *id.* § 4617(b)(2)(D)(i). And they are plainly not the actions of a conservator. *See Del E. Webb McQueen Dev. Corp.*, 69 F.3d at 361. As conservator, FHFA must "assum[e]" that the Companies "may well return to the transaction of [their] business" outside of governmental control. *See* Malloy, *supra*, § 11.3.4.2. FHFA's actions to the contrary exceeded its authority under HERA and its own regulations and, therefore, violated the APA.

* * *

As the foregoing discussion makes clear, Plaintiffs do not seek to "avoid" Section 4617(f) "by alleging that the Conservator did a bad job or took action based on an improper motive." FHFA Br. 24; *see also* Treas. Br. 12–13. Rather, Plaintiffs contend that FHFA contravened and exceeded its statutory authority as conservator under HERA. Accordingly, the various cases invoked by Defendants holding that Section 4617(f) (or its FIRREA analogue) bars equitable relief where Plaintiffs argue only that a conservator did not properly exercise otherwise-legitimate powers, violated provisions of other law, or acted with a bad motive are wholly inapposite here. *See* FHFA

Br. 19–21, 24–25; Treas. Br. 12–13, 15–17.[10]

f. Defendants' Purported Justifications for the Net Worth Sweep Lack Merit.

i. Defendants argue that even if the Net Worth Sweep was intended as a step toward "winding up" the Companies' affairs, FHFA had authority to take this step. *See* FHFA Br. 28; Treas. Br. 15–16. But the argument that a conservator can wind down an entity toward eventual liquidation—contrary to the language of HERA and FHFA's own expressed goal of using the conservatorship to return the Companies to normal business operations, Compl. ¶ 7—is simply "untenable," *CedarMinn*, 956 F.2d at 1454.

Liquidation is exclusively the province of a receiver, as both HERA's text and FHFA's regulations provide. By prohibiting FHFA from liquidating the Companies while it acts as their conservator, HERA also prohibits FHFA from "winding [them] up" in preparation for liquidation. Indeed, HERA, caselaw, commentators, and even dictionaries all use "liquidation" and "wind up" synonymously. For example, HERA imposes specific requirements on FHFA when it initiates "the *liquidation* or *winding up* of the [Companies'] affairs." *Id.* § 4617(b)(3)(B) (emphasis added). Caselaw regarding the FDIC's receivership authority underscores this point, holding that the purpose of a receivership is "to expeditiously 'wind up the affairs of failed banks.' " *Freeman*, 56 F.3d at 1401 (quoting *Local 2 v. FDIC*, 962 F.2d 63, 64 (D.C. Cir. 1992)). Treatises explain that receivers "liquidate the institution and wind up its affairs." Resseguie, *supra*, § 11.01. Dictionaries also define "liquidation" and "winding up" as virtually the same. *See* BLACK'S LAW DICTIONARY 1738 (10th ed. 2014) (winding up: "The process of settling accounts and liquidating assets in anticipation of a partnership's or a corporation's dissolution."); OXFORD ENGLISH DICTIONARY

[10] In all events, it is not the case that Section 4617(f) bars this court from inquiring into Defendants' purpose in entering into the Net Worth Sweep, as discussed more fully below. *See infra* at 20, 48–49.

ONLINE (Dec. 2013) ("liquidation, n." defined as "[t]he action or process of winding up the affairs of a company"). Because HERA prohibits FHFA as conservator from liquidating the Companies, it also prohibits FHFA as conservator from winding them up.

Defendants nevertheless argue that HERA empowers conservators to wind down regulated entities because Section 4617(a)(2) states that FHFA may "be appointed conservator *or* receiver for the purpose of *reorganizing*, *rehabilitating*, or *winding up* the affairs of a [regulated entity]." *See* Treas. Br. 15–16 (first emphasis added); FHFA Br. 28. Defendants misread the statute. It does not follow that the powers articulated in Section 4617(a)(2) belong to conservators and receivers alike. After all, "the words of a statute must be read in their context." *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000); *see also King v. Burwell*, 135 S. Ct. 2480, 2487 (2015). As explained above, HERA, caselaw, commentators, and dictionaries use "liquidation" and "winding up" as synonyms. And given that liquidating the Companies is beyond FHFA's conservatorship powers, it follows that steps to wind down the Companies are also forbidden to FHFA as conservator. Further, concluding that FHFA as conservator may wind down the Companies generates absurd results: If FHFA as conservator has all three powers listed in Section 4617(a)(2)—"reorganizing, rehabilitating, [and] winding up"—it follows that FHFA as receiver must also have these three powers, including rehabilitation. But that cannot be, as even FHFA explains that as receiver it "shall place the [Companies] in liquidation," leaving no room to rehabilitate them. 12 C.F.R. § 1237.3(b) (quoting 12 U.S.C. § 4617(b)(2)(E)).[11] Section 4617(a)(2) is thus best read as a general, introductory provision that summarizes the authorities collectively

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[11] In other litigation, FHFA has argued that HERA allows a receiver to rehabilitate the business and operations of the Companies by creating a limited-life regulated entity. This is incorrect. The section addressing limited entities nowhere mentions "rehabilitation." Instead, those entities are authorized solely as a bridge between the Companies and liquidation and must be wound down within two years. *See* 12 U.S.C. § 4617(i)(6).

granted to FHFA as conservator and receiver, while the following provisions of the statute specify which authorities FHFA may exercise in a particular capacity. The structure of HERA's various provisions provides further support for this interpretation. *See* 12 U.S.C. § 4617(a) ("Appointment of the Agency as conservator or receiver"); *id.* § 4617(b) ("Powers and duties of the Agency as conservator or receiver"); *id.* § 4617(b)(2)(D) ("Powers as conservator"); *id.* § 4617(b)(2)(E) ("Additional powers as receiver").

Further, HERA lays out a complex procedure for processing claims against the Companies during liquidation that applies only during receivership. 12 U.S.C. § 4617(b)(3) through (9). If Defendants were correct—and FHFA could wind down the Companies as conservator—it would have license to evade these procedural safeguards. HERA requires FHFA, "as receiver, [to] determine claims in accordance with the requirements of" Section 4617(b). 12 U.S.C. § 4617(b)(3)(A). These rules require FHFA as receiver, "in any case involving the liquidation *or winding up* of the affairs of a closed regulated entity," to "promptly publish a notice to the creditors of the regulated entity to present their claims, together with proof . . . not less than 90 days after the date of publication of such notice," and to provide a mailing to the same effect. *Id.* § 4617(b)(3)(B), (C) (emphasis added). After considering these claims, FHFA may allow or disallow a creditor's claim under its prescribed rules. *Id.* § 4617(b)(5)(B), (C). These rules ensure that receivers "fairly adjudicat[e] claims against failed financial institutions." *Whatley v. RTC*, 32 F.3d 905, 909–10 (5th Cir. 1994) (describing similar procedures for FDIC and RTC). Indeed, several Courts of Appeals have recognized that a receiver's failure to provide statutorily required notice raises "serious due process concerns." *Freeman*, 56 F.3d at 1403 n.2; *see also Greater Slidell Auto Auction, Inc. v. American Bank & Trust Co. of Baton Rouge*, 32 F.3d 939, 942 (5th Cir. 1994) ("Mailing of notice to claimants known to the receiver is constitutionally required.");

Elmco, 94 F.3d at 922 ("[I]t would violate the Due Process Clause of the Fifth Amendment to allow the RTC to treat Elmco's claim as untimely, hence permanently denied.").

FHFA should not be allowed to circumvent this adjudication process. The Net Worth Sweep transfers all of the Companies' existing net worth and future profits to Treasury, leaving Plaintiffs and other private shareholders with nothing, no matter how valuable or profitable the Companies' assets may become. This result is what would happen if FHFA as receiver had adjudicated, and disallowed, Plaintiffs' claims. *See MBIA Ins. Corp.*, 816 F. Supp. 2d at 87 (describing FDIC receivership notice that the entity's funds "are insufficient to pay claims below the depositor class and that all non-depositor creditor claims have no value"). Yet FHFA provided no notice to Plaintiffs, who have valid claims against the Companies' assets. FHFA's action, if permitted, would deprive Plaintiffs of due process. *See Freeman*, 56 F.3d at 1403 n.2.[12]

ii. Clearly prohibited from winding up the Companies, FHFA further argues that it may accomplish the same end by virtue of its authority under HERA to " 'transfer or sell any asset' of the [Companies] 'without any approval, assignment, or consent.' " FHFA Br. 23 (citing 12 U.S.C. § 4617(b)(2)(G)); *see also* Treas. Br. 14. This argument fails.

As an initial matter, although FHFA as conservator may engage in a wide array of conduct while it oversees the Companies, transferring the entirety of the Companies' residual economic value from private investors to another government agency in exchange for virtually nothing is not

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[12] Defendants also claim that they are not winding up Fannie and Freddie through the Net Worth Sweep. *See* FHFA Br. 28. But this argument is difficult to take seriously given that the avowed purpose and indisputable effect of the Net Worth Sweep is to "expedite the wind down of Fannie Mae and Freddie Mac" and to ensure that these two companies "will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." Compl. ¶ 117 (quoting Treasury Net Worth Sweep Press Release); *see also* Compl. ¶ 120 (quoting Remarks of Edward J. DeMarco, Getting Our House in Order at 6 (Wash., D.C., Oct. 24, 2013) (acknowledging FHFA's plan to "wind[ ] up the affairs of Fannie and Freddie")).

among the powers conferred by HERA. To the contrary, when FHFA transfers the Companies' assets, HERA specifically requires it to "maximize[ ] the net present value return" the Companies receive, 12 U.S.C. § 4617(b)(11)(E)(i), something that the Net Worth Sweep plainly did not do. HERA would raise grave constitutional concerns if it authorized giveaways to the government of the sort at issue here. *See United States v. Security Indus. Bank*, 459 U.S. 70, 78–82 (1982) (construing statute narrowly to avoid takings difficulty).

Second, Section 4617(b)(2)(G) specifies that the agency may only transfer assets "*as conservator or receiver*," 12 U.S.C. § 4617(b)(2)(G) (emphasis added). FHFA was never appointed receiver, of course, and as conservator, FHFA is charged by HERA with taking actions necessary and appropriate to "put [Fannie and Freddie] in a sound and solvent condition" and to "preserve and conserve [their] assets and property," *id.* § 4617(b)(2)(D), as discussed at length above. Again, as FHFA has explained outside the context of this litigation, these statutes require it to use its powers to "rehabilitate" the Companies for eventual return to normal business operations. 76 Fed. Reg. at 35,730. The Net Worth Sweep has the purpose and effect of preventing the Companies from ever rebuilding capital so that they could be rehabilitated, and FHFA as conservator lacks the authority to "transfer assets" to *prevent*, rather than to *promote*, rehabilitation of the Companies.

Third, FHFA's contention that the law "does not provide any limitation" on its authority to transfer the Companies' assets, FHFA Br. 23 (quotation marks omitted), would allow it to completely ignore HERA's detailed procedures and order of priorities for the distribution of assets during liquidation, *see* 12 U.S.C. § 4617(b)(3) through (9), (c). Under FHFA's reading of HERA's transfer provision, for example, during a liquidation the agency would be free to transfer the Companies' assets to subordinated debtholders before paying general creditors, in direct

contravention of 12 U.S.C. § 4617(c)(1)(B). The Supreme Court rejected a construction of language in FIRREA's predecessor that would have made nonsense out of other provisions of the same Act, and FHFA's reading of HERA's transfer provision should similarly be rejected. *See Coit Independence Joint Venture*, 489 U.S. at 573–74; *see also King v. Burwell*, 135 S. Ct. 2480, 2495 (2015) (declining to adopt interpretation of provision that "turns out to be untenable in light of the statute as a whole" (quotation marks and alterations omitted)).

FHFA attempts to prop up its reading of the transfer provision by citing a handful of cases in which courts ruled that FIRREA barred plaintiffs from suing receivers to enjoin specific transfers of assets. FHFA Br. 23 & n.15 (citing *Gosnell v. FDIC*, 1991 WL 533637, at *5–*6 (W.D.N.Y. Feb. 4, 1991); *Waterview Mgmt. Co. v. FDIC*, 105 F.3d 696, 700–02 (D.C. Cir. 1997); *Courtney v. Halleran*, 485 F.3d 942, 949 (7th Cir. 2007); *Volges v. RTC*, 32 F.3d 50, 53 (2d Cir. 1994); *United Liberty Life Ins. Co. v. Ryan*, 985 F.2d 1320, 1328–29 (6th Cir. 1993)). But all of those cases involved *receivership* and thus did not implicate the issue here: whether FHFA as conservator may effect an otherwise impermissible wind down of the Companies by transferring all of their profits in perpetuity to another federal agency. Moreover, the transfers at issue in FHFA's cases were all routine exercises of a receiver's powers; none involved self-dealing or waste on the scale alleged here, let alone suggested that a federal conservator may transfer its ward's entire net worth to another entity, effectively nullifying HERA's specific distribution requirements as well as the statutory requirements that a conservator take actions to place its ward "in a sound and solvent condition" and "preserve and conserve [its] assets and property." 12 U.S.C. § 4617(b)(2)(D). Nor do those cases suggest that conduct such as that at issue here would escape review. *See, e.g.*, *Gosnell*, 1991 WL 533637, at *6 (observing that receiver is not "wholly above

the law" and that "truly ultra vires or arbitrary and capricious acts on its part may be enjoined").[13]

iii. FHFA further claims that the Net Worth Sweep was within its statutory authority to "carry on the business" of Fannie and Freddie, to "operate the [Enterprises]," and to "conduct all business of the [Enterprises]" in the manner the Conservator "determines is in the [Enterprises' or FHFA's] best interests." FHFA Br. 21 (alterations in original) (quoting 12 U.S.C. §§ 4617(b)(2)(B)(i), 4617(b)(2)(B)(iv), 4617(b)(2)(J)(ii)); *see also* Treas. Br. 14.[14] FHFA does not muster any support for this stunning proposition that it can disregard its conservatorship obligations if it, in its sole discretion, concludes that an action may benefit the Companies, or even

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[13] These cases are inapposite for other reasons as well. In *Courtney*, for example, the FDIC as receiver entered into an agreement with a third party to pursue legal claims against another entity and divide the proceeds of any recovery. The Seventh Circuit held that the receiver's express statutory power to settle legal claims, "if it is to mean anything at all," must "operate independently" of any statutory priority distribution scheme. *Courtney*, 485 F.3d at 949. That ruling provides no support for Defendants' argument that a conservator's power to transfer assets is unrestrained by the limits of its authority as conservator. And the Sixth Circuit's decision in *Ryan* addressed a transfer of assets to a bridge depository institution, a type of transfer that FIRREA explicitly authorizes. *See* 12 U.S.C. § 1821(n). Nothing in *Ryan* suggests that courts are powerless to enjoin transfers that HERA or FIRREA prohibit.

[14] FHFA invokes in passing what it describes as its authority to "enter into contracts on behalf of the enterprises." FHFA Br. 21, 27 (citing 12 U.S.C. § 4617(b)(2)(B)(v)). But apart from the single word "contract," FHFA's discussion of this provision does not actually quote the statute, which says only that FHFA may "provide by contract for assistance *in fulfilling any function, activity, action, or duty of the Agency as conservator or receiver*." 12 U.S.C. § 4617(b)(2)(B)(v) (emphasis added). As the italicized language makes clear, this provision does not confer upon FHFA an open-ended, unqualified power to enter into whatever contracts it chooses, but only the incidental power to enter into contracts that further FHFA's other powers and duties as conservator or receiver. And as demonstrated above, the Net Worth Sweep does not further any of these powers or duties. In addition, Treasury briefly invokes FHFA's responsibilities as conservator to "put the [Companies] in a sound and solvent condition" and "to preserve and conserve the assets and property of the [Companies]." Treas. Br. 14. But as Plaintiffs have demonstrated at length, the Net Worth Sweep does the precise opposite. *See supra* 32–37. Treasury also invokes in passing FHFA's power to "take over the assets of [the Companies]." Treas. Br. 14. But this power is simply a corollary of the conservator's authority to "operate" the Companies and "conduct [their] business." *See* 12 U.S.C. § 4617(b)(2)(B) (As conservator, FHFA may "take over the assets of and operate the regulated entity . . . and conduct all business of the regulated entity."). This provision provides no warrant for giving all of the Companies' assets away.

itself. That is not the law, and "FHFA cannot evade judicial scrutiny by merely labeling its actions with a conservator stamp." *Leon Cty. v. FHFA*, 700 F.3d 1273, 1278 (11th Cir. 2012).

In all events, HERA expressly links FHFA's power as conservator to "carry on the business" of Fannie and Freddie with its duty to "preserve and conserve [their] assets and property." 12 U.S.C. § 4617(b)(2)(D) ("The Agency may, as conservator, take such action as may be . . . appropriate to carry on the business of the regulated entity and *preserve and conserve the assets and property of the regulated entity*.") (emphasis added); *see also FHFA v. City of Chicago*, 962 F. Supp. 2d 1044, 1057–58 (N.D. Ill. 2013) ("As conservator, FHFA has broad powers to operate Fannie and Freddie and do what it sees fit *to 'preserve and conserve [their] assets.'* ") (emphasis added) (quoting 12 U.S.C. § 4617(c)(2), (b)(2)(D)(ii)); *cf. Leon County*, 700 F.3d at 1278–79 ("A conservator is one who has been given the legal authority to establish control of an entity to put it in a sound and solvent condition. Essentially, the powers of the directors, officers, and shareholders of the entity in conservatorship are transferred to the conservator, and those powers include marshaling, protecting, and managing assets."); *Massachusetts v. FHFA*, 54 F. Supp. 3d at 100 (same). Far from preserving and conserving the Companies' assets, the Net Worth Sweep does the precise opposite, transferring all of these entities' net worth to the Government.

Nor can the Net Worth Sweep be sustained as an exercise of FHFA's "[i]ncidental power[ ]" to "take *any action authorized by this section*, which the Agency determines is in the best interests of the regulated entity or the Agency." 12 U.S.C. § 4617(b)(2)(J)(ii) (emphasis added). As the italicized language makes clear, the incidental power to take actions that FHFA determines are in the best interests of FHFA or the Companies is limited to actions otherwise authorized by HERA. There is no basis for reading a broad, free-floating grant of authority into a provision that provides merely for the exercise of authority incidental to that expressly granted by

HERA to FHFA. *Cf. McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 411 (1819) ("[A] great substantive and independent power . . . cannot be implied as incidental to other powers, or used as a means of executing them."); *Whitman v. American Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001) ("Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.").[15]

d. The *Perry Capital* Court Did Not Consider the Detailed Allegations in Plaintiffs' Complaint and in Any Event Erred in Holding that FHFA Acted Within Its Authorities in Executing the Net Worth Sweep.

Defendants repeatedly trumpet the district court's decision in *Perry Capital*—an appeal of which is pending in the D.C. Circuit—which rejected a challenge to the Net Worth Sweep. While the district court in that case did hold that FHFA acted within its authority in executing the Net Worth Sweep, it did not have the benefit of the detailed allegations that appear in Plaintiffs' Complaint, and in any event its reasoning was hopelessly flawed.

First, the Complaint in this case includes allegations different than those presented to the *Perry Capital* court, including allegations supported by evidence produced in discovery in the

[15] FHFA suggests that review of its execution and implementation of the Net Worth Sweep is barred by 5 U.S.C. § 701, which exempts agency actions from judicial review under the APA where (1) "statutes preclude judicial review," *id.* § 701(a)(1), or (2) "agency action is committed to agency discretion by law," *id.* § 701(a)(2). *See* FHFA Br. 29 n.19. As demonstrated above, 12 U.S.C. § 4617(f) does not bar review of FHFA's actions where, as here, those actions exceed or contravene its statutory authorities as conservator. Accordingly, Section 701(a)(1) has no application in this case. And as FHFA's own authorities acknowledge, Section 702(a)(2) "is a very narrow exception" that applies only "in those rare instances where statutes are drawn in such broad terms that in a given case there is no law to apply." *Heckler v. Chaney*, 470 U.S. 821, 830 (1985) (quotation marks omitted); *North Dakota ex rel. Bd. of Univ. and Sch. Lands v. Yeutter*, 914 F.2d 1031, 1033 (8th Cir. 1990); *see also Bowen v. Michigan Acad. of Family Physicians*, 476 U.S. 667, 670 (1986) (noting "the strong presumption that Congress intends judicial review of administrative action"); *Yeutter*, 914 F.2d at 1033 (same). This case does not present a "rare instance" where "there is no law to apply." As demonstrated above, *see supra* 27–32, HERA, regulations, precedent, and historical practice provide clear limits on a conservator's authority, and even the most seemingly broad statutory powers invoked by FHFA are tied, both expressly and implicitly, to these limits.

Court of Federal Claims that was not available to the *Perry Capital* court. For example, the Complaint in this case alleges that the Companies were not in financial distress when FHFA and Treasury took them over in 2008, Compl. ¶¶ 40–41, that their draws on Treasury's funding commitment prior to the Net Worth Sweep were the result of improper and unduly pessimistic accounting manipulations made at the behest of FHFA, *id.* ¶¶ 70–75, and that when the Net Worth Sweep was announced, key decision makers at Treasury and FHFA had specific information before them showing that the Companies would soon report tens of billions of dollars in profits, *id.* ¶¶ 78–88. Furthermore, specific facts alleged in the Complaint, which are themselves derived from deposition testimony given by the same witness in the Court of Federal Claims, directly contradict a sworn declaration FHFA submitted in defense of the Net Worth Sweep in the *Perry Capital* case. *Compare, e.g.*, *id.* ¶ 85 ("[N]either the Conservator nor Treasury envisioned at the time of the Third Amendment that Fannie Mae's valuation allowance on its deferred tax assets would be reversed in early 2013" (quoting Ugoletti declaration submitted in *Perry Capital*)), *with id.* ("I don't know who else in FHFA or what they knew about the potential for that [i.e., that the deferred tax assets might be written back up in 2013]" (quoting subsequent Ugoletti deposition testimony in Court of Federal Claims case)); *id.* (recounting that when asked during his Court of Federal Claims deposition whether he knew "what Treasury thought about" the deferred tax assets issue, Mr. Ugoletti responded "I do not."). The Court must accept the facts alleged in the Complaint as true for present purposes, and those facts paint the Net Worth Sweep in a very different light than the one described by the court in *Perry Capital*. *See, e.g.*, *Perry Capital*, 70 F. Supp. 3d at 227 (the Net Worth Sweep "was executed by two sophisticated parties, and there is nothing in the pleadings or the administrative record provided by Treasury that hints at coercion"); *id.* at 227 ("Four years ago, on the brink of collapse, the GSEs went into conservatorship under the authority

of FHFA."); *id.* at 233 (describing the supposedly "harsh economic realities facing the GSEs . . . when FHFA and Treasury executed the PSPAs in 2008").

Second, the *Perry Capital* court deliberately blinded itself to the purpose of the Net Worth Sweep, stating that "FHFA's underlying motives . . . do not matter" and that it would look only "at *what* has happened, not *why* it happened." *Perry Capital v. Lew*, 70 F. Supp. 3d 208, 226 (D.D.C. 2014). While the court cited language from the district court's decision in *Leon County v. FHFA*, 816 F. Supp. 2d 1205, 1208 (N.D. Fla. 2011), in support of its approach, it disregarded the Eleventh Circuit's later statement in the same case that in deciding whether FHFA acted within its statutory powers, a court "must consider *all* relevant factors," including the action's "subject matter, *its purpose*, [and] its outcome," *Leon County*, 700 F.3d at 1278 (emphasis added); *see also Massachusetts v. FHFA*, 54 F. Supp. 3d at 100 ("[P]urpose, rather than labels, determines whether the FHFA in any given instance is acting . . . as a conservator.").

In blinding itself to the purpose of the Net Worth Sweep, the *Perry Capital* court went astray. HERA defines FHFA's "powers as conservator" by reference to what is "*necessary* to put the [Companies] in a sound and solvent condition" and "*appropriate* to . . . preserve and conserve the [Companies'] assets." 12 U.S.C. § 4617(b)(2)(D) (emphases added). To determine whether FHFA's actions are "necessary" or "appropriate" to achieve its statutory goals generally requires analysis of what the agency was trying to accomplish. Indeed, by refusing to consider even FHFA's self-proclaimed purpose, the *Perry Capital* court erased a principal distinction between conservators and receivers: While a few statutory powers are reserved to conservators alone or receivers alone, many powers (like transferring assets) are granted to both. *See* 12 U.S.C. § 4617(b)(2)(A) through (C), (G) through (J). When exercising these common powers, conservators distinguish themselves from receivers by their "distinct missions": The conservator

must aim to rehabilitate, while the receiver must "shut a business down and sell off its assets." *RTC v. United Trust Fund, Inc.*, 57 F.3d 1025, 1033 (11th Cir. 1995). Had it considered FHFA's purpose, the *Perry Capital* court would have found that FHFA adopted the Net Worth Sweep to implement Treasury's goal to "wind down" Fannie and Freddie by ensuring that they would not "retain profits, rebuild capital, and return to market in their prior form." Compl. ¶ 117 (quoting Treasury Net Worth Sweep Press Release). That is clearly inconsistent with FHFA's mission and authorities as a conservator.

Third, even focusing narrowly, as *Perry Capital* did, on "*what* has happened, not *why* it happened," 70 F. Supp. 3d at 226, the Net Worth Sweep cannot be reconciled with FHFA's duties as a conservator under HERA. The Net Worth Sweep gave away the assets that FHFA was supposed to "preserve and conserve," 12 U.S.C. § 4617(b)(2)(D)(ii), foreclosed the possibility that the Companies would ever return to "a sound and solvent condition," *id.* § 4617(b)(2)(D)(i), and guaranteed that FHFA will never achieve the fundamental goal of conservatorship, which is to see the Companies rebuild capital and resume normal business operations. Actions with those inevitable consequences, whatever their motive, are not those of a conservator.

Fourth, the *Perry Capital* court held that FHFA had acted within its statutory authority simply because "both GSEs continue to operate, and have now regained profitability." 70 F. Supp. 3d at 227. Accordingly, the court reasoned, Fannie and Freddie were not in "*de facto* liquidation" and "FHFA ha[d] acted within its broad statutory authority as a conservator." *Id*. These facts, however, are not dispositive of whether FHFA acted within its authority as conservator. As discussed above, *see supra* 27–32, HERA, regulations, precedent, and historical practice provide clear limits on a conservator's authority that have nothing to do with *de facto* liquidation or profitability. As conservator, FHFA's duty is not merely to operate the Companies and see that

they generate profits. Rather, as FHFA's own regulations interpreting HERA make clear: "the Conservator is charged with *rehabilitating* the regulated entity," "the essential function of a conservator is to *preserve and conserve the institution's assets*," and "one of the primary objectives of conservatorship of a regulated entity would be *restoring that regulated entity to a sound and solvent condition*." 76 Fed. Reg. at 35,727 (emphases added). Transferring all of Fannie's and Freddie's net worth, in perpetuity, to Treasury—transfers that have already exceeded by tens of billions of dollars the amount borrowed from Treasury in the first place but that have not reduced the Companies' debt by even one dollar—and leaving those Companies just one bad quarter away from insolvency cannot be reconciled with FHFA's conservatorship duties.[16]

B. Section 4617(f) Does Not Bar Plaintiffs' Claims Against Treasury.

1. Section 4617(f) Does Not Preclude Judicial Review of Treasury's Violation of HERA.

Though HERA includes no provision limiting judicial review of claims against it, Treasury nevertheless seeks to immunize its own actions from judicial review by arguing that Section 4617(f) bars any challenge to any action Treasury might take with the agreement of FHFA as conservator. Treas. Br. 17–18. This is an audacious argument; if it were adopted, it would empower FHFA to use contracts to immunize third parties—including other federal agencies—from their own, independent legal obligations. To take just one example, Treasury could openly resume new purchases of the Companies' securities notwithstanding the expiration of its purchasing authority and, simply because such purchases were agreed to by FHFA as conservator, there could be no judicial review of Treasury's concededly unlawful actions. Indeed, on Treasury's view, FHFA

[16] Defendants also repeatedly invoke the district court's decision in *Continental Western Insurance Company v. FHFA*, 83 F. Supp. 3d 828 (S.D. Iowa 2015). That decision rested on preclusion grounds and stated in dicta that it agreed with the *Perry Capital* court's conclusion that FHFA acted within its statutory authority in implementing the Net Worth Sweep. *See* 83 F. Supp. 3d at 840 n.6. The court's dicta add nothing to the flawed analysis of *Perry Capital*.

could effectively suspend any law simply by entering into a contract obliging a third party to violate it. Treasury's argument lacks merit.

As an initial matter, Section 4617(f) does not bar suits against FHFA for violating HERA, and by extension Plaintiffs' claims against Treasury for violating HERA may also proceed. As even the *Perry Capital* court recognized, "if FHFA, as a conservator or receiver, signs a contract with another government entity that is acting beyond the scope of its HERA powers, then FHFA is functionally complicit in its counterparty's misconduct, and such unlawful actions may be imputed to FHFA." 70 F. Supp. 3d at 222. Treasury violated HERA when it agreed to the Net Worth Sweep, FHFA's complicity in Treasury's actions does not preclude judicial review.

Furthermore, to conclude that Section 4617(f) prohibits Plaintiffs' claims that Treasury violated HERA, this Court must find "clear and convincing evidence to dislodge the presumption" "favoring judicial review of administrative action." *Kucana v. Holder*, 558 U.S. 233, 251–52 (2010) (quotation marks omitted). But the text of Section 4617(f) suggests nothing of the sort. Rather, Congress circumscribed review of certain actions *only as to FHFA*—it did not address, much less prohibit, claims against Treasury. Congress's "silence" cannot be construed "as a denial of authority . . . to seek appropriate relief in the federal courts." *See Reno v. Catholic Soc. Servs., Inc.*, 509 U.S. 43, 56 (1993). And there is nothing in the structure or history of the statute that even remotely suggests that Congress intended to allow Treasury to violate HERA simply by reaching an agreement with FHFA to do so.

The cases invoked by Treasury cannot fill the gap. Treas. Br. 17–18. In each of these cases, the plaintiffs were at bottom challenging the conduct or attempting to enforce the legal obligations of the federal conservator or receiver or its ward. *Hindes v. FDIC*, 137 F.3d 148, 160–61 (3d Cir. 1998), is illustrative. In that case, the plaintiffs sought to belatedly challenge the appointment of

the FDIC as receiver for Meritor Savings Bank by suing both the FDIC in its corporate capacity and Pennsylvania's Secretary of Banking, who had appointed FDIC receiver. In an alternative holding that it cautioned "should not be overread," the Third Circuit said that the plaintiffs could not obtain a declaration of invalidity and rescission of a finding, made by FDIC in its corporate capacity, that "Meritor was operating in an unsafe and unsound condition," thus triggering the receivership, since such relief would "throw into question every act of FDIC-Receiver." *Id.* at 159, 161. Nor could plaintiffs obtain "rescission of the Secretary's appointment of a receiver, because it would wholly prevent the FDIC from continuing as receiver." *Id*. at 168; *see also id*. ("Once again, we emphasize the limits of our holding."). In other words, the *Hindes* plaintiffs effectively were challenging the very appointment of the receiver and the continuing validity of the receivership. Accordingly, the court did not have occasion to decide the question presented here—whether a federal conservator's contract with an independent third party can relieve the third party of its own distinct legal obligations that it did not inherit from the conservator or its ward. Treasury's other cases similarly fail to address this question. *See Dittmer Props., LP v. FDIC*, 708 F.3d 1011, 1019 (8th Cir. 2013) (plaintiff's claim turned on validity of debt held by bank subsequently placed in receivership, not the independent legal obligations of third party that contracted with receiver); *Telematics Int'l, Inc. v. NEMLC Leasing Corp.*, 967 F.2d 703, 707 (1st Cir. 1992) (same). Furthermore, in none of those cases was the claim against the "third party" a claim that a federal agency violated a separate provision of federal law, unrelated to the conduct of receivership. And none of these cases suggests that Section 4617(f) prohibits suit against any agency other than FHFA for a violation of federal law unrelated to FHFA's conduct of the conservatorship, such as the claim Plaintiffs bring against Treasury here.

In contrast to the claims at issue in *Hindes* and Treasury's other cases, Plaintiffs' claims

against Treasury allege that Treasury's *own* conduct was unlawful. Other courts have concluded that FIRREA's analogous provision did not apply in similar circumstances, and this Court should likewise hold that Section 4617(f) is inapplicable. *See Stommel v. LNV Corp.*, 2014 WL 1340676, at *5 (D. Utah Apr. 4, 2014) (Section 1821(j) did not preclude claims against third party that "focus[ed] on [the third party's] actions not the actions of the FDIC."); *LNV Corp. v. Outsource Serv. Mgmt., LLC*, 2014 WL 834977, at *4 (D. Minn. Mar. 4, 2014) (similar).

More fundamentally, Treasury errs when it argues that judicial relief that would compel Treasury to abide by its own, independent legal obligations when it contracts with the Companies would "affect" FHFA's exercise of its conservatorship powers within the meaning of Section 4617(f). As the Supreme Court has explained in an analogous context, the word "affect" reaches only "collateral attacks attempting to restrain the receiver from carrying out its basic functions." *Coit*, 489 U.S. at 575. Immunizing Treasury from liability for violations of its independent obligations under HERA and the APA is not among those basic functions, and the word "affect" in Section 4617(f) cannot be used to bootstrap that or any other power onto the carefully circumscribed list of conservatorship powers found elsewhere in HERA. *See id.* at 574.

2. Treasury Exceeded Its Authority Under HERA When It Agreed to the Net Worth Sweep.

a. As Treasury admits, its "authority to purchase new securities from [Fannie and Freddie] expired on December 31, 2009." Treas. Br. 19; *see* 12 U.S.C. § 1719(g)(4).[17] After that date, HERA limited Treasury's authority to "hold[ing], exercis[ing] any rights received in connection with, or sell[ing]" the Companies' securities, 12 U.S.C. § 1719(g)(2)(D), and, as Treasury

[17] For the sake of convenience, we generally refer to the statutory provisions governing Treasury's authority to purchase Fannie's stock. The same analysis applies to the parallel provisions governing Treasury's authority to purchase Freddie's stock. *See* 12 U.S.C. § 1455(*l*).

acknowledged, its "ability to make further changes to the PSPAs . . . [was] constrained," Compl. ¶ 69. Treasury violated HERA by entering into the Net Worth Sweep in 2012, long after its authority to take such an action had expired.

Treasury responds by arguing that the Net Worth Sweep was authorized as a mere "amendment" to securities Treasury already owned rather than a purchase of new securities. Treas. Br. 19. But the power to amend the terms of Treasury's investment in the Companies is not a "right" that Treasury can "exercise" within the meaning of Section 1719(g)(2)(D). A "right" to act means "[a] legal, equitable, or moral entitlement to do something." OED Online (right, n.). Similarly, "exercise"—in the context of contracts—means "[t]o implement the terms of; to execute," as in to "exercise the option to buy the commodities." BLACK'S LAW DICTIONARY 693 (10th ed. 2014). A party has a contractual "right" when it "can initiate legal proceedings that will result in coercing" the other party to act. 1 E. Allen Farnsworth, *Farnsworth on Contracts* § 3.4, at 205 n.3 (3d ed. 2004). Definitionally, a contractual "right" is an entitlement to certain performance from the counter-party, and it is "exercised" through unilateral action that does not require negotiation or mutual assent. By contrast, an arrangement that depends on "mutual consent" is not a right at all. *See United States v. Petty Motor Co.*, 327 U.S. 372, 380 n.9 (1946) (an agreement that depends on the parties' subsequent "mutual consent" "does not add to their rights"). Because Treasury could not lawfully require FHFA to agree to the Net Worth Sweep, Treasury's decision to adopt the Net Worth Sweep was not an "exercise" of a "right."

Rather than an amendment to existing securities, the Net Worth Sweep constituted the "purchase" of new securities after Treasury's purchasing authority had expired on December 31, 2009. 12 U.S.C. § 1719(g)(1)(A), (g)(4). The Oxford English Dictionary defines "purchase" as "[t]o acquire in exchange for payment in money or an equivalent; to buy," OED Online (purchase,

v.), the Uniform Commercial Code defines that term as "any other voluntary transaction creating an interest in property," U.C.C. § 1-201(b)(29), and Black's Law Dictionary defines "purchaser" to mean "one who obtains property for money or *other valuable consideration*," BLACK'S LAW DICTIONARY, *supra*, 1430 (emphasis added). The Net Worth Sweep clearly meets these definitions of "purchase." Purchases are not confined to cash. *See SEC v. National Sec., Inc.*, 393 U.S. 453, 467 (1969). The Companies sold Treasury a new security—one that hands over their net worth each quarter—in exchange for canceling the securities issued to Treasury in 2008. Indeed, this is precisely how FHFA describes the transaction: "By executing the Third Amendment, the Conservator . . . trad[ed] the Enterprises' annual fixed dividend and periodic commitment fee obligations *for* the payment of a variable dividend based on net worth." FHFA Br. 22 (emphasis added). This 2012 transfer of obligations was clearly a "purchase"—albeit an exceedingly one-sided one—that Treasury was unauthorized to make.

Treasury nevertheless argues that the Net Worth Sweep transaction was not a purchase because Treasury did not increase its funding commitment. Treas. Br. 19. But the existence of a funding commitment does not determine whether there is a purchase under Section 1719(g). Treasury could have purchased securities with no funding commitment at all. The touchstone of a purchase is an *exchange of value*. Here, Treasury acquired the Companies' existing net worth and future profits in exchange for cancellation of its right to a stated dividend and commitment fee. The transfer of a fixed dividend obligation worth $18.9 billion per year in exchange for the Companies' net worth and future earnings (a transaction that has netted Treasury $125 billion to date) most certainly constitutes a new investment in the Companies—Treasury now essentially owns 100% of the Companies' equity value. Indeed, the Government itself has argued in other litigation 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), ECF No. 100. After the Net Worth Sweep, only Treasury has any interest in Fannie's and Freddie's residual profits. Treasury's decision to exchange its fixed dividend for the Companies' equity value was a "purchase" prohibited by HERA.[18]

An array of securities laws and Treasury's own IRS regulations recognize that "amendments" such as the Net Worth Sweep that fundamentally change a security's nature create an entirely new security and that this transformation constitutes a purchase. Section 10(b) of the Securities Exchange Act of 1934 prohibits fraud "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b). When deciding whether plaintiffs have purchased or sold securities under this provision and Rule 10b-5, courts ask whether there is "such significant change in the nature of the investment or in the investment risks as to amount to a new investment." *Gelles v. TDA Indus., Inc*., 44 F.3d 102, 104 (2d Cir. 1994). This analysis requires assessing the "economic reality of [a] transaction," *Keys v. Wolfe*, 709 F.2d 413, 417 (5th Cir. 1983), including the investment's altered risk profile, *see 7547 Corp. v. Parker & Parsley Dev. Partners, LP*, 38 F.3d 211, 229 (5th Cir. 1994) (plaintiff exchanged "units in a financially solvent limited partnership" for stock in a financially unstable corporation). Holders of a fundamentally changed security are considered purchasers of new securities. *National Sec., Inc.*, 393 U.S. at 467.[19] The SEC has taken

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[18] In addition, if Treasury were deemed to have a right to amend its securities, there would be no basis for distinguishing amendments that increase Treasury's funding commitment versus those that do not, because HERA grants Treasury the authority to "exercise any rights received in connection with" purchases of Fannie's and Freddie's stock "at any time." 12 U.S.C. § 1719(g)(2)(A). This underscores why HERA must not be interpreted to grant Treasury a right to amend its securities, because any such right would make the expiration of Treasury's purchase authority wholly illusory.

[19] Treasury contends that the fundamental change doctrine is "dubious," Treas. Br. 20, but the cases Treasury cites do not call into question the principle—recognized across a variety of securities law doctrines and by Treasury's own IRS regulations—that an agreed-upon amendment

the same basic approach when interpreting Section 303 of the Trust Indenture Act, advising that an amendment that extends a bond's maturity and increases its interest rate qualifies as a "sale" of a new security under that statute. *Allied-Carson Corp.*, SEC No-Action Letter, Fed. Sec. L. Rep. ¶ 80,434 (Mar. 12, 1976). Courts interpreted the Public Utility Holding Company Act of 1935 in a similar manner. *SEC v. Associated Gas & Elec. Co.*, 24 F. Supp. 899, 903 (S.D.N.Y. 1938).

Treasury's taxation regulations similarly recognize that a major change to a security is a purchase. Normally, the IRS taxes assets when sold. To prevent tax evasion, IRS regulations provide that "a significant modification of a debt instrument . . . results in an exchange of the original debt instrument for a modified instrument." 26 C.F.R. § 1.1001-3(b). A modification is "significant" if it alters the security's annual yield by "¼ of one percent" or "5 percent of the annual yield of the unmodified instrument," or if it converts debt into equity. *Id.* § 1.1001-3(e)(1), (2)(ii), (5)(i). In addition, and most notably, the IRS has ruled that an amendment changing the value of preferred stock to "equal the net worth of [a] corporation" "constitutes, in substance, . . . new preferred stock." Rev. Rul. 56-564, 1956-2 C.B. 216, 1956 WL 10781. Treasury suggests no reason why Congress would have excluded from its definition of "purchase" a transaction the IRS itself would regard as an exchange of value for a new security.

The Net Worth Sweep's change to the Government Stock's fixed dividend gave Treasury

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to the most basic terms of an investment should be treated as the sale of a new security. Dicta in *Isquith ex rel. Isquith v. Caremark International, Inc.*, 136 F.3d 531 (7th Cir. 1998), and *Katz v. Gerardi*, 655 F.3d 1212 (10th Cir. 2011), merely criticize the rule that a non-controlling shareholder may sue for securities fraud under Rule 10b-5 for having his investments fraudulently altered without his consent. *See Isquith*, 136 F.3d at 534 (arguing that securities fraud laws presuppose that the investor "had a choice, a choice distorted by the fraud"); *Katz*, 655 F.3d at 1221 (questioning application of doctrine to situation in which shareholder is forced to "exchang[e] his shares for value as is the case in liquidations and certain types of mergers" (quotation marks omitted)). Unlike the plaintiffs in those cases, Treasury *agreed* to the Net Worth Sweep "amendment." And regardless of dicta from other Circuits, Eighth Circuit precedent continues to recognize the fundamental change doctrine. *Bold v. Simpson*, 802 F.2d 314, 320 (8th Cir. 1986).

a new and very different security. Under the "economic reality of the transaction," *Keys*, 709 F.2d at 417, the Net Worth Sweep generated more than $110 billion in additional dividends during 2013 alone. And Treasury's annual yield soared from 10% of the liquidation preference to almost 70% of the preference—many multiples of the IRS's threshold (i.e., $130 billion in 2013 dividends vs. $189 billion in outstanding liquidation preference).

The Net Worth Sweep also fundamentally transformed Treasury's fixed-dividend preferred stock into what is effectively unlimited-upside common stock. *Cf.* 26 C.F.R. § 1.1001-3(e)(5)(i) (exchange where "modification . . . results in an instrument or property right that is not debt"). Preferred shares "generally give the holder a claim to a fixed dividend that must be satisfied before any dividend is paid on common shares. . . . In contrast to common shares, preferred shares do not provide an unlimited claim on the corporation's residual earnings." 11 *Fletcher Cyclopedia of the Law of Corporations* § 5283, at 464 (2011 rev. vol.). Under the Net Worth Sweep, Treasury takes all of the Companies' net worth—their "residual earnings." Indeed, having wiped out the Companies' remaining equity pursuant to a secret Administration policy, *see* Compl. ¶ 118, there is effectively no longer any lower-ranked equity over which Treasury's stock could take "priority." *See Folk on the Delaware General Corporation Law* § 151.04 (2015). Because the Net Worth Sweep in substance changed debt-like preferred stock into common stock, it constituted a purchase of new securities.

b. Treasury also violated HERA and the APA by entering into the Net Worth Sweep because its discretion to choose among policy options under those statutes is constrained by its fiduciary duty to Plaintiffs and the Companies' other shareholders. *See Cobell v. Norton*, 240 F.3d 1081, 1099 (D.C. Cir. 2001) (fiduciary duty "necessarily constrains" agency's discretion to act under the APA). Like other "important aspect[s] of [any] problem," an agency bearing fiduciary

responsibilities acts arbitrarily and capriciously—and violates the APA—when it "fail[s] to . . . offer[ ] an explanation for its decision" that harms its fiduciary charge. *See Motor Vehicles Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

As the Companies' dominant shareholder, Treasury had a fiduciary duty to take minority shareholders' interests into account before entering into the Net Worth Sweep. *See Kahn v. Lynch Commc'n Sys. Inc.*, 638 A.2d 1110, 1115 (Del. 1994); *Parsch v. Massey*, 79 Va. Cir. 446, 2009 WL 7416040, at *11 (Va. Cir. Ct. Nov. 5, 2009). "Dominant shareholders" are those that "exercise[ ] control over the business affairs of the corporation," as demonstrated by "actual control of corporation conduct." *See Kahn*, 638 A.2d at 1113–14. Any dealings between such control persons and the corporation must meet a rigorous test to ensure fairness to the minority shareholders. *See Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983); *see also Kahn*, 638 A.2d at 1115; *Upton v. Southern Produce Co.*, 133 S.E. 576, 580 (Va. Special Ct. App. 1926).

Treasury contends that it is not the Companies' dominant shareholder because it has not yet exercised its warrants to acquire a majority of the Companies' common stock and the mere "potential ability to exercise control" does not give rise to a fiduciary duty. Treas. Br. 30 (quoting *In re Sea-Land Corp. S'holders Litig.*, 1987 WL11283, at *5 (Del. Ch. May 22, 1987)). But the Congressional Budget Office treats Fannie and Freddie as part of the federal government for budgetary purposes in light of the nature of Treasury's investment. *See generally* CONGRESSIONAL BUDGET OFFICE, CBO'S BUDGETARY TREATMENT OF FANNIE MAE AND FREDDIE MAC (Jan. 2010), https://goo.gl/81CH2S. In any event, even Treasury acknowledges that "the actual exercise" of control by a shareholder normally brings with it a corresponding fiduciary duty to minority shareholders, Treas. Br. 30 (emphasis omitted), and the Complaint alleges that Treasury exercised actual control over FHFA (and thus the Companies) when the Net Worth Sweep was imposed. *See*

Compl. ¶ 139 ("FHFA agreed to the Net Worth Sweep only at the insistence and under the direction and supervision of Treasury."). The Court must accept that well-pleaded allegation as true for purposes of Treasury's motion to dismiss, and it is more than enough to establish for present purposes that Treasury acted as a dominant shareholder when it imposed the Net Worth Sweep.

Treasury asserts that under the doctrine of intergovernmental immunity, "state corporate law does not apply *of its own force* to the federal government." Treas. Br. 28–29 (emphasis added). But it is well settled that where, as here, the federal government acquires property that is subject to state law—in this case, stock in the Companies—that law remains in effect unless displaced by federal legislation. *See, e.g.*, *Pacific Coast Dairy v. Department of Agric. of Cal.*, 318 U.S. 285, 294 (1943); *James Steward & Co. v. Sadrakula*, 309 U.S. 94, 99–100 (1940). In this case, moreover, federal law *itself* directs that the Companies are subject to state corporate law. Specifically, a duly promulgated federal regulation instructs Fannie and Freddie to "elect to follow the corporate governance . . . practices and procedures set forth in . . . (i) [t]he law of the jurisdiction in which the principal office of the regulated entity is located", (ii) "[t]he Delaware General Corporation law . . . , or (iii) [t]he Revised Model Business Corporation Act" unless "inconsistent" with Fannie's and Freddie's "authorizing statutes," "other Federal law, rules, and regulations," or "the safe and sound operations of the regulated entities." 12 C.F.R. § 1239.3(a), (b) (recently relocated from 12 C.F.R. § 1710(b)). Pursuant to this regulation, Fannie and Freddie have elected to be subject to Delaware and Virginia corporate law, respectively. *See* Fannie Mae Bylaws, Corporate Governance Practices & Procedures, Art. 1, § 1.05, http://goo.gl/973DZI; Bylaws of the Federal Home Loan Mortgage Corporation, Corporate Governance Practices & Procedures & Governing Law, Art. 11, § 11.3, http://goo.gl/3XIGw9; *see also Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Raines*, 534 F.3d 779, 783 n.1 (D.C. Cir. 2008) ("[T]he relevant

Fannie statute and regulation have been applied so as to incorporate Delaware General Corporation Law."). Accordingly, Treasury's argument fails even on its own terms.

Treasury also asserts that requiring it to comply with the fiduciary obligations that normally apply to dominant shareholders would be inconsistent with its powers and obligations under HERA. Treas. Br. 29. But nothing in HERA suggests that Treasury's purported public mandate is at all inconsistent with fiduciary duties to shareholders. HERA nowhere authorizes or requires Treasury to take action that would violate its fiduciary duties to minority shareholders. To the contrary, HERA's grant of temporary authority to Treasury to invest in the Companies' stock expressly requires Treasury to take into consideration the economic rights of the Companies' shareholders, including the Companies' plans "for the orderly resumption of private market funding or capital market access" and the "need to maintain the [Companies'] status as . . . private shareholder-owned compan[ies]." 12 U.S.C. § 1719(g)(1)(C). Thus, requiring Treasury to comply with the same fiduciary duties that apply to any other dominant shareholder is fully consistent with Treasury's obligations under HERA.

C. Omnibus Appropriations Legislation Did Not Ratify the Net Worth Sweep.

FHFA and Treasury also argue that the Consolidated Appropriations Act of 2016, H.R. 2029, 114th Cong. § 702, Tit. VII, Div. O, 129 Stat. 2242 (2015) (the "Appropriations Act"), approves the Net Worth Sweep because that statute "circumscribed Treasury's authority in one area—the right to sell the [Treasury Stock]—but left [the Net Worth Sweep] intact." FHFA Br. 29–31; *see also* Treasury Br. 22–25. The Agencies err.

The Supreme Court has repeatedly emphasized the need to use "extreme care" before crediting arguments that Congress acquiesced to an agency's decision by failing to overturn it. *Solid Waste Agency of N. Cook Cty. v. United States Army Corps of Eng'rs*, 531 U.S. 159, 169

(2001); *see also, e.g.*, *Bruesewitz v. Wyeth LLC*, 562 U.S. 223, 242 (2011); *Patterson v. McLean Credit Union*, 491 U.S. 164, 175 n.1 (1989). Indeed, when interpreting a federal statute, the actions of subsequent Congresses have "little probative value because a post-enactment legislative body has no special insight regarding the intent of a past legislative body." *Laborers' Local 265 Pension Fund v. iShares Trust*, 769 F.3d 399, 409 (6th Cir. 2014). Moreover, arguments that an amendment to a federal statute implicitly ratified earlier agency action are especially weak where, as here, the amendment is both an appropriations act presumed not to alter substantive law, *see Tennessee Valley Authority v. Hill*, 437 U.S. 153, 190-91 (1978), and an isolated rather than comprehensive amendment that cannot be understood to ratify all preceding agency interpretations, *see Alexander v. Sandoval*, 532 U.S. 275, 292 (2001).

Moreover, the Appropriations Act does not address the *propriety* of the Net Worth Sweep or Treasury's purported authority to amend its securities; rather, it simply prohibits Treasury from selling its preferred stock in the Companies until 2018. The only reason it even mentions the August 17, 2012 "amendment" or potential future amendments is to *define* the stock it is addressing. *See* Consolidated Appropriations Act of 2016, Pub. L. No. 114-113 § 702(a)(2), 129 Stat. 2242, 3024 (2015). Several Senators—including Senator Corker, the driving force behind this provision—expressly stated that the Appropriations Act "does not prejudice" Plaintiffs' claims in this litigation, and that the provision does not "have any effect on the court cases . . . challenging the validity of the [Net Worth Sweep]." 161 CONG. REC. S8857 (daily ed. Dec. 18, 2015) (statement of Sen. Brown); *see also* 161 CONG. REC. S8760 (daily ed. Dec. 17, 2015) (statement of Sen. Corker). Instead, the law includes a "[s]ense of Congress" that Congress and the President, not Treasury or FHFA, "should . . . determin[e] the future of Fannie Mae and Freddie Mac." Consolidated Appropriations Act § 702(c). Vacating the Net Worth Sweep would further that

sense of Congress, allowing Congress and the President a full slate of options to determine the future of the Companies, rather than the *fait accompli* engineered by the Net Worth Sweep.

II. Section 4617(b)(2)(A) Does Not Strip Plaintiffs of Their Rights in Their Stock.

By imposing the Net Worth Sweep, FHFA and Treasury expropriated the economic rights of Fannie's and Freddie's private shareholders and transferred them to Treasury, Fannie's and Freddie's dominant shareholder. Defendants, incredibly, argue that under HERA *only FHFA* has the authority to challenge the government's own destruction of shareholder rights. *See* FHFA Br. 32–36; Treas. Br. 24–28. This argument is meritless for two independent reasons. First, HERA does not bar Plaintiffs from asserting direct claims that relate to their ownership of stock, and all of the claims at issue here are direct. Second, even if Plaintiffs' claims were derivative, the courts repeatedly have recognized that shareholders may bring derivative claims during conservatorship where, as here, the conservator has a manifest conflict of interest.

B. Plaintiffs May Bring Direct Claims Arising from Their Ownership of Stock.

1. Section 4617(b)(2) Does Not Apply to Direct Claims.

HERA provides that FHFA as conservator succeeds to "all rights, titles, powers, and privileges of . . . any stockholder . . . of the regulated entity [i.e., Fannie and Freddie] *with respect to the regulated entity and the assets of the regulated entity*." 12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added). Whatever implications this language may have for shareholders seeking to bring derivative claims *on behalf of Fannie and Freddie*, it does nothing to divest shareholders of their own, personal economic rights in Fannie and Freddie and, therefore, does nothing to prevent shareholders from bringing direct claims *on behalf of themselves* to protect *their own rights*. This is why, upon imposition of the conservatorship, FHFA correctly insisted that Fannie's and Freddie's shareholders would continue to "have an economic interest in the companies" and would "retain all rights in the stock's financial worth." Compl. ¶ 49. If Defendants' current litigating

position were correct, these repeated public assurances would have been blatantly false.[20]

To be sure, the courts have held that "absent a manifest conflict of interest . . . the statutory language bars shareholder derivative actions." *E.g.*, *Kellmer v. Raines*, 674 F.3d 848, 850 (D.C. Cir. 2012). But "[n]o federal court has read" Section 4617(b)(2) or the analogous provision of FIRREA to transfer direct shareholder claims to the conservator or receiver. *Levin v. Miller*, 763 F.3d 667, 672 (7th Cir. 2014); *see also Barnes v. Harris*, 783 F.3d 1185, 1193, 1195 (10th Cir. 2015); *In re Beach First Nat'l Bancshares, Inc.*, 702 F.3d 772, 778, 780 (4th Cir. 2012); *Lubin v. Skow*, 382 F. App'x 866, 870–71 (11th Cir. 2010); *Plaintiffs in All Winstar-Related Cases v. United States*, 44 Fed. Cl. 3, 9–10 (1999).[21] Even the district court's decision in *Perry Capital*, which Defendants repeatedly invoke, did not hold that Section 4617(b)(2) bars direct, as opposed to derivative claims, by shareholders—to the contrary, it implicitly recognized that this statute *does not* bar direct claims. *See, e.g.*, 70 F. Supp. 3d at 229 n.24 ("[I]f such a determination were

[20] Adopting Defendants' position would make numerous additional conservatorship decisions nonsensical. For example, FHFA expressly suspended payment of dividends to private shareholders during conservatorship. But if FHFA had in fact succeeded to the shareholders' contractual dividend rights, any payment of dividends would have been to FHFA itself, not to shareholders. FHFA then would have had no need to announce *to itself* that it was halting the payment of dividends. Moreover, FHFA entered into contractual agreements with Treasury—a *shareholder* in the Companies—that provided Treasury with dividend and liquidation rights, and FHFA has paid tens of billions of dollars in dividends under those agreements. If the government's assertion were correct, Treasury's dividend rights would belong to FHFA, and these payments should have been retained by FHFA rather than given to Treasury.

[21] The authorities cited by Defendants hold only that HERA or FIRREA bar *derivative* claims by shareholders; they do not hold that those statutes bar *direct* shareholder claims. *See Kellmer*, 674 F.3d at 850–51; *Continental Western*, 83 F. Supp. 3d at 840 n.6; *Perry Capital*, 70 F. Supp. 3d at 230; *Gail C. Sweeney Estate Marital Trust*, 68 F. Supp. 3d at 119, 126 n.13; *Esther Sadowsky Testamentary Trust v. Syron*, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009); *In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 795 (E.D. Va. 2009); *In re Fed. Nat'l Mortg. Ass'n Sec. Derivative, ERISA Litig.*, 629 F. Supp. 2d 1, 4 (D.D.C. 2009), *aff'd sub nom. Kellmer*, 674 F.3d 848. FHFA also cites *Hennepin County v. Federal National Mortgage Association*, 742 F.3d 818, 822 (8th Cir. 2008), but that case does not even address the statutory language or the subrogation issues disputed here.

necessary, the Court notes that it would find that the *Fairholme* plaintiffs' fiduciary duty claim is derivative in nature and, *therefore*, barred under § 4617(b)(2)(A)(i) as well.") (emphasis added).

Indeed, FHFA itself took this position in the *Kellmer* litigation. In addition to derivative claims, a plaintiff in that litigation brought a claim asserting that Fannie's pre-conservatorship Board had violated shareholders' rights under the Exchange Act and SEC regulations. FHFA expressly disclaimed any conservator interest in that claim:

> Plaintiff in *Agnes v. Raines* . . . has sued both derivatively and in his individual capacity. . . FHFA moves to substitute only with respect to the derivative claims asserted by Fannie Mae shareholders. Accordingly, FHFA seeks to substitute for plaintiff Agnes only insofar as he asserts derivative claims; Agnes's individual claims should be consolidated with the other non-derivative securities actions against Fannie Mae that are pending before this Court.

Motion of FHFA as Conservator for Fannie Mae to Substitute For Shareholder Derivative Plaintiffs at 1 n.1, *Kellmer v. Raines*, No. 07-1173 (D.D.C. Feb. 2, 2009), ECF No. 68.

In support of its about-face here, FHFA (and, in passing, Treasury) principally rely on Section 4617(b)(2)'s use of the word "all." *See* FHFA Br. 32; Treas. Br. 28. But as discussed above, "all" this provision transfers is shareholder rights "*with respect to the regulated entity and the assets of the regulated entity*," 12 U.S.C. § 4617(b)(2)(A) (emphasis added). Nor does our interpretation render this provision's reference to the "rights . . . of any stockholder" meaningless. *See* FHFA Br. 34. To be sure, even without the shareholder rights language FHFA could "already pursue what would be a derivative claim because the claim really belongs to" Fannie and Freddie themselves. *Levin*, 763 F.3d at 673 (Hamilton, J., concurring). But the addition of that language clarifies that, absent a manifest conflict of interest, shareholders themselves generally cannot pursue the same claim derivatively. *See In re Federal Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 796 (E.D. Va. 2009).

Further, the Constitution forecloses reading HERA to force Plaintiffs to accept FHFA, a

government agency, as their representative in pursuing claims against the government itself. In a long line of cases under the Due Process Clause, the Supreme Court has held that a person cannot be relegated to representation by a party whose interests conflict with its own. For example, in the class action context, the Court has consistently held that due process requires adequate representation, free of significant potential for conflict of interest, for absent class members. *See generally Richards v. Jefferson Cty.*, 517 U.S. 793, 801 (1996) (holding that taxpayers could not be adequately represented by city finance director); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985) ("the Due Process Clause of course requires that the named plaintiff at all times adequately represent the interests of the absent class members"). Likewise, the Court has held that the Due Process Clause is violated where a criminal defendant is represented by a lawyer who has a conflict of interest. In *Wood v. Georgia*, 450 U.S. 261, 271–72 (1981), the Court held that due process was violated if the party's attorney "may not have pursued [his clients'] interests single-mindedly." Indeed, because the government cannot compel a litigant to press his case before a judge who has a stake in the outcome and an interest in seeing the litigant lose, *see Ward v. Village of Monroeville*, 409 U.S. 57, 61–62 (1972); *Tumey v. Ohio*, 273 U.S. 510, 523 (1927), it necessarily must be an even clearer violation of the Due Process Clause for the government to compel a litigant to rely upon a government agency as his exclusive legal representative in a case against the government itself.

Straining to read HERA as transferring all shareholder rights to the conservator would raise addition constitutional concerns, for even a temporary governmental appropriation of private property is a taking that requires just compensation to the displaced owner. *See Waterview Mgmt. Co. v. FDIC*, 105 F.3d 696, 699 (D.C. Cir. 1997) ("[T]o hold that the federal government could simply vitiate the terms of existing assets, taking rights of value from private owners with no

compensation in return, would raise serious constitutional issues."); *see also, e.g.*, *Arkansas Game & Fish Comm'n v. United States*, 133 S. Ct. 511, 515 (2012) ("Ordinarily, . . . if government action would qualify as a taking when permanently continued, temporary actions of the same character may also qualify as a taking."). Thus, even if Plaintiffs' interpretation *were not* the most natural reading of HERA—which, in fact, it is—it would still be improper to interpret HERA's language as transferring *all* shareholder rights, including the ability to bring direct causes of action to protect those rights, to the conservator, because any such interpretation would raise serious constitutional difficulties. *See National Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2593–94 (2012) (opinion of Roberts, C.J.). Significantly, the Seventh Circuit relied on essentially the same reasoning in holding that a materially identical provision of FIRREA—12 U.S.C. § 1821(d)(2)(A)(i)—grants the FDIC rights only to derivative shareholder claims, not direct shareholder claims:

> Section 1821(d)(2)(A)(i) transfers to the FDIC only stockholders' claims "with respect to . . . the assets of the institution"—in other words, those that investors . . . would pursue derivatively on behalf of the failed bank. This is why we have read § 1821(d)(2)(A)(i) as allocating claims between the FDIC and the failed bank's shareholders rather than transferring to the FDIC every investor's claims of every description. Any other reading of § 1821(d)(2)(A)(i) would pose the question whether . . . stockholders would be entitled to compensation for a taking; our reading of the statute . . . avoids the need to tackle that question.

Levin, 763 F.3d at 672 (first omission in original); *see also id.* at 673 (Hamilton, J., concurring) (underscoring "our adoption of the direct/derivative dichotomy").

2. Plaintiffs' Claims Are Direct, Not Derivative.

In arguing that Plaintiffs' claims are derivative rather than direct, Defendants rely primarily on the test set forth in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), a leading Delaware case elaborating the distinction between these two categories of claims. *See* FHFA Br. 14–16; Treas. Br. 25–27. Because the APA affords Plaintiffs a federal cause of action,

however, Plaintiffs' claims are direct as a matter of law. Even if the *Tooley* test applies to Plaintiffs' claims, moreover, they are still manifestly direct.

a. Plaintiffs' Claims Are Direct Under Federal Law.

Plaintiffs allege that both Defendant agencies violated HERA and that Treasury acted arbitrarily and capriciously. Plaintiffs seek redress pursuant to the Administrative Procedure Act. As a matter of federal law, Plaintiffs' APA claims are their own, not Fannie's and Freddie's. The APA creates a cause of action for any person "adversely affected or aggrieved by agency action within the meaning of a relevant statute." 5 U.S.C. § 702. This language requires only that an APA plaintiff satisfy Article III's standing requirements and show that the interest he asserts is " 'arguably within the zone of interests to be protected or regulated by the statute' that he says was violated." *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Patchak*, 132 S. Ct. 2199, 2210 (2012) (quoting *Association of Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 153 (1970)). The standard for asserting a claim under the APA "is not meant to be especially demanding," does "not require any indication of congressional purpose to benefit the would-be plaintiff," and conspicuously includes the word "arguably" "to indicate that the benefit of any doubt goes to the plaintiff." *Id.* (quotation marks omitted).

Plaintiffs' claims easily satisfy this test. Plaintiffs have suffered injury in fact by having their economic interest in Fannie and Freddie eliminated and transferred to Treasury. And this interest is protected by HERA, as one of the principal purposes of a conservatorship or receivership is to protect the interests of an entity's creditors and shareholders. *See*, *e.g.*, 12 U.S.C. § 4617(b)(2)(D) (conservator's authority limited to actions that "preserve and conserve" assets and "put the regulated entity in a sound and solvent condition"); *id.* § 4617(c)(1)(D) (listing shareholders as residual claimants during receivership). Indeed, as conservator FHFA has a fiduciary responsibility to Fannie's and Freddie's shareholders. *See*, *e.g.*, *Golden Pac. Bancorp v.*

FDIC, 375 F.3d 196, 201 (2d Cir. 2004); *Suess v. FDIC*, 770 F. Supp. 2d 32, 38 (D.D.C. 2011). Plaintiffs' claims are thus squarely within the zone of interests protected by HERA.

Because Plaintiffs have a valid federal cause of action under the APA, inquiry into whether their claims would be considered direct or derivative under state law is unnecessary. As the United States Court of Appeals for the D.C. Circuit has explained,

> The zone of interests adequate to sustain judicial review is particularly broad in suits to compel federal agency compliance with law, since Congress itself has pared back traditional prudential limitations by the Administrative Procedure Act, which affords review to any person "adversely affected or aggrieved by [federal] agency action within the meaning of a relevant statute."

FAIC Sec., Inc. v. United States, 768 F.2d 353, 357 (D.C. Cir. 1985) (alteration in original) (citation omitted) (quoting 5 U.S.C. § 702). This Court should not lightly read state corporate law to limit Congress's sweeping conferral of standing. *See Kamen v. Kemper Fin. Servs.*, *Inc*., 500 U.S. 90, 99 (1991) ("gaps" in federal statutes "bearing on the allocation of governing power within the corporation should be filled with state law 'unless . . . [its] application would be inconsistent with the federal policy underlying the cause of action.' ").[22]

b. Plaintiffs' Claims Are Direct Under State Law.

To the extent it is appropriate to consult state law to determine whether Plaintiffs' claims are direct or derivative, this Court should look to the laws of Delaware and Virginia, the corporate laws that Fannie and Freddie have elected to follow pursuant to federal regulation. *See supra* at 60. While Delaware law is well-developed on this distinction, Virginia law is not. *See, e.g.*, *Remora Invs., LLC v. Orr*, 673 S.E.2d 845, 848 (Va. 2009) (discussing, but ultimately not deciding "whether to adopt the analysis employed by the Delaware Supreme Court in *Tooley*"). In the

[22] Although FHFA cites the district court's decision in *Perry Capital* in support of its argument that Plaintiffs' claims are derivative, *see* FHFA Br. 15–16, the *Perry Capital* court did not hold that the APA claims at issue there were derivative, *see* 70 F. Supp. 3d at 229 n.24.

absence of settled law of their own, Plaintiffs respectfully submit that the Virginia courts would follow the principles and analysis set forth by the Delaware courts. *See, e.g.*, *U.S. Inspect Inc. v. McGreevy*, 2000 WL 33232337, at *4 (Va. Cir. Ct. Nov. 27, 2000) (looking to Delaware law for guidance in the absence of Virginia Supreme Court precedent).[23]

As a matter of Delaware law, the fact that Plaintiffs have a valid federal cause of action under the APA establishes that their claims are direct as a matter of law, without regard for the test set forth in *Tooley*. For as the Delaware Supreme Court recently made clear, *Tooley* should not be read as "a general statement requiring all claims, whether based on a tort, contract, or statutory cause of action (e.g., antitrust), to be brought derivatively whenever the corporation of which the plaintiff is a stockholder suffered the alleged harm." *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.*, 118 A.3d 175, 180 (Del. 2015). But in all events, even if the *Tooley* test applies to Plaintiffs' claims, those claims are still manifestly direct.

1. While Delaware law permits stockholders to bring derivative suits "on behalf of the corporation for harm done to the corporation," it also provides that "[a] stockholder who is directly injured . . . retain[s] the right to bring *an individual action* for injuries affecting his or her legal rights as a stockholder." *Tooley*, 845 A.2d at 1036 (emphasis added). "[W]hether a stockholder's claim is derivative or direct" turns "*solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the

[23] For this reason, the cases that Treasury cites that apply the law of States other than Delaware and Virginia have little bearing on whether Plaintiffs' claims are direct or derivative. *See, e.g.*, *Levin v. Miller*, 763 F.3d 667, 670 (7th Cir. 2014) (applying Indiana law); *Pareto v. FDIC*, 139 F.3d 696, 698 (9th Cir. 1998) (applying California law); *Sax v. World Wide Press, Inc.*, 809 F.2d 610, 613 (9th Cir. 1987) (applying Montana law). More generally, to the extent that Treasury cites cases from various other jurisdictions that purport to apply Delaware law, these cases have considerably less persuasive force than the authoritative interpretations of Delaware law by the Delaware courts themselves on which our arguments rely.

benefit of any recovery or other remedy (the corporation or the stockholders, individually)." *Id.* at 1033. In analyzing the first question, the court considers "whether the stockholder has demonstrated that he or she has suffered an injury that is not dependent on an injury to the corporation"—that is, whether the plaintiff has "demonstrated that he or she can prevail without showing an injury to the corporation." *Id.* at 1036. Once this first inquiry is conducted, "[t]he second prong of the analysis should logically follow." *Id.*

Although FHFA suggests otherwise, *see* FHFA Br. 14–15, this analysis does not imply that a stockholder must show that the action which harmed his or her own interests did not also harm the corporation—to the contrary, some wrongs harm *both* the corporation and its stockholders directly and can be challenged through *either* derivative or direct actions. *See, e.g.*, *Gatz v. Ponsoldt*, 925 A.2d 1265, 1278 (Del. 2007) ("claim could have been brought either as a direct or as a derivative claim"); *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006) (holding that claim "was both derivative and direct"); *see also Tooley*, 845 A.2d at 1036 (distinguishing "individual action for injuries affecting [stockholder's] legal rights as a stockholder" from derivative action seeking redress for "an injury caused to the corporation *alone*") (emphasis added). Rather, it means only that the stockholder must be able to prove his own injury *without regard to* whether the corporation was also harmed.

2. In this case, the harms for which Plaintiffs seek redress—the unlawful transfer of the economic bundle of rights and value of their stock to a dominant shareholder, in violation of HERA and the APA—were suffered by Plaintiffs directly. While Plaintiffs believe that the Net Worth Sweep also injured Fannie and Freddie, the injury Plaintiffs suffered "is not dependent on an injury to [either] corporation." *Tooley*, 845 A.2d at 1036; *see also Rossette*, 906 A.2d at 102–03 ("Although the corporation suffered harm (in the form of a diminution of its net worth), the

minority shareholders also suffered a harm that was unique to them and independent of any injury to the corporation."). Indeed, even if Defendants' apparent (though facially implausible and, for purposes of the motions to dismiss, irrelevant) suggestion that the Net Worth Sweep somehow benefitted Fannie and Freddie were correct, *see, e.g.*, FHFA Br. 21–22; Treas. Br. 8, Plaintiffs were still directly injured because the Net Worth Sweep destroyed the value of their investments through the transfer of Fannie's and Freddie's entire net worth to Treasury. The gravamen of Plaintiffs' Complaint is not that the Net Worth Sweep has diminished Fannie's and Freddie's overall corporate profits and thus harmed all shareholders indirectly, but rather that it has improperly allocated to a single, dominant shareholder whatever profits those corporations do make, harming minority shareholders and destroying the economic interest in the Companies to which Plaintiffs are entitled as owners of stock. It follows that Plaintiffs "can prevail without showing an injury" to Fannie or Freddie, *Tooley*, 845 A.2d at 1036, and thus that Plaintiffs—not Fannie and Freddie—suffered the specific injury complained of here.

Significantly, the Delaware Supreme Court has expressly approved direct stockholder suits to redress the "improper extraction or expropriation, by the controlling shareholder, of economic value and voting power that belonged to the minority stockholders." *Rossette*, 906 A.2d at 102; *see also, e.g.*, *Gatz*, 925 A.2d at 1278, 1280–81 (allowing direct suit in analogous circumstances raising the same policy concerns as *Rossette*); *In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 330–32 (Del. 1993); *In re Activision Blizzard, Inc. Stockholder Litig.*, 124 A.3d 1025, 1052–54 (Del. Ch. 2015); *Gradient OC Master, Ltd. v. NBC Universal, Inc.*, 930 A.2d 104, 130 (Del. Ch. 2007). As the Delaware Supreme Court explained, although in such cases the corporation may "suffer[ ] harm (in the form of a diminution of its net worth), the minority shareholders also suffer[ ] a harm that [is] unique to them and independent of any injury to the corporation." *Rossette*,

906 A.2d at 103. Indeed, in the recent AIG litigation, the Government "concede[d] that the *Gatz-Rossette* line of cases recognize the right of a plaintiff to bring a direct claim where a stockholder uses its majority or effective control to dilute minority shares," but argued that these cases did not apply in that case "because the Government was not a stockholder, nor did it have majority or effective control of AIG, when the purported dilution occurred." *Starr Int'l Co. v. United States*, 106 Fed. Cl. 50, 64 (2012) (quotation marks omitted), *appeal filed*, No. 15-5133 (Fed. Cir.); *see also id*. at 65 (rejecting Government's argument and following *Gatz* and *Rossette* in upholding shareholder's "right to maintain a direct claim"). Here, also, the crux of Plaintiffs' claim is not that there has been "an equal dilution of the economic value . . . of each of [Fannie's and Freddie's] outstanding shares." *Rossette*, 906 A.2d at 100. Rather, it is that the Net Worth Sweep constituted an unlawful "extraction from [Plaintiffs], and a redistribution to [Treasury,] the controlling shareholder, of . . . the economic value" of their stock. *Id*. It is Plaintiffs, not Fannie and Freddie, who have suffered this harm.[24]

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[24] For this reason, the various cases cited by Defendants discussing claims based solely on waste or depletion of corporate assets, reduction in stock value, and other injuries that affect all shareholders equally and indirectly are inapposite here. *See* FHFA Br. 14–16; Treas. Br. 24–27. Indeed, the very authorities Defendants cite in support of these propositions expressly or at least implicitly recognize that a shareholder may assert a direct claim when he suffers "some individualized harm not suffered by all of the stockholders at large." *E.g.*, *Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008); *see also Pareto*, 139 F.3d at 699–700 (plaintiff "did not allege a majority stockholders' breach of a fiduciary duty to minority stockholders, which resulted in the majority stockholders retaining a disproportionate share of the corporation's ongoing value."); *Sax*, 809 F.2d at 614 ("A direct action can be brought . . . when the shareholder suffers injury separate and distinct from that suffered by other shareholders."); *Cowin v. Bresler*, 741 F.2d 410, 414 (D.C. Cir. 1984) (claim derivative when "an injury to corporate stock falls equally upon all stockholders"). In all events, the argument that claims seeking redress for injury to the value of a shareholder's stock are necessarily and categorically derivative has been recently and authoritatively rejected by the Delaware Supreme Court, which, as discussed above, squarely rejected the proposition that Delaware law requires "all claims, whether based on a tort, contract, or statutory cause of action . . . to be brought derivatively whenever the corporation of which the plaintiff is a stockholder suffered the alleged harm." *NAF Holdings*, 118 A.3d at 180.

Nor are direct "expropriation" claims limited to the factual scenario that was present in *Rossette*. As the Delaware Chancery Court recently explained,

> Subsequent cases have recognized that the principle recognized in *Gentile* [*v. Rossette*] was not limited to dilutive issuances involving majority stockholders; it applies equally to stock transfers involving significant stockholders. Indeed, *Gentile*'s core insight applies to any insider stock issuance where the value transferred directly to the insider exceeds the share of the loss that the insider suffers through its stock ownership.
>
> Not only that, but the expropriation principle actually applies to insider transfers generally, regardless of whether the nature of the consideration received by the insider is cash, stock, or other corporate property. Whenever the value of the transfer to the insider exceeds the share of the loss that the insider suffers through its stock ownership, the insider transfer expropriates value from the unaffiliated investors. This effect happens precisely because the insider receives benefits to the exclusion of the other investors, resulting in a distinct injury to the other investors and a corresponding benefit to the insider.

In re El Paso Pipeline Partners, LP, 2015 WL 7758609, at *28 (Del. Ch. Dec. 2, 2015) (footnotes omitted); *see also Gatz*, 925 A.2d at 1278, 1280–81 (looking beyond "transactional form" to "underlying concerns and substantive effects" and allowing direct suit in circumstances raising the same policy concerns as *Rossette*); *Gradient OC Master, Ltd. v. NBC Universal, Inc*., 930 A.2d 104, 130 (Del. Ch. 2007) ("[W]hen a controlling shareholder extracts financial benefit from the shareholders and procures a financial benefit exclusive to himself, the non-controlling shareholders have a direct claim . . .").

3. Given that Plaintiffs' claims easily qualify as direct under the first prong of *Tooley*, "[t]he second prong of the analysis should logically follow." *Tooley*, 845 A.2d at 1036. "[C]ourts have been more prepared to permit the plaintiff to characterize the action as direct when the plaintiff is seeking only injunctive or prospective relief," as is the case here. *Grimes v. Donald*, 673 A.2d 1207, 1213 (Del. 1996), *overruled on other grounds*, *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000); *see also Tooley*, 845 A.2d at 1038 (citing *Grimes* with approval). Thus, even

before the Delaware Supreme Court's decision in *Rossette*, the Delaware Court of Chancery held in *Gatz v. Ponsoldt* that a shareholder's claim was direct where the plaintiff asked the court to unwind a transaction entered into by the corporation to the advantage of certain shareholders at the expense of others. 2004 WL 3029868, at *7–*8 (Del. Ch. Nov. 5, 2004); *see also San Antonio Fire & Police Pension Fund v. Bradbury*, 2010 WL 4273171, at *9 (Del. Ch. Oct. 28, 2010); *Grayson v. Imagination Station, Inc.*, 2010 WL 3221951, at *6 (Del. Ch. Aug. 16, 2010). Because Plaintiffs' claims seek similar relief, Plaintiffs are entitled to press those claims directly. However the requested relief would affect Fannie and Freddie, Plaintiffs would benefit from the requested relief in a way that is unique and independent from the Companies, since the relief would restore the balance of value between Treasury's holding and the other classes of stock.

C. Plaintiffs May Bring Even Derivative Claims Where, as Here, the Conservator Has a Manifest Conflict of Interest.

1. Even if HERA did bar direct claims by shareholders of entities in conservatorship (or if Plaintiffs' direct claims were construed to be derivative), HERA still would permit Plaintiffs to bring their claims here. While Section 4617(b)(2)(A) generally has been interpreted to bar derivative (but not direct) suits by shareholders during conservatorship or receivership, it does not follow that *all* shareholder derivative suits are barred without exception, including derivative suits involving a challenge to the actions of the conservator or receiver itself or a closely related federal agency. Indeed, any such interpretation would be highly suspect, for it is well settled that there is a "strong presumption that Congress intends judicial review of administrative action." *Bowen v. Michigan Acad. of Family Physicians*, 476 U.S. 667, 670 (1986). In light of this bedrock principle, HERA cannot reasonably be read to bar shareholders from obtaining meaningful judicial review of claims where FHFA has a manifest conflict of interest that prevents it from adequately safeguarding shareholders' rights.

Two federal courts of appeals have squarely addressed this question, both in the context of 12 U.S.C. § 1821(d)(2)(A)(i), the provision of FIRREA on which Section 4617(b)(2)(A) was modeled. And both of those courts held that shareholders may maintain a derivative suit when the conservator or receiver has a manifest conflict of interest. *See First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279, 1283 (Fed. Cir. 1999) (finding standing to sue "because of the FDIC's conflict of interest by which it is both alleged to have caused the breach and controls the depository institution"); *Delta Sav. Bank v. United States*, 265 F.3d 1017, 1024 (9th Cir. 2001) (adopting "a common-sense, conflict of interest exception to the commands of FIRREA" and permitting a shareholder to bring a derivative suit against one of the FDIC's "closely-related, sister agencies"). Although FHFA seeks to dismiss these cases as "outliers with no precedential effect," FHFA Br. 35, the opposite is true. Indeed, in the context of HERA, even Defendants' own authorities generally recognize a "conflict of interest exception" to the bar on derivative actions urged by Defendants here.[25]

The district court in *Perry Capital*, to be sure, rejected interpreting HERA to allow shareholder derivative suits when a conservator is conflicted, but its reasoning, echoed by Defendants here, is faulty. First, "Professor Frankfurter's timeless advice" to "(1) Read the statute; (2) read the statute; (3) read the statute" does not preclude a conflict-of-interest exception. *Perry Capital*, 70 F. Supp. 3d at 231. The statute does not explicitly address derivative suits by shareholders when the conservator is conflicted, nor does it explicitly address derivative suits by shareholders generally. Resolution of this question thus is a matter of interpretation, not merely

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[25] *See Kellmer*, 674 F.3d at 850; *In re Fed. Nat'l Mortg. Ass'n Sec., Derivative, & ERISA Litig.*, 629 F. Supp. 2d 1, 4 n.5 (D.D.C. 2009); *In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 798 (E.D. Va. 2009); *Esther Sadowsky Testamentary Trust*, 639 F. Supp. 2d at 350.

reading the statute's text. And particularly noteworthy here is the fact that every appellate court to address this question in the context of FIRREA before HERA was enacted interpreted the relevant language to include a conflict-of-interest exception to the general rule that shareholders may not bring derivative actions. When Congress reenacted substantially the same language in HERA, it can be presumed to have accepted the consistent judicial construction of that language as including a conflict-of-interest exception. *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85–86 (2006).

Second, a conflict-of-interest "exception would [not] swallow the rule" against shareholder derivative suits, *Perry Capital*, 70 F. Supp. 3d at 231, as reflected by cases denying shareholders the right to bring derivative claims despite acknowledging a conflict-of-interest exception. Indeed, a conflict-of-interest exception would do nothing to displace a conservator's or receiver's exclusive control over actions relating to corporate mismanagement leading to the appointment of the conservator or receiver in the first place, as it would not permit shareholders to bring derivative actions asserting such claims during conservatorship or receivership.

Third, there is nothing "odd" about concluding that Congress intended shareholders to retain the right to bring derivative claims when the conservator is conflicted while also "grant[ing] immense discretionary power to the conservator . . . and prohibit[ing] courts from interfering with the exercise of such power." *Id.* at 230–31. This right will only come into play when the conservator is alleged to have acted *outside* of the bounds of its power or in cases seeking damages—both situations in which Congress *has not* shielded the conservator's actions from judicial scrutiny. *See* 12 U.S.C. § 4617(f). The "odd" interpretation of HERA would be to strain to read it as shielding the conservator's actions from judicial review in situations not covered by the statute's provision directly addressing that subject.

2. In this case, Plaintiffs challenge the Net Worth Sweep—an "agreement" between FHFA, the conservator, and the Department of Treasury, a sister federal agency which has acquired a direct and controlling interest in Fannie and Freddie and with which FHFA has obediently coordinated its actions as conservator. FHFA plainly has a "manifest conflict of interest" within the meaning of *First Hartford*, 194 F.3d at 1295, and the numerous other authorities recognizing this common-sense exception, and Plaintiffs, rather than FHFA, are thus the proper parties to seek redress for the injury inflicted by the Net Worth Sweep.

Treasury, relying on *Perry Capital*, nevertheless argues that the claims against it, as opposed to the claims against FHFA, do not present a manifest conflict of interest. Treas. Br. 28. FHFA, notably, does not disclaim a conflict in determining whether to sue Treasury, and the notion that FHFA is not conflicted is risible. Indeed, the Complaint alleges that Treasury *compelled* FHFA to enter the Net Worth Sweep, *see, e.g.*, Compl. ¶¶ 11, 112–115, 133, 139, 149; in light of that allegation (which must be taken as true), there is no reason to believe that Treasury would allow FHFA to initiate a lawsuit challenging Treasury's actions. And even putting that issue aside, the Net Worth Sweep at a minimum is a joint FHFA-Treasury initiative and FHFA reasonably cannot be held to be free from bias in evaluating claims that Treasury acted illegally in agreeing to it.

In holding otherwise, *Perry Capital* attempted to distinguish *Delta Savings*, a case in which the Ninth Circuit held that a stockholder of a bank in receivership had standing to sue the Office of Thrift Supervision ("OTS") because the bank's receiver, the FDIC, was conflicted. *See Perry Capital*, 70 F. Supp. 3d at 232–33. But whatever distinctions there may be in the relationship between FHFA and Treasury and the relationship between FDIC and OTS in *Delta Savings*—and

any such distinctions are not as pronounced as *Perry Capital* made them out to be[26]—the bottom line should be the same: FHFA "should not have the final say on whether it is in [Fannie's and Freddie's] best interests to sue" Treasury for acting illegally in entering the Net Worth Sweep because FHFA "faces a conflict of interests when it contemplates" such a suit. *Delta Savings*, 265 F.3d at 1021–22.

Also relying on *Perry Capital*, FHFA briefly suggests that a conflict-of-interest exception is less suited to the conservatorship context than to the receivership context. *See* FHFA Br. 35–36. But the opposite is true: Unlike the appointment of a receiver, the appointment of a conservator does not "terminate" shareholder claims and relegate them to a statutory claims process. *See* 12 U.S.C. § 4617(b)(2)(K)(i). And without the protections of this statutory claims process, *see supra* 40–41, there is an even greater need for a conflict-of-interest exception to protect the interests of shareholders during conservatorship than during receivership.

III. Plaintiffs' Claims Are Not Precluded.

Both FHFA and Treasury argue that Plaintiffs' APA claims are precluded by the district court decision in *Perry Capital*, 70 F. Supp. 3d 208. *See* FHFA Br. 12–18; Treas. Br. 30–33. While *Perry Capital* did involve APA claims similar to those at issue here, Defendants do not dispute that Plaintiffs were not parties to that case. Because Plaintiffs were not parties, the *Perry Capital*

[26] FHFA and Treasury "are not two disengaged bodies on the opposite ends of an organizational chart" but are "closely related entities," particularly when it comes to the Net Worth Sweep. *See Delta Savings*, 265 F.3d at 1023. For example, the Secretary of the Treasury is "a member of [a Government] Board" that advises FHFA's director in carrying out his statutory duties. *Id.*; *see* 12 U.S.C. § 4513a. And FHFA and Treasury "play complementary roles in the process of" rehabilitating Fannie and Freddie, with FHFA having authority to appoint itself conservator and Treasury having the now-expired authority to invest in the Companies. *Delta Savings*, 265 F.3d at 1023. (Contrary to *Perry Capital*, *see* 70 F. Supp. 3d at 232–33, this interrelationship cuts in favor of finding a conflict of interest, not against it.) FHFA "cannot be expected to objectively pursue lawsuits" against Treasury relating to the Net Worth Sweep, "even when it is in the best interest of [Fannie and Freddie] to do so." *Delta Savings*, 265 F.3d at 1023.

decision could potentially have affected Plaintiffs' rights only if the *Perry Capital* plaintiffs were somehow in privity with Plaintiffs here. Defendants' argument that Plaintiffs are in privity with the *Perry Capital* plaintiffs rests entirely on the distinction between direct and derivative actions. Although the APA claims rejected in *Perry Capital* were indisputably asserted and prosecuted as direct claims, Defendants maintain that they were actually derivative claims brought on behalf of Fannie and Freddie and that the judgment in that case thus binds the two companies. And although Plaintiffs in this case likewise seek to assert only direct claims, Defendants maintain that the APA claims at issue here are in fact derivative claims that belong to Fannie and Freddie and are thus foreclosed by the earlier judgments.

Defendants' preclusion argument fails for the simple reason that Plaintiffs' claims are direct, not derivative, as demonstrated above. *See Guenther v. Pacific Telecom, Inc.*, 123 F.R.D. 341, 347 n.10 (D. Or. 1987) (observing that "the judgment in a derivative suit will not preclude any right of action that an absent shareholder might have in his or her *individual* capacity").

Even if Defendants' characterization of Plaintiffs' claims were correct, moreover, issue preclusion should not apply here. As an initial matter, it is undisputed that the plaintiffs in *Perry Capital* did not assert or seek to prosecute their APA claims as derivative actions.[27] Nor does it appear that they made any attempt to comply with the rigorous procedural or substantive requirements for bringing a derivative action imposed by the Federal Rules of Civil Procedure and Delaware and Virginia law. For example, there is no indication in the record of *Perry Capital* that

[27] To be sure, some of the plaintiffs in *Perry Capital* did seek to assert derivative, state-law claims that FHFA and Treasury had breached their fiduciary duties to Fannie and Freddie. *See Perry Capital*, 70 F. Supp. 3d at 218–19. Not only have Plaintiffs not asserted such a claim here, but the *Perry Capital* court has made clear that its decision did not have preclusive effect even on plaintiffs seeking to assert direct, state-law fiduciary duty claims in a separate case. *See* Order, *Rafter v. Department of Treasury*, No. 1:14-cv-01404-RCL (D.D.C. Jan. 21, 2015), Doc. 20.

the plaintiffs either made demands on the Boards of Fannie and Freddie to bring APA claims against FHFA and Treasury or determined that such demands would be futile. *See, e.g.*, *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 366–67 (Del. 2006) (explaining that "the right of a stockholder to prosecute a derivative suit is limited to situations where either the stockholder has demanded the directors pursue a corporate claim and the directors have wrongfully refused to do so, or where demand is excused because the directors are incapable of making an impartial decision regarding whether to institute such litigation"). Certainly, the plaintiffs did not "state with particularity" in their pleadings that they had made either such a demand or such a determination as is required by FED. R. CIV. P. 23.1. Nor did the district court hold that the APA claim was derivative. *See Perry Capital*, 70 F. Supp. 3d at 229 n.24.

Under these circumstances, even if Plaintiffs' claims in this case truly were derivative, issue preclusion plainly should not apply. First, the suit in *Perry Capital* was not an avowed derivative action brought "expressly for the benefit of any and all the stockholders," *Henik ex rel. LaBranche & Co., Inc. v. LaBranche*, 433 F. Supp. 2d 372, 382 (S.D.N.Y. 2006) (quoting *Dana v. Morgan*, 232 F. 85, 91 (2d Cir. 1916)), and Plaintiffs cannot be presumed to have been on notice that their rights were at issue in that case, *see United States v. LTV Corp.*, 746 F.2d 51, 53 n.5 (D.C. Cir. 1984). Second, as Defendants' own authorities acknowledge, "[h]owever established the principle that the same party, the corporation, has sued in each derivative action, it is subject to an important caveat: to bind the corporation, the shareholder plaintiff must have adequately represented the interests of the corporation." *In re Sonus Networks, Inc., S'holder Derivative Litig.*, 499 F.3d 47, 64 (1st Cir. 2007). The plaintiffs in *Perry Capital*—who did not even purport to assert APA claims on behalf of Fannie and Freddie, let alone make any attempt to satisfy the substantive and procedural requirements for doing so—certainly cannot be said to have adequately represented

the interests of these corporate entities. Third, it appears that the court in *Perry Capital* would not regard its judgment as precluding this claim. *See supra* n. 27. Finally, and at a bare minimum, the unusual posture of this case and the district court proceedings on which Defendants rely surely constitute "special circumstances" that "warrant an exception to the normal rules of preclusion." *Montana v. United States*, 440 U.S. 147, 155 (1979); *see Taylor v. Sturgell*, 553 U.S. 880, 897 (2008) (observing that due process limits application of issue preclusion in absence of "special procedures to protect the nonparties' interests or an understanding by the concerned parties that the first suit was brought in a representative capacity").

Not surprisingly, none of the preclusion cases that Defendants cite holds that a claim that was unsuccessfully prosecuted as a direct claim will preclude a subsequent suit by a different plaintiff, even if (as did not happen here) the court in the first case holds that the initial claim should have been brought as a derivative action, and even if (as is not the case here) the claims in the second case truly are derivative. Nor are Plaintiffs aware of any cases that would support this remarkable proposition. For all of these reasons, issue preclusion should not apply here.

IV. Section 4623(d) Does Not Bar Plaintiffs' Claims.

Finally, FHFA belatedly argues that Plaintiffs' 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." *See* Supplemental Brief of Defendants FHFA and Melvin L. Watt in Further Support of Their Motion to Dismiss at 6 (June 16, 2016), Doc. 83 ("Suppl. Br."). 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 the Plaintiffs' 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 Plaintiffs have not challenged FHFA's 2008 decision. In addition, that decision falls outside the scope of Section 4623(d), and, in any event, this lawsuit will have no effect on that decision.[28]

A. 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

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[28] Even if Section 4623(d) somehow did 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).

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 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."[29] 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 on 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 at 26, *California ex rel. Harris v. FHFA*, No. 10-CV-3084 (N.D. Cal. Oct. 14, 2010), ECF No. 49 (emphasis added).

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[29] *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.").

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 "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 action[s]" authorized under Sections 4615 and 4616. *Id.* § 4623(a)(1). Under Section 4623(d), 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).

B. Section 4623(d) Has No Application Here.

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. 4 n.2. 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 A to FHFA and Watt's Motion to Dismiss the Amended Complaint at 59, 67 (Mar. 18, 2016) Doc. 76-2. 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.[30] 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.

In all events, Plaintiffs are not challenging the decision to temporarily suspend the Companies' capital classifications and related regulatory capital requirements. Plaintiffs have not argued that that decision was unlawful. They have not asked this Court to vacate or reverse that

[30] The Companies' minimum and critical capital requirements are prescribed by 12 U.S.C. § 4612(a) and 12 U.S.C. § 4613(a). 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.

decision, or even to address its legality in any way. And the relief Plaintiffs do 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, Plaintiffs seek 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 Plaintiffs' claims would nevertheless somehow "affect" the decision to suspend the Companies' capital classifications, FHFA highlights Plaintiffs' 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 Plaintiffs have not requested such relief.

FHFA's apparent claim that the decision to suspend the 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. 83-1). 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://goo.gl/A8QSy8.

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." Doc. 76-2, at 3, 17. In all events, as Plaintiffs have already explained, *see supra* at 34–35, 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 Plaintiffs seek—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 to Treasury, or (2) creating a substantial capital buffer that would make any further draws less likely.

CONCLUSION

For the foregoing reasons, Defendants' motions to dismiss should be denied.

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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/ Alexander M. Johnson
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