IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

CHRISTOPHER M. ROBERTS and
THOMAS P. FISCHER,

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, THE DEPARTMENT OF THE TREASURY, and JACOB J. LEW, in his official capacity as Secretary of the Treasury,

Defendants.

No. 1:16-cv-2107

PLAINTIFFS' CONSOLIDATED RESPONSE IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS

August 12, 2016

Christian D. Ambler
ARDC No. 6228749
Stone & Johnson, Chtd.
111 West Washington St.
Suite 1800
Chicago, Illinois 60602
(312) 332-565 – tel.
(312) 556-5858 – fax
cambler@stonejohnsonlaw.com
Counsel for Plaintiffs

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INTRODUCTION

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")—expropriated the entire economic value of the Companies, including the value held by private shareholders, for the exclusive benefit of the federal government.

FHFA and Treasury accomplished their objective by purporting to "amend" the terms of Fannie and Freddie equity securities held by Treasury. Before the amendment (called the "Net Worth Sweep" by Treasury), these securities entitled Treasury to dividends of 10% of the outstanding liquidation preference of Treasury's stock, if paid in cash, or 12% if paid in kind. After the Net Worth Sweep, the Companies are *forever* required to pay their *entire* net worth (i.e., including *all* contributed capital by shareholders, *all* retained earnings, and *all* future profits) to Treasury *every quarter*, minus a small capital reserve that will soon decrease to zero.

The Net Worth Sweep has been tremendously lucrative for the government. Under the Net Worth Sweep, Treasury will soon have usurped *$195 billion* from the Companies—approximately $124 billion more than they would have paid under the prior arrangement. Pls.' Am. Compl. for Declaratory & Injunctive Relief ¶ 127 (Apr. 5, 2016), Doc. 22 ("Compl."); FHFA, TABLE 2: DIVIDENDS ON ENTERPRISE DRAWS FROM TREASURY, http://goo.gl/vHl8V0. Because the Agencies treat these enormous cash payments as mere "dividends," not pay-downs of principal, moreover, the face value of Treasury's stock has not decreased by one cent. The Companies' private shareholders, by contrast, are guaranteed to never receive any return of their investments nor any return on their investments.

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

The Net Worth Sweep *thwarts* these statutory mandates. Rather than rehabilitating the Companies, it prevents them from exiting conservatorship. The Net Worth Sweep does not *preserve* and *conserve* the Companies' assets, but rather expropriates those assets. And the Net Worth Sweep prevents the Companies from ever being sound and solvent, because it prohibits them from building any capital, which is the essence of soundness and solvency.

The Net Worth Sweep likewise exceeded Treasury's statutory powers. Treasury's temporary authority to purchase the Companies' securities expired on December 31, 2009; after that date, it could only "hold, exercise any rights received in connection with, or sell" those securities. *Id*. §§ 1455(*l*); 1719(g). The Net Worth Sweep did none of these things. Rather, it so fundamentally altered Treasury's securities that it amounted to an exchange of those securities for new securities, an exchange Treasury had no authority to make in 2012.

Plaintiffs challenge the Net Worth Sweep, as well as other unlawful terms of Treasury's securities and practices of FHFA. These include provisions granting Treasury veto authority over core conservatorship decisions, including the fundamental decision whether to end conservatorship, forbidding pay down or redemption of Treasury's investment, and permitting continuing increases in Treasury's financial interest in the Companies even after the expiration of Treasury's investment authority; as well as FHFA's deleterious practice of requiring the Companies to pay cash dividends to Treasury, even when they must incur debt or draw funds from Treasury to do so.

STATEMENT OF FACTS

Fannie and Freddie are two of the world's largest privately owned financial institutions. 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 and preferred stock and have been shareholders since before imposition of the conservatorship. Compl. ¶ 40.

As mortgage insurers, Fannie and Freddie are designed to generate ample cash to cover their operating expenses. Unlike the nation's largest banks, the Companies also took a relatively conservative approach to investing in mortgages during the national run up in home prices from 2004 to 2007. For both reasons, the Companies remained in a comparatively strong financial condition during the ensuing financial crisis, and were at all times capable of meeting their obligations to insureds and creditors and of absorbing any losses they might reasonably incur as a result of the financial downturn. *See id.* ¶¶ 3, 42–44, 91.

Treasury nevertheless implemented a deliberate strategy to seize the Companies and operate them for its exclusive benefit. Despite prior statements assuring investors that the Companies were in sound financial shape, FHFA forced the Companies into conservatorship, at Treasury's urging, on September 6, 2008. Treasury's then-Secretary Hank Paulson stated that "seizing control" of Fannie and Freddie was an action "I took." *Id*. ¶¶ 52, 134. FHFA stated that under the Housing and Economic Recovery Act of 2008 ("HERA") 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.* ¶ 49. As FHFA publicly confirmed, conservatorship is necessarily temporary, and FHFA may act as conservator for the Companies only until they are stabilized. *Id.* ¶ 54. Neither Company was experiencing a liquidity crisis or a short-term fall in operating revenue at the time. *Id.* ¶¶ 8, 42, 91.

Treasury then exercised its temporary authority under HERA to enter agreements with FHFA to purchase equity in the Companies ("Preferred Stock Purchase Agreements" or "PSPAs"). *Id.* ¶¶ 57–58. The PSPAs created a new class of securities with very favorable terms, known as Senior Preferred Stock ("Government Stock"). Treasury received $1 billion of Government Stock in each Company and warrants to purchase 79.9% of each Company's common stock at a nominal price. *Id.* ¶¶ 62–63. Treasury's equity in each Company had an initial liquidation preference of $1 billion. The PSPAs allowed the Companies to draw funds from Treasury as needed to avoid a negative net worth, and the liquidation preference increases by one dollar for each dollar the Companies draw. These draws could continue even after Treasury's authority to invest in the Companies expired at the end of 2009. *See* 12 U.S.C. §§ 1455(*l*), 1719(g). If the Companies liquidate, Treasury is entitled to recover its entire liquidation preference before any other shareholder receives anything. Compl. ¶¶ 9, 58.

The PSPAs required the Companies to pay quarterly dividends on the outstanding liquidation preference. These dividends may be paid in cash, at an annual rate of 10%, or in kind, at an annual rate of 12%, by adding to the liquidation preference the amount of dividends due—an option Treasury repeatedly acknowledged. *See id.* ¶¶ 11, 66–68.

Contrary to HERA's explicit provision that FHFA shall not be subject to the direction or supervision of any other government agency, the PSPAs also granted Treasury extraordinary control over FHFA's operation of the Companies in conservatorship. Absent Treasury's consent, the Companies are prohibited from (i) issuing new equity; (ii) paying dividends (except to Treasury); (iii) selling or transferring assets outside the ordinary course of business; (iv) incurring debt above a specified level; (v) making certain fundamental changes to their business; or (vi) engaging in certain transactions with affiliates. Indeed, the PSPAs even purported to prohibit termination of the conservatorships without Treasury's consent other than to place the Companies in receivership. *Id.* ¶¶ 12, 74.

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 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 would retain rights to 20.1% of the Companies' residual value). As FHFA's Director assured Congress shortly after imposing the conservatorship, the Companies' "shareholders are still in place," and "both the preferred and common shareholders have an economic interest in the companies," which "going forward . . . may [have] some value." *See id.* ¶ 13.

Under FHFA's supervision—and, on information and belief, at the insistence and direction of Treasury—the Companies were forced to dramatically write down the value of their assets and to incur substantial non-cash accounting losses in the form of loan loss provisions and write-offs of deferred tax assets.[1] Tens of billions of dollars of these accounting adjustments were based on

[1] Loan loss reserves reduce reported net worth to reflect anticipated future losses. *Id.* ¶ 83. Deferred tax assets are used to reduce taxable income on future earnings. The book value of a tax asset depends on the likelihood that the corporation will earn sufficient income to use the tax asset. *Id.* ¶ 82.

FHFA's wildly pessimistic assumptions about potential future losses and were wholly unwarranted. Nonetheless, by June 2012, the Agencies had forced Fannie and Freddie to draw $161 billion from Treasury to make up for the balance-sheet deficits caused by these 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 forced to draw $26 billion more to pay dividends to Treasury. Because (i) the Companies were forced to draw funds from Treasury that were not needed to continue operations and (ii) the PSPAs did not permit the Companies to redeem the Government Stock or pay down the liquidation preference, the dividends owed to Treasury were artificially—and permanently—inflated with each additional draw. *See id*. ¶¶ 14, 72, 81–85.

As a result of these transactions, Treasury's liquidation preference swelled to $189 billion. But based on the Companies' performance in the second quarter of 2012, it was apparent that the Companies' private shares still had value. The Companies were thriving, paying 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, the Agencies knew the Companies would enjoy stable profitability for the foreseeable future. For example, minutes of a July 2012 Fannie management meeting indicating that the Company was entering a period of "golden years" of earnings were circulated broadly within FHFA, including to Acting Director Edward DeMarco, and projections attached to those minutes showed that Fannie expected its cumulative dividend payments to Treasury to exceed its total draws under the PSPAs by 2020 and that over $115 billion of Treasury's commitment would remain available after 2022. Similar projections were shared with Treasury. *See id*. ¶¶ 23, 88.

The Agencies also knew that the Companies would soon reverse many of the non-cash accounting losses previously imposed upon them. Indeed, at an August 9, 2012 meeting, just eight days before the Net Worth Sweep, Fannie's Chief Financial Officer told senior Treasury officials 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. *See id.* ¶¶ 21, 99. This $50 billion reversal was not included in the projections from the month before. Treasury was keenly interested in the deferred tax assets; indeed, it had discussed them with its financial consultant as early as May 2012, and a key item on Treasury's agenda for the August 9 meeting was how quickly Fannie forecasted releasing its reserves. *See id.* ¶¶ 21, 98.

By August 2012, the Agencies thus 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.* ¶¶ 86–101. Treasury, moreover, had secretly resolved "to ensure existing common equity holders will not have access to any positive earnings from the [Companies] in the future." *Id.* ¶¶ 16, 140. Therefore, on August 17, 2012, just days after the Companies announced their robust second quarter earnings, the Agencies imposed the Net Worth Sweep to ensure, as Treasury put it, that "every dollar of earnings that Fannie Mae and Freddie Mac generate will benefit taxpayers." The Agencies thus nationalized the Companies and expropriated not just their future earnings but also their retained capital, thereby depriving the private shareholders of all of their economic rights. *See id.* ¶¶ 17, 110.

The government has claimed, both publicly and before the courts, that the Net Worth Sweep was necessary to prevent the Companies from falling into a purported "death spiral" in which the Companies' increasing dividend obligations to Treasury would consume Treasury's remaining funding commitment. *See id.* ¶ 19. But, as explained above, at all times prior to the Net Worth Sweep, the PSPAs permitted the Companies to pay dividends in kind—they were never required to pay cash dividends, let alone to do so by drawing on the funding commitment.

More important, the government's "death spiral" narrative cannot be squared with internal government documents and testimony obtained through discovery in other litigation. As summarized above, this evidence reveals that the Net Worth Sweep was imposed *after* the Companies had returned to stable profitability, and *just days after* Treasury learned that they were on the verge of reporting tens of billions of dollars in profits that would far exceed their existing dividend obligations. *See id*. Indeed, the *same day* that Fannie's Chief Financial Officer 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 impose the Net Worth Sweep. *Id.* ¶ 104.

The available evidence thus makes clear that the Net Worth Sweep was adopted not out of concern that the Companies would earn too little, but rather out of concern that the Companies would earn *too much* and complicate the Administration's plans to hold them in perpetual conservatorship and to prevent their private shareholders from recouping their investment principal, let alone any return on that investment. Indeed, an internal Treasury document finalized the day before the sweep was announced specifically identified the Companies' "improving operating performance" and the "potential for near-term earnings to *exceed* the 10% dividend" as support for the Net Worth Sweep. *Id*. ¶¶ 24, 104. And after the Net Worth Sweep was finalized, a senior White House advisor involved in that process wrote to a Treasury official that "we've closed off [the] possibility that [Fannie and Freddie] ever[ ] go (pretend) private again." *Id.* ¶ 107 (alterations in original). Edward DeMarco, FHFA's then-Acting Director, likewise testified that he had no intention of allowing the Companies to emerge from conservatorship under what he viewed as flawed charters. *Id.* ¶ 138.

As the Agencies expected, *see id*. ¶¶ 87–101, the Net Worth Sweep has resulted in massive and unprecedented payments to the government. From the fourth quarter of 2012, the first fiscal quarter subject to the Net Worth Sweep, through the second quarter of 2016, the most recently reported fiscal quarter, the Companies generated $194 billion in comprehensive income. But rather than using these profits to prudently build capital reserves and prepare to exit conservatorship, the Companies have instead been forced to pay these profits as "dividends" to Treasury—approximately $124 billion more than Treasury would have received under the original PSPAs. *See* Compl. ¶ 127; FHFA, TABLE 2: DIVIDENDS ON ENTERPRISE DRAWS FROM TREASURY, http://goo.gl/vHl8V0. Altogether, Treasury will soon have recouped nearly $64 billion *more* than it disbursed to the Companies. Yet Treasury insists that the outstanding liquidation preference remains firmly fixed at $189 billion and that it has the right to all of the Companies' net worth *in perpetuity*.

ARGUMENT

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

Plaintiffs' claims may proceed despite 12 U.S.C. § 4617(f). 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), and should conclude that such review is unavailable only "if presented with clear and convincing evidence" that this was Congress's intent. *Reno v. Catholic Soc. Servs. Inc.*, 509 U.S. 43, 63–64 (1993) (quotation marks omitted). 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 Plaintiffs' allegations that FHFA grossly exceeded and contravened those "powers" and "functions." 12 U.S.C. § 4617(f) (emphasis added). 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.

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

Section 4617(f) "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). Courts uniformly agree on this point.[2] Indeed, even the district court opinion in *Perry Capital v. Lew*, upon which Defendants repeatedly rely, acknowledged that Section 4617(f) does not bar 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 208, 220 (D.D.C. 2014) (quoting *National Tr. for Historic Pres. in United States v. FDIC*, 21 F.3d 469, 472 (D.C. Cir. 1994)).

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. *Sharpe* upheld claims for equitable relief and held Section 1821(j) inapplicable where "the FDIC as receiver" had "assert[ed] authority beyond that granted to it as a receiver" by breaching a contract without statutory authorization. *Id*. at 1155; *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 Section 1821(j)'s predecessor, 12 U.S.C. § 1464(d)(6)(C). *See* H.R. REP. NO. 101-54, at 130 (1989), *reprinted in* 1989 U.S.C.C.A.N. 86. In *Coit Independence Joint Venture v. Federal Savings & Loan Insurance*

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[2] *See 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).

Corp., the Court held that this provision posed no obstacle to judicial review where a federal receiver purported to adjudicate a claim the statute did not authorize it to adjudicate. 489 U.S. 561, 572–79 (1989).

"FHFA," thus, "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; *Chemical Futures & Options, Inc. v. RTC*, 832 F. Supp. 1188, 1192–93 (N.D. Ill. 1993). 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.[3]

Citing *Gross v. Bell Savings Bank PaSA*, Defendants argue that Section 4617(f) permits relief only when FHFA's actions as Conservator fall " 'clearly outside' its statutory powers and functions." Joint Mem. of Defs. in Supp. of Mot. to Dismiss at 16 (July 13, 2016), Doc. 39-1 ("Joint Br.") (quoting 974 F.2d 403, 407 (3d Cir. 1992)). *Gross*, however, simply affirmed that "federal courts" *do* "have the ability to restrain" a federal conservator or receiver "acting clearly outside its statutory powers" in the course of explaining that "where the [conservator or receiver] performs functions assigned it under the statute, injunctive relief will be denied even where the [conservator or receiver] 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

[3] That Section 1821(j) "effect[s] a sweeping ouster of courts' power to grant equitable remedies" is simply a recognition that it applies not only to injunctions but also "reaches declaratory relief and other equitable relief." *Courtney v. Halleran*, 485 F.3d 942, 948 (7th Cir. 2007) (alteration in original) (quoting *Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995)); *FDIC v. OneBeacon Midwest Ins. Co*., 883 F. Supp. 2d 754, 761 (N.D. Ill. 2012) (Section 1821(j) "bar[red] claims for injunctive, declaratory, and equitable relief" where there was "no allegation . . . that the FDIC has acted *ultra vires*"). That the set of *remedies* that Section 1821(j) forecloses is "sweeping" does not imply that a conservator's *statutory powers* are likewise "sweeping," let alone that a conservator may violate or exceed those powers with impunity.

Section 4617(f) bars relief for claims based solely on the conservator's violations of *other* laws or disagreements with a conservator's *lawful, statutorily authorized* choices, it cannot reasonably be read 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, the conduct challenged here either violated HERA 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 any distinction 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 FHFA may not be enjoined from violating the very statute from which it derives its authority cannot be reconciled with this decision. Thus, before the Court can determine whether Section 4617(f) even applies to Plaintiffs' claims, it must first determine whether the actions they challenge were within FHFA's authority as conservator. *See, e.g.*, *County of Sonoma*, 710 F.3d at 994. Any other reading of Section 4617(f) would render meaningless HERA's careful enumeration of FHFA's powers as conservator. *See* 12 U.S.C. § 4617(b).[4]

2. The Challenged Actions Exceeded FHFA's Statutory Authority.

Even if courts could intervene only when FHFA acts "clearly outside" its statutory powers, relief is clearly warranted here. The gravamen of Plaintiffs' Complaint is that Defendants placed the Companies in a financial coma and prevented them from rebuilding their capital reserves in

[4] 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* Joint Br. 11, 16 n.10. These 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 cannot be reconciled with *City of Arlington* or with FIRREA's (and HERA's) careful enumeration of the powers of conservators and receivers.

order to harvest all of their value for themselves. Whatever the precise scope of FHFA's statutory powers as conservator—and, contrary to Defendants' stunning assertion, the specific powers enumerated in HERA are far from "plenary," Joint Br. 13—looting the Companies and expropriating private shareholders' investments is "clearly outside" of it.

a. FHFA Exceeded Its Statutory Authority by Subjecting Itself to Treasury's Direction and Control.

To ensure that FHFA would exercise its *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).[5] FHFA violated that provision by agreeing to the Net Worth Sweep at Treasury's direction and by agreeing to terms in the PSPAs surrendering to Treasury extraordinary control over FHFA's operation of the Companies in conservatorship—including the right to veto such core decisions as whether to issue new securities, whether to incur debt above a specified level, and whether to make certain fundamental changes to the Companies' business. The PSPAs even purport to prohibit FHFA from terminating the conservatorship that FHFA itself administers without Treasury's consent (except to place the Companies in receivership). Compl. ¶¶ 12, 74–75,

[5] Plaintiffs are well within the "zone of interests" protected by Section 4617(a)(7). This provision 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 *all* of Fannie's and Freddie's shareholders. *See, e.g.*, 12 U.S.C. § 1831f(d)(3); *id.* § 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); *Gibraltar 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) (citation omitted) (quoting 5 U.S.C. § 702).

133–34, 137, 167, 177.

Although Defendants concede that Section 4617(a)(7) bars FHFA "from being *involuntarily* subjected to legally binding directives of other federal agencies," they seek to defend the Net Worth Sweep and challenged PSPA provisions on the ground that Section 4617(a)(7) permits FHFA to "voluntarily" negotiate and execute agreements with other agencies. Joint Br. 18. Section 4617(a)(7)'s mandatory language, however cannot plausibly be read to permit FHFA to cede—even voluntarily—"direction or supervision" of its actions as Conservator to another agency. More important still, Defendants flatly and impermissibly controvert Plaintiffs' factual allegations in seeking to characterize the Net Worth Sweep as an agreement that FHFA "*voluntarily*" negotiated and executed after determining that it was in the "best interests of the [Companies] or the [a]gency." Joint Br. 18–19; *see also* Dep't of Treasury & Treasury Sec'y Jacob J. Lew's Mem. in Supp. of Mot. to Dismiss at 10–11 (July 13, 2016), Doc. 40 ("Treas. Br.").[6]

The Complaint alleges that "FHFA agreed to the Net Worth Sweep only at the insistence and under the direction and supervision of Treasury," "subject[ed] itself to Treasury's will," and did not obtain for the Companies "any meaningful consideration." Compl. ¶¶ 120, 133, 163. Specific facts support these allegations. Treasury has exerted significant influence over FHFA throughout the conservatorships, *id.* ¶¶ 134–35, and a White House official closely involved in the development of the Net Worth Sweep explicitly acknowledged that the Net Worth Sweep was imposed through "a Treasury-driven process," *id.* ¶ 133.[7] Furthermore, the Net Worth Sweep

[6] *Gail C. Sweeney Estate Marital Trust*, which Defendants cite in support of this argument, did not involve a challenge to the PSPA terms at issue here or to the Net Worth Sweep, and it did not consider the facts and circumstances surrounding the Net Worth Sweep.

[7] Various allegations corroborate this concession 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 the Companies' private shareholders from any

transfers to Treasury, in perpetuity, every penny that the Companies earn while leaving the principal of the Companies' obligation to Treasury untouched. *Id.* ¶ 155. It was entered into almost immediately after the Companies announced their return to substantial profitability, *id.* ¶¶ 19, 102–03, was adopted with specific knowledge that it would result in massive profits for Treasury, *id.* ¶¶ 89–101, and provides the Companies with no relief from their obligation to pay cash dividends that they did not already enjoy, *id.* ¶ 113.[8] FHFA would no doubt have understood all this had it exercised its independent judgment, for it was clear that recognition of deferred tax assets, release of loan loss reserves, and monetary recoveries from legal settlements with big banks would soon make enormous contributions to the Companies' net worth. *Id.* ¶¶ 89–101. And that is to say nothing of the real and substantial profits the Companies had resumed earning from their core business of guaranteeing and securitizing mortgages as the housing market recovered. *Id.* ¶¶ 86–88. Only a conservator that has surrendered its independent judgment could agree to forfeit so much for so little under such circumstances.[9]

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access to the Companies' positive earnings, 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," and the White House hailed the Net Worth Sweep as achieving the Administration's policy objectives. Compl. ¶¶ 105–08, 110 (quotation marks omitted).

[8] The Net Worth Sweep did waive any periodic commitment fee under the PSPAs. But this relief is no more adequate consideration for the Companies giving up their entire net worth than is relief from property taxes adequate consideration for giving up one's home. In all events, Treasury had consistently waived the periodic commitment fee before the Net Worth Sweep was imposed *Id*. ¶ 72. Further, the purpose of the fee was to compensate Treasury for its ongoing funding commitment, and Treasury could set the amount of the fee only by agreement with the Companies and at a market rate. 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 any additional fee would have been inappropriate. Even if a market-rate fee had been agreed upon, moreover, such a fee would have been negligible. *See id*. ¶¶ 121–22. Finally, the Companies had sufficient market power to pass any commitment fee through to their customers—as the Companies do for other operating and financing costs—without affecting their profitability or value. *Id.* ¶ 122.

[9] Defendants rely on *Perry Capital*, which rejected the argument that FHFA had acted at

b. FHFA Violated Its Core Statutory Mandates As Conservator.

i. As Conservator, FHFA Is Obligated to Preserve and Conserve Assets with the Aim of Rehabilitation to Soundness and Solvency.

When Congress enacts a statute using "a well-established term," courts presume that it "intended the term to be construed in accordance with pre-existing . . . interpretations." *Bragdon v. Abbott*, 524 U.S. 624, 631 (1998). "Conservatorship" is one such "well-established term," 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.

Courts, and regulators, including FHFA itself, have emphasized that a conservator's purpose is to revive a troubled entity. The Seventh Circuit, for example, has explained that "a conservator . . . tries to return" its ward "to solvency, rather than liquidating it." *DeKalb Cty. v. FHFA*, 741 F.3d 795, 798 (7th Cir. 2013), and other courts uniformly agree.[10] The FDIC likewise

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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 subsequent discovery in the Court of Federal Claims.

[10] *See, e.g.*, *Delaware Cty. v. FHFA*, 747 F.3d 215, 219 (3d Cir. 2014); *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."); *RTC v. United Trust Fund, Inc.*, 57 F.3d 1025, 1033 (11th

understands that "[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." FDIC, MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 216 (1998), *available for download at* https://goo.gl/qjIjTh. Commentators agree. *E.g.*, 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").

FHFA repeatedly 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. Compl. ¶ 49. Contemporaneous internal FHFA documents reflect the same understanding of FHFA's role as conservator, *see id*. ¶ 51, and FHFA repeatedly reiterated this understanding.[11] An internal Treasury document from 2011 likewise recognized that "the path laid out under HERA" was for Fannie and Freddie to "becom[e]

Cir. 1995) ("The conservator's mission is to conserve assets which often involves continuing an ongoing business," while "[t]he receiver's mission is to shut a business down and sell off its assets."); *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); *RTC v. CedarMinn Bldg. Ltd. P'ship*, 956 F.2d 1446, 1453–54 (8th Cir. 1992) ("The conservator's mission is to conduct an institution as an ongoing business" while restoring it "to a solvent position.").

[11] *See, e.g.*, Compl. ¶¶ 49, 51; 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. ¶ 138 ("[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)); 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.").

adequately capitalized" and "exit conservatorship as private companies." Compl. ¶ 140.

This defining purpose—rehabilitation 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." 956 F.2d at 1454; *see also MBIA Ins. Corp. v. FDIC*, 816 F. Supp. 2d 81, 97 (D.D.C. 2011). 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. *McAllister v. RTC*, 201 F.3d 570, 579 (5th Cir. 2000) (emphasis added). Thus, when exercising its powers as conservator, FHFA must 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 contrasts with that of a receiver, "whose interest, by definition, is shutting the business down." *CedarMinn*, 956 F.2d at 1454. Receivers thus "liquidat[e] [an] institution and wind[ ] up its affairs." *See* CARPENTER & MURPHY, *supra*, at 6. During the liquidation process, a receiver gathers and sells the financial institution's assets and distributes the proceeds in accordance with the statutory priority scheme. *See Freeman*, 56 F.3d at 1401.

The fundamental role of a conservator 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 "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.

ii. The Net Worth Sweep Violated FHFA's Mandates As Conservator.

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's regulations rightly declare "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 retain and 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. ¶ 139. The Net Worth Sweep is thus 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 depletion of the Companies' capital also violates FHFA's obligation to "put the [Companies] in a sound and solvent condition." *Id.* § 4617(b)(2)(D)(i). It is well understood that capital reserves are a critical aspect of soundness and solvency. Such reserves serve 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 are deemed unsound. The Net Worth Sweep prohibits 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. The Companies have thus described the Net Worth Sweep as a "risk factor," *see* FANNIE MAE, FANNIE MAE 2012 ANNUAL REPORT at 46–47 (Form 10-K) (Apr. 2, 2013), http://goo.gl/rGVpQq, and the Director of FHFA has acknowledged the Companies' resulting "lack of capital" as their "most serious risk," Melvin L. Watt, Dir., FHFA, Prepared Remarks at the Bipartisan Policy Center (Feb. 18, 2016), http://goo.gl/A8QSy8, since they have "no ability to weather quarterly losses," Compl. ¶ 116. It is difficult to imagine an action more calculated to undermine the "soundness and solvency" of a financial institution than the Net Worth Sweep.

Any defense of the Net Worth Sweep as having *improved* the Companies' capital position by preserving Treasury's funding commitment would impermissibly contradict the factual allegations in the Complaint and blink reality. But for the Net Worth Sweep, the Companies would have approximately $124 billion in capital that they have instead been forced to turn over to Treasury. *See* FHFA, TABLE 2: DIVIDENDS ON ENTERPRISE DRAWS FROM TREASURY, http://goo.gl/vHl8V0. Without this capital, the Companies are *more*, not less, likely to need to draw on Treasury's commitment in the future. In all events, 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, and doing so would not have reduced the funding commitment. *See*

Compl. ¶¶ 65–69. The Companies were likewise authorized to pay in kind any commitment fee that Treasury might have decided to charge. *See id.* ¶ 72.

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 (or use them to pay off excessive or expensive debt, *see infra* Part I.A.2.b.iii). 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." *Tennessee Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1208 n.2 (D.C. Cir. 1991). FHFA has clearly and impermissibly abandoned its conservatorship duty to "rehabilitate" the Companies and has instead converted them into a permanent ATM for the government. *See* Compl. ¶ 130; 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 fluctuating market prices, increases in the Companies' net worth do not necessarily reflect increased cash on hand. Recognizing deferred tax assets, for example, is an accounting decision that does not generate any cash. A cash dividend based solely on net worth may thus require financing 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. ¶¶ 147–49. Ordering the Companies to pay debt-financed dividends when they are in conservatorship is financially reckless and at war with FHFA's statutory mandates 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).

Fourth, Treasury has openly avowed that, far from rehabilitation, the Net Worth Sweep is specifically designed to "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. ¶ 139. 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.* ¶ 142. 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); *see also* Compl. ¶ 138 (quoting Mr. Ugoletti's testimony in other litigation concerning the Net Worth Sweep that FHFA's objective "was not for [the Companies] to emerge from conservatorship"). And a key White House official hailed the Net Worth Sweep as "clos[ing] off [the] possibility that [the Companies] ever[ ] go (pretend) private again." *Id.* ¶ 107.

iii. The Terms and Implementation of the PSPAs Violated FHFA's Mandates As Conservator.

The Net Worth Sweep also reaffirmed and aggravated the consequences of other terms of the PSPAs and practices of FHFA as conservator that exceeded its authority and violated its charge to rehabilitate the Companies, preserve and conserve their assets, and restore them to soundness and solvency. For example, although the Companies have paid Treasury nearly $200 billion under the Net Worth Sweep—more than the entire amount drawn from Treasury's funding commitment and $124 billion more than they would have paid under the prior dividend arrangement—not one penny of that amount has been credited toward reducing the principle of Treasury's stock. Indeed, the terms of the PSPAs continue to prohibit the Companies from redeeming Treasury's stock or repaying amounts drawn from the funding commitment. *See id.* ¶ 155. This prohibition cannot be reconciled with FHFA's mandate to rehabilitate the Companies to soundness, solvency, and normal business operations—after all, during good times, normal companies use their profits not only to build and maintain capital against possible future downturns, but also to reduce unnecessary operating costs by repaying or redeeming costly and excessive obligations acquired to weather financial distress. Normal companies also have the ability to refinance their capital during good times so as to lower their cost of capital, but Fannie and Freddie are forbidden from doing so. These prohibitions are especially indefensible given that the Companies' draws resulted primarily from overly pessimistic accounting decisions made during the conservatorship. Those decisions resulted in artificial and unnecessary increases of the liquidation preference, but under the terms of the PSPAs, the reversal of those accounting decisions cannot result in a corresponding decrease of the liquidation preference. *See id*. ¶ 166.

FHFA's practice of requiring the Companies to pay cash dividends to Treasury, even when such payments required them to draw upon the funding commitment or borrow money from other sources likewise violates FHFA's statutory mandates as conservator. FHFA's own regulations emphasize that "capital distributions"—such as dividends—that "deplete the entity's conservatorship assets" are "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." 76 Fed. Reg. at 35,727. Not only did FHFA's practice force the Companies to pay vast sums of cash to Treasury, it also compelled them to make interest payments on subordinated debt that they could have otherwise deferred. *See* Compl. ¶ 149. FHFA's practice demonstrates that it is operating the Companies with the aim of maximizing dividend payments to Treasury and with no concern for rehabilitating the Companies, preserving and conserving their assets, or restoring them to soundness and solvency. *See id*. ¶¶ 11, 149, 165.

*   *   *

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." Joint Br. 16. 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 simply acted with a bad motive are wholly inapposite here. *See* Joint Br. 10–11, 16–18.

c. Defendants' Justifications for the Net Worth Sweep Lack Merit.

Defendants do not even attempt to justify the PSPAs' prohibition on repaying draws from Treasury or FHFA's practice of requiring the Companies to pay cash dividends to Treasury even when doing so required them to draw on the funding commitment or borrow money from other sources. And while they do attempt to justify the Net Worth Sweep as an exercise of FHFA's statutory powers as conservator under HERA, their arguments are unavailing.

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* Joint Br. 19. But the argument that a conservator can take steps to wind down its charge is simply "untenable." *CedarMinn*, 956 F.2d at 1454.

To be sure, 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]." But this provision cannot plausibly be read to suggest that all of the powers it articulates belong to both 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). HERA, caselaw, commentators, and dictionaries all use "liquidation" and "wind up" synonymously.[12] Liquidation is exclusively the province of a receiver, as both HERA's text and FHFA's regulations provide. *See* 12 U.S.C. § 4617(b)(2)(E); 12 C.F.R. § 1237.3(b). And given that liquidating the Companies is beyond FHFA's powers as conservator, it follows that "winding [them] up" also exceeds these powers.

Further, 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 have them all as well. 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)). Section 4617(a)(2) is thus best read as a general, introductory provision that summarizes the authorities collectively granted to FHFA as conservator and receiver, while the following provisions of the statute specify which authorities FHFA may exercise in a particular capacity. HERA's structure further supports 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").

HERA also lays out procedures for resolving claims against the Companies during liquidation that apply only during receivership. *See* 12 U.S.C. § 4617(b)(3)–(9). These procedures

[12] For example, HERA imposes specific requirements on FHFA when it initiates "the *liquidation* or *winding up* of the [Companies'] affairs." 12 U.S.C. § 4617(b)(3)(B) (emphasis added). Caselaw holds 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 define "liquidation" and "winding up" virtually synonymously. *Compare* 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."), *with* OXFORD ENGLISH DICTIONARY ONLINE (Dec. 2013) (liquidation, n.: "The action or process of winding up the affairs of a company").

ensure that receivers "fairly adjudicat[e] claims against failed financial institutions," *Whatley v. RTC*, 32 F.3d 905, 909–10 (5th Cir. 1994), and may be constitutionally required to afford due process. *See Freeman*, 56 F.3d at 1403 n.2; *Greater Slidell Auto Auction, Inc. v. American Bank & Trust Co. of Baton Rouge*, 32 F.3d 939, 942 (5th Cir. 1994); *Elmco*, 94 F.3d at 922. Section 4617(a)(2) does not permit FHFA to evade these procedures by winding down the Companies as conservator.[13]

ii. Although FHFA is thus clearly prohibited from winding up the Companies, Defendants argue that its authority under HERA to " 'transfer or sell any asset' of the [Companies] 'without any approval, assignment, or consent' " permits it to accomplish the same end. Joint Br. 14 (quoting 12 U.S.C. § 4617(b)(2)(G)). This argument fails.

As an initial matter, 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 FHFA to transfer private assets to the government in exchange for virtually nothing, as happened 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

[13] Defendants also claim that they are not winding up Fannie and Freddie through the Net Worth Sweep. *See* Joint Br. 19–20. 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. ¶ 139 (quoting Treasury Net Worth Sweep Press Release); *see also* Compl. ¶ 142 (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")).

appointed receiver, of course, and as conservator, FHFA is charged by HERA with rehabilitating the Companies, preserving and conserving their assets, and restoring them to soundness and solvency, as explained at length above. *See supra* at Part I.A.2.b.i. As conservator, FHFA lacks the authority to "transfer assets" to *prevent*, rather than to *promote* these statutory mandates.

Third, Defendants' contention that the law "does not provide any limitation" on its authority to transfer the Companies' assets, Joint Br. 15 (quotation marks omitted), would allow FHFA to completely ignore HERA's specific order of priorities for distributing assets during liquidation, *see* 12 U.S.C. § 4617(c). For example, during liquidation FHFA 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*, 489 U.S. at 573–74; *see also King v. Burwell*, 135 S. Ct. at 2495.

Defendants invoke a handful of cases in which courts ruled that FIRREA barred plaintiffs from suing receivers to enjoin specific transfers of assets. Joint Br. 15 & n.9 (citing *Gosnell v. FDIC*, 1991 WL 533637, at *5–*6 (W.D.N.Y. Feb. 4, 1991)); *Courtney*, 485 F.3d at 949; *Waterview Mgmt. Co. v. FDIC*, 105 F.3d 696, 700–02 (D.C. Cir. 1997); *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 these cases all 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 Defendants' 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 its statutory mandates as conservator. 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").[14]

iii. Defendants further claim that the Net Worth Sweep was within FHFA's 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." Joint Br. 13 (second alteration in original) (emphasis omitted) (quoting 12 U.S.C. §§ 4617(b)(2)(B)(i), 4617(b)(2)(B)(iv), 4617(b)(2)(J)(ii)).[15] But Defendants offer no support for the stunning proposition that these specific statutory authorities give FHFA "plenary power" over the Companies, or that it can disregard its conservatorship obligations if it, in its sole discretion, concludes that an action may benefit the Companies, or even

[14] 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.

[15] Defendants invoke in passing what they describe as FHFA's authority to "enter into contracts on behalf of the enterprises." Joint Br. 13, 18 (citing 12 U.S.C. § 4617(b)(2)(B)(v)). But apart from the single word "contract," Defendants' 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). This provision plainly 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.

itself. That is not the law, and "FHFA cannot evade judicial scrutiny by merely labeling its actions with a conservator stamp." *Leon County*, 700 F.3d at 1278.

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); *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; *Massachusetts v. FHFA*, 54 F. Supp. 3d at 100. Far from preserving and conserving the Companies' assets, the Net Worth Sweep does the precise opposite, transferring their entire 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, this incidental power is limited to actions otherwise authorized by HERA and, as demonstrated above, the Net Worth Sweep is not.[16]

[16] Defendants suggest that review 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* Joint Br. 20 n.13. As demonstrated above, 12 U.S.C. § 4617(f) does not bar review of FHFA's actions here. 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). This case does not present a "rare instance" where "there is no law to apply." As demonstrated above, *see supra* Part I.A.2.b.i, HERA, regulations, precedent, and historical practice provide clear limits on a conservator's authority, and the statutory powers invoked by FHFA are tied, both expressly and implicitly, to these limits.

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.

Although 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, their reliance on that decision is unavailing.

First, the Complaint in this case includes allegations different than those presented in *Perry Capital*, including allegations supported by evidence produced in subsequent discovery in the Court of Federal Claims. For example, the Complaint here alleges that when the Net Worth Sweep was announced, key decision-makers at Treasury and FHFA had received specific information that the Companies would soon report tens of billions of dollars in profits. Compl. ¶¶ 88–101. Furthermore, specific facts alleged in the Complaint and derived from deposition testimony in the Court of Federal Claims directly contradict an earlier declaration by the same witness submitted by FHFA in defense of the Net Worth Sweep in *Perry Capital*.[17] 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*.

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*, 70 F. Supp. 3d at 226. While the court cited language from the district court's decision in *Leon County v. FHFA*, 816 F. Supp. 2d

[17] *Compare, e.g.*, Compl. ¶ 100 ("[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 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.* (when asked during his deposition whether he knew "what Treasury thought about" the deferred tax assets issue, Mr. Ugoletti responded "I do not.").

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. A conservator is defined by its purpose. HERA states that FHFA may "be appointed conservator or receiver for the *purpose* of reorganizing, rehabilitating, or winding up the affairs of a regulated entity." 12 U.S.C. § 4617(a)(2) (emphasis added). Thus, the statute itself requires an examination of the purpose of FHFA's conduct. And 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." *Id*. § 4617(b)(2)(D) (emphases added). To determine whether FHFA's actions are "necessary" or "appropriate" to achieve its statutorily prescribed rehabilitative goals generally requires analysis of the purpose of the agency's actions. 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)–(C), (G)–(J). When exercising these common powers, conservators distinguish themselves from receivers by their "distinct missions": "[t]he conservator's mission is to conserve assets," while "[t]he receiver's mission is to shut a business down and sell off its assets." *United Trust Fund*, 57 F.3d at 1033. 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. ¶ 139. That is clearly inconsistent with FHFA's mandate 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 mandates 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" by stripping all the capital out of the Companies, *id.* § 4617(b)(2)(D)(i), and guaranteed that the Companies could never resume normal business operations since they are unable to rebuild their capital positions. 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 are not in "*de facto* liquidation" and "FHFA has acted within its broad statutory authority as a conservator." *Id*. But FHFA's mandate as conservator is not merely to operate the Companies and see that they generate profits. Rather, "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" is to "*restor[e] th[e] regulated entity to a sound and solvent condition*." 76 Fed. Reg. at 35,727 (emphases added). Transferring all of the Companies' net worth, in perpetuity, to Treasury and leaving those Companies just one bad quarter away from insolvency cannot be reconciled with this mandate.[18]

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

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

Treasury argues that Section 4617(f) bars any challenge to any action Treasury might take with the agreement of FHFA as conservator. Treas. Br. 6–7. This is an audacious argument: if it were adopted, FHFA could effectively suspend any independent legal obligation on a third party by entering into a contract obliging the third party to violate it. Treasury's argument lacks merit.

As an initial matter, because Section 4617(f) does not bar suits against FHFA for violating HERA, it certainly does not bar Plaintiffs' claims against Treasury for violating the same statute. 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. FHFA's complicity in Treasury's violations of HERA does not preclude judicial review.

Furthermore, to conclude that Section 4617(f) prohibits Plaintiffs' claims against Treasury, 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). The text of Section 4617(f) provides nothing of the sort. The statute limits review of certain actions *only as to FHFA*—it did not even address, much less prohibit, claims against Treasury. Congress's "silence" cannot be construed "as a denial of authority . . . to

[18] 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*.

seek appropriate relief in the federal courts." *See Reno*, 509 U.S. at 56. And nothing in the structure or history of the statute even remotely suggests that Congress intended to allow Treasury to violate HERA simply by agreeing with FHFA to do so.

The cases invoked by Treasury cannot fill the gap. Treas. Br. 7. 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 belatedly to challenge FDIC's appointment as receiver by suing both FDIC in its corporate capacity and the state official who had appointed FDIC receiver. The court held that plaintiffs could not invalidate the finding, made by FDIC in its corporate capacity, that had triggered 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 [state official's] appointment of a receiver, because it would wholly prevent the FDIC from continuing as receiver." *Id*. at 168. Because the *Hindes* plaintiffs were effectively challenging the appointment of the receiver and the continuing validity of the receivership, the court had no occasion to address 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). None of these cases suggests that Section 4617(f) prohibits suit against any agency other than FHFA for violations of separate provisions of federal law, unrelated to FHFA's conduct of the conservatorship.

In contrast, the claims against Treasury here allege that Treasury's *own* conduct was unlawful. Other courts have concluded that FIRREA's analogous provision did not apply in similar circumstances, *see Stommel v. LNV Corp.*, 2014 WL 1340676, at *5 (D. Utah Apr. 4, 2014); *LNV Corp. v. Outsource Serv. Mgmt., LLC*, 2014 WL 834977, at *4 (D. Minn. Mar. 4, 2014), and this Court should likewise hold that Section 4617(f) is inapplicable.

More fundamentally, judicial relief compelling Treasury to abide by its own, independent legal obligations in its dealings with the Companies would not "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 functions. *See id.* at 574.

2. Treasury Exceeded Its Authority 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. 8 (citing 12 U.S.C. § 1719(g)(4)).[19] 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 acknowledged, its "ability to make further changes to the PSPAs . . . [was] constrained," Compl. ¶ 80. Treasury violated HERA by entering into the Net Worth Sweep in 2012, long after its authority to take such action had expired, and by effectively and repeatedly increasing its stock in

[19] 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*).

the Companies each time they drew upon the funding commitment after 2009.

Treasury offers no legal justification of post-2009 draws on its funding commitment, which increase its financial interest in the Companies and are the economic equivalent of purchases of stock. Compl. ¶ 10.[20] It does seek to defend the Net Worth Sweep, however, arguing that it was authorized as a mere "amendment" to securities Treasury already owned rather than a purchase of new securities. Treas. Br. 9. 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 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). By contrast, an arrangement that depends on "mutual consent" is no right at all. *United States v. Petty Motor Co.*, 327 U.S. 372, 380 n.9 (1946). 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."

In all events, the Net Worth Sweep constituted not an amendment to existing securities, but rather the "purchase" of new securities. 12 U.S.C. § 1719(g)(1)(A). The Oxford English Dictionary defines "purchase" as "[t]o acquire in exchange for payment in money or an equivalent;

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[20] Each draw increases Treasury's liquidation preference, and draws before the Net Worth Sweep accordingly increased dividends due to Treasury each quarter. Treasury Secretary Paulson has thus admitted that "when Treasury provides money to [the Companies] under the PSPAs, it is 'purchasing preferred shares.' " Compl. ¶ 64; *see also id.* (quoting Action Memo for Secretary Paulson (Sept. 7, 2008) ("Treasury's [PSPA] provides for the purchase of up to $100 billion in [Government Stock] from each [Company] . . . .")). While the draws did not formally increase the number of shares of Treasury's stock, the purpose and effect of this arrangement was to attempt to evade the sunset of Treasury's purchase authority. *Id.* ¶ 10. Indeed, Secretary Paulson has admitted that the PSPAs "turned [Treasury's] temporary authority to invest in Fannie and Freddie, which would expire at year-end 2009, into what effectively was a permanent guarantee on all their debt.' " *Id.* ¶ 64. That the continuing draws violate HERA is underscored by the Congressional Budget Office's conclusion that "only 'before the temporary authority expired' could Treasury 'provide funds to the [Companies].' " *Id.* ¶ 59.

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 Defendants describe 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 at the time." Joint Br. 13 (emphasis added). This 2012 transfer of obligations was clearly a "purchase"—albeit an exceedingly one-sided one—that Treasury no longer had authority to make.

Treasury argues that the Net Worth Sweep transaction was not a purchase because Treasury did not increase its funding commitment. Treas. Br. 9. But while an increased funding commitment certainly *suffices* to establish a purchase under Section 1719(g), it is not a *necessary* condition of such a purchase. 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 $124 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.

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 a 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). Holders of a fundamentally changed security are considered purchasers of new securities. *National Sec., Inc.*, 393 U.S. at 467.[21] The SEC has taken the same basic approach when interpreting Section 303 of the Trust Indenture Act, *see Allied-Carson Corp.*, SEC No-Action Letter, Fed. Sec. L. Rep. ¶ 80,434, 1976 WL 10614, at *2 (Mar. 12, 1976) (advising that an amendment that extends a bond's maturity and increases its interest rate qualifies as a "sale" of a

[21] Treasury contends that the fundamental change doctrine is "dubious," Treas. Br. 9, 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 amendment 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, 534 (7th Cir. 1998), and *Katz v. Gerardi*, 655 F.3d 1212, 1221 (10th Cir. 2011), merely suggest that *Rule 10b-5* does not protect minority shareholders from having their investments altered without their consent. Treasury's further arguments against application of the fundamental change doctrine here likewise rely on the limited reach of Rule 10b-5, not the scope of the fundamental change doctrine itself.

new security under that statute), as well as Section 2(3) of the Securities Act, *see* General Counsel, SEC Release No. 33-929, 1936 WL 28873 (July 29, 1936) (explaining that a sale of a security would occur if holders of common stock agreed to forgo a cash dividend in exchange for a dividend in the form of common stock). Courts have 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, 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.

The Net Worth Sweep's change to the Government Stock's fixed dividend gave Treasury a new and very different security. Under the "economic reality of the transaction," *Keys*, 709 F.2d at 417, the Net Worth Sweep generated $130 billion in dividends in 2013 alone, an increase of over $110 billion. 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.

The Net Worth Sweep also fundamentally transformed Treasury's preferred stock into what is effectively common stock. "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." Because the Net Worth Sweep in substance changed debt-like preferred stock into common stock, it constituted a purchase of new securities. *Cf.* 26 C.F.R. § 1.1001-3(b), (e)(5)(i).

b. Treasury independently violated HERA and the APA by disregarding its fiduciary duties to 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). As when it ignores other "important aspect[s] of [any] problem," an agency with 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. *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 "actual control of corporation conduct." *See Kahn*, 638 A.2d at 1113–14.

Treasury contends that it is not the Companies' dominant shareholder because it has not 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. 15 (quoting *In re Sea-Land Corp. S'holders Litig.*, 1987 WL11283, at *5 (Del. Ch. May 22, 1987)). But "the actual exercise" of control by a shareholder normally brings with it a corresponding fiduciary duty to minority shareholders, as even Treasury acknowledges. Treas. Br. 15 (emphasis omitted). The Complaint alleges that Treasury exercised actual control over FHFA (and thus the Companies) when the Net Worth Sweep was imposed, when draws were made after Treasury's purchasing authority expired, and when cash dividends to Treasury were financed by borrowing or by draws upon the funding commitment. *See* Compl. ¶¶ 12, 74, 134–37. The Court must accept these allegations as true, and they establish that Treasury acted as a dominant shareholder.

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. 14 (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 federal regulation instructs Fannie and Freddie to "elect to follow the corporate governance . . . practices and procedures set forth in . . . [*inter alia*,] (i) [t]he law of the jurisdiction in which the principal office of the regulated entity is located", or "(ii) [t]he Delaware General Corporation law," 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). Accordingly, Treasury's argument fails even on its own terms.

Treasury also asserts that the fiduciary obligations that normally govern dominant shareholders are inconsistent with its powers and obligations under HERA. Treas. Br. 14–15. But HERA nowhere authorizes or requires Treasury to take action that would violate its fiduciary duties to minority shareholders. To the contrary, in granting Treasury temporary authority to invest in the Companies, HERA expressly requires Treasury to consider 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).

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

Defendants 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"), ratifies the Net Worth Sweep because that statute "circumscribed Treasury's authority in one area [the right to sell Treasury's Stock] but left Treasury's entitlement to the variable dividend [the Net Worth Sweep] intact." Treas. Br. 13; *see also id*. at 11–13; Mem. in Supp. of Mot. to Dismiss by Defs. FHFA As Conservator for Fannie Mae & Freddie Mac & FHFA Dir. Melvin L. Watt at 6–9 (July 13, 2016), Doc. 41 ("FHFA Br."). Defendants err.

The Supreme Court has repeatedly emphasized the need for "extreme care" before crediting arguments that Congress acquiesced in 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); *National Org. for Women, Inc. v. Scheidler*, 267 F.3d 687, 699 (7th Cir. 2001), *rev'd on other grounds*, 537 U.S. 393 (2003). Arguments that an amendment to a federal statute implicitly ratified earlier agency action are especially weak here, where 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* Appropriations Act § 702(a)(2), 129 Stat. at 3024. Several Senators—including Senator Corker, the driving force behind this provision—expressly stated that the Act "does not prejudice" Plaintiffs' claims or "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).

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

Defendants argue that under HERA *only FHFA* has the authority to seek redress for the injury it and Treasury have together inflicted on the Companies' private shareholders. *See* Joint Br. 20–25. But 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. And even if Plaintiffs' claims were derivative, shareholders may bring derivative claims during conservatorship where, as here, the conservator has a manifest conflict of interest.

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

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

Under HERA, FHFA as conservator succeeds to "all rights, titles, powers, and privileges of . . . any stockholder . . . of the [Companies] *with respect to the [Companies] and the assets of* *the [Companies]*." 12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added). This language does not divest shareholders of their personal economic rights in Fannie and Freddie and, therefore, does nothing to prevent shareholders from bringing direct claims to protect those rights.

The statutory structure demonstrates that Congress intended only to transfer shareholder rights related to operational control of Fannie and Freddie. After providing that FHFA succeeds to shareholder rights with respect to a regulated entity and its assets, HERA provides that FHFA as conservator may "take over the assets of and operate the regulated entity with all the powers of the shareholders . . . ." 12 U.S.C. § 4617(b)(2)(B)(i). The succession provision transfers to FHFA the shareholder powers necessary for exercise of this operational control—for example, the right to elect a board of directors. It does not transfer to FHFA shareholders' economic interest in the Companies and other personal rights such as the right to buy and sell shares. Indeed, at the outset of conservatorship FHFA acknowledged that Fannie's and Freddie's stock would "continue[ ] to trade" and that "both the preferred and common shareholders have an economic interest in the companies." Compl. ¶ 53.[22]

In accordance with the statutory language and structure, "[n]o federal court has read" Section 4617(b)(2) or the analogous provision of FIRREA to transfer *direct*—as opposed to derivative—shareholder claims to the conservator or receiver. *See Levin v. Miller*, 763 F.3d 667, 672 (7th Cir. 2014). Indeed, the Seventh Circuit has squarely held that the materially identical provision of FIRREA on which Section 4617(b)(2) was modeled does *not* transfer such claims to the conservator or receiver. *See id.*; *see also Barnes v. Harris*, 783 F.3d 1185, 1193, 1195 (10th

[22] Adopting Defendants' litigating position would render other conservatorship decisions nonsensical. For example, FHFA has paid tens of billions of dollars in dividends to Treasury—a *shareholder* in the Companies. If Defendants' assertion were correct, Treasury's dividend rights would belong to FHFA, which should have retained the payments.

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).[23] Defendants attempt to sidestep *Levin* by observing that the FDIC in that case was not willing to defend the interpretation that they press here. Joint Br. 23.[24] But Judge Easterbrook's opinion for the majority makes clear that the *Levin* Court considered and rejected the alternative interpretation Defendants favor, and in any event the Seventh Circuit's pronouncements on the meaning of a federal statute are no less binding on this Court because the litigants in a prior case did not make every conceivable argument. *See Kamen v. Kemper Fin. Servs. Inc.*, 500 U.S. 90, 99 (1991) ("When an issue or claim is properly before the court, the court is not limited to the particular legal theories advanced by the parties, but rather retains the independent power to identify and apply the proper construction of governing law.").

In support of the position *Levin* rejected, Defendants principally rely on Section 4617(b)(2)'s use of the word "all." *See* Joint Br. 23. But "all" this provision transfers are 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). As the Seventh Circuit explained:

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[23] 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 v. Raines*, 674 F.3d 848, 850–51 (D.C. Cir. 2012); *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. Defendants also cite *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 subrogation issues disputed here.

[24] FHFA has likewise conceded that Section 4617(b)(2) does not bar direct claims in other litigation. *See* Mot. of FHFA to Substitute for Shareholder Derivative Pls. & Statement of P. & A. in Supp. Thereof at 1 n.1, *Kellmer v. Raines*, No. 07-1173 (D.D.C. Feb. 2, 2009), ECF No. 68 ("Plaintiff . . . has sued both derivatively and in his individual capacity. . . . FHFA seeks to substitute for plaintiff . . . only insofar as he asserts derivative 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.

Levin, 763 F.3d at 672 (first omission in original). Nor does our interpretation render this provision's reference to the "rights . . . of any stockholder" meaningless. *See* Joint Br. 23. To be sure, even without this language FHFA could pursue derivative claims because such claims ultimately belong to the Companies themselves. But this language clarifies that, absent a manifest conflict of interest, shareholders generally cannot pursue the same claims derivatively. *See In re Federal Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d at 796.

Further, constitutional avoidance strongly counsels against Defendants' interpretation, for it would violate due process to force Plaintiffs to accept FHFA, a government agency, as their representative in pursuing claims against itself and a closely related agency. In a long line of cases under the Due Process Clause, the Supreme Court has held that a litigant cannot be bound by the decisions of a conflicted class representative, *Richards v. Jefferson Cty.*, 517 U.S. 793, 801 (1996); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985), criminal defense lawyer, *Wood v. Georgia*, 450 U.S. 261, 271–72 (1981), or judge, *Ward v. Village of Monroeville*, 409 U.S. 57, 61–62 (1972); *Tumey v. Ohio*, 273 U.S. 510, 523 (1927). The same reasoning applies here. Moreover, as *Levin* recognized, Defendants' interpretation would "pose the question whether . . . stockholders would be entitled to compensation for a taking" when conservatorship or receivership is imposed. *Levin*, 763 F.3d at 672; *see also Waterview Mgmt. Co. v. FDIC*, 105 F.3d at 699. 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 Section 4617(b)(2) to transfer shareholders' personal economic rights, including the ability to bring direct causes of action to protect those rights, to the conservator.[25]

2. Plaintiffs' Claims Are Direct, Not Derivative.

Defendants argue that Plaintiffs' claims are derivative rather than direct, relying primarily on the test set forth in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). *See* Treas. Br. 17–21; Joint Br. 24. 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 APA. 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, requiring 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)). This showing "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 these requirements. Plaintiffs have suffered injury in fact

[25] Defendants urge the Court to follow an alternative reading of FIRREA's succession provision discussed in Judge Hamilton's concurring opinion. But it is the majority opinion that is controlling, and Judge Hamilton joined that opinion. *See Levin*, 763 F.3d at 673 (Hamilton, J., concurring) (underscoring "*our* adoption of the direct/derivative dichotomy") (emphasis added).

by having their entire economic interest in the Companies 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*, 770 F. Supp. 2d at 38. 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.

> 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 Securities, 768 F.2d at 357 (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*, 500 U.S. at 99 ("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.' ").

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

41. Delaware law is well-developed on this distinction. While Virginia law is not, Virginia courts likely 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).[26]

As a matter of Delaware law, the fact that Plaintiffs have a valid federal cause of action 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); *see also Citigroup, Inc. v. AHW Inv. P'ship*, ___ A.3d ___ , 2016 WL 2994902, at *9 & n.70 (Del. May 24, 2016). "Rather, *Tooley* and its progeny deal with the narrow issue of whether a claim for breach of fiduciary duty or otherwise to enforce the corporation's own rights must be asserted derivatively or directly." *Id.* at *1.[27] Thus, "[b]efore evaluating a claim under *Tooley*, a more important initial question has to be answered: does the plaintiff seek to bring a claim belonging to her personally or one belonging to the corporation itself?" *id*. (quotation marks omitted), for "when a plaintiff asserts a claim based on the plaintiff's own right . . . *Tooley* does not apply," *id*. at *10. In answering this question, Delaware courts look to the "laws that

[26] For this reason, Treasury's cases 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*, 763 F.3d at 670; *Pareto v. FDIC*, 139 F.3d 696, 698 (9th Cir. 1998); *Sax v. World Wide Press, Inc.*, 809 F.2d 610, 613 (9th Cir. 1987). And Treasury's cases from other jurisdictions purporting to apply Delaware law have considerably less persuasive force than the authoritative interpretations of Delaware law by the Delaware courts on which our arguments rely.

[27] Contrary to Treasury's assertions, Plaintiffs do not assert a fiduciary duty claim. Although Treasury's fiduciary duties are relevant to one (but only one) of Plaintiffs' claims, even that claim arises under the APA.

govern the claims," *id*. at *1; *see also id*. at *8, *10—here, federal law and the APA—under which Plaintiffs' claims are direct, as shown above.

Even if the *Tooley* test did apply to Plaintiffs' claims, those claims would still be 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. "[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 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. Although Treasury suggests otherwise, *see* Treas. Br. 19–20, 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); *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006); *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); *cf. Franchise Tax Bd. of Cal. v. Alcan Aluminium Ltd.*, 493 U.S. 331, 336 (1990) ("[A] shareholder with a direct, personal interest in a cause of action [may] bring suit even if the corporation's rights are also implicated."). 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 basic harm for which Plaintiffs seek redress—the unlawful transfer of the value of their stock to a dominant shareholder, in violation of HERA and the APA—was suffered by Plaintiffs directly.[28] While Plaintiffs believe that the Net Worth Sweep also injured the Companies, the injury Plaintiffs suffered "is not dependent on an injury to [either] corporation." *Tooley*, 845 A.2d at 1036. 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 the Companies were correct, *see, e.g.*, Joint Br. 13, Plaintiffs were still directly injured because the Net Worth Sweep destroyed the value of their investments through the transfer of the Companies' 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, destroying minority shareholders' economic interest in the Companies. It follows that Plaintiffs "can prevail without showing an injury" to the Companies, *Tooley*, 845 A.2d at 1036, and thus that Plaintiffs—not the Companies—suffered the specific injury complained of here.

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

[28] The same is true of the other practices and PSPA provisions Plaintiffs challenge: payment of cash dividends to Treasury, ceding of conservatorship authority to Treasury, prohibition of redeeming Treasury's investment, and provision for continued illegal purchases of stock by Treasury are all actions that benefit Treasury to the detriment of other shareholders.

voting power that belonged to the minority stockholders." *Gentile*, 906 A.2d at 102.[29] 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." *Id.* at 103. Indeed, in the recent AIG litigation, the Government "concede[d]" that the Delaware 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." *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 (following *Gatz* and *Gentile* in upholding shareholder's "right to maintain a direct claim"). Here, also, the crux of Plaintiffs' suit is not that there has been "an equal dilution of the economic value . . . of each of [the Companies'] outstanding shares." *Gentile*, 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 the Companies, who have suffered this harm.[30]

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[29] *See also, e.g.*, *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). "*Gentile*'s core insight applies . . . [w]henever the value of [a] transfer to [an] insider exceeds the share of the loss that the insider suffers through its stock ownership," for in such circumstances "the insider transfer expropriates value from the unaffiliated investors . . . , resulting in a distinct injury to the other investors and a corresponding benefit to the insider." *In re El Paso Pipeline Partners, LP Derivative Litig.*, 132 A.3d 67, 107 (Del. Ch. 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 *Gentile*); *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 . . .").

[30] Defendants' cases discussing claims based on waste of corporate assets, reduction in stock value, and other injuries that affect all shareholders equally and indirectly are inapposite. *See* Treas. Br. 17–19. The authorities Defendants cite expressly or implicitly recognize that a shareholder may assert a direct claim when he suffers "some individualized harm not suffered by

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. This is most obvious when a plaintiff seeks injunctive or declaratory relief rather than damages, for in such cases the only way to determine to whom the relief flows is to consider whose injury it remedies. Accordingly, "[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). For example, even before the Delaware Supreme Court's decision in *Gentile*, 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, they are entitled to press those claims

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all of the stockholders at large." *E.g.*, *Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008); *see also Bixler v. Foster*, 596 F.3d 751, 758 (10th Cir. 2010) (Minority shareholders failed to show "that the value of the majority shareholders' shares increased more than theirs."); *Rawoof v. Texor Petroleum Co.*, 521 F.3d 750, 757 (7th Cir. 2008) (A "shareholder [may] pursue an action originating from an injury to the corporation if he has suffered a direct, personal injury independent of the derivative injury common to all shareholders."); *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"). And as noted above, the argument that claims seeking redress for injury to the value of a shareholder's stock are necessarily derivative has been rejected by the Delaware Supreme Court. *See NAF Holdings*, 118 A.3d at 180.

directly. However the requested relief would affect the Companies, 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 holdings and the other classes of stock.

B. 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 the Companies' shareholders (or if Plaintiffs' direct claims were construed to be derivative), Plaintiffs could still bring their claims here. While Section 4617(b)(2)(A) generally bars derivative (but not direct) suits by shareholders during conservatorship or receivership, it does not bar derivative suits challenging the actions of the conservator or receiver itself or a closely related federal agency. In such cases, FHFA has a manifest conflict of interest that prevents it from adequately safeguarding shareholders' rights.

The two federal courts of appeals that have squarely addressed this question (both in the context of FIRREA) have both held that shareholders may maintain derivative suits in such circumstances. *See First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279, 1283 (Fed. Cir. 1999); *Delta Sav. Bank v. United States,* 265 F.3d 1017, 1024 (9th Cir. 2001). And 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.[31]

To be sure, the district court in *Perry Capital* rejected these precedents, but its reasoning 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. To the contrary, HERA states that FHFA succeeds to certain shareholder rights "as conservator." 12 U.S.C. § 4617(b)(2)(A). A conservator by its nature is a fiduciary, and a

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

fiduciary cannot be expected to properly fulfill its charge on an issue if it is inherently conflicted. Indeed, placing a claim such as a challenge to the Net Worth Sweep in the hands of FHFA would effectively extinguish that claim and, as explained above, raise serious constitutional issues. Furthermore, the statute does not explicitly address derivative suits by shareholders when the conservator is conflicted or even derivative suits by shareholders generally. Resolution of this question is thus a matter of interpretation, not merely reading the statute's text. And 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 this consistent judicial construction of that language. *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 would be to strain to read HERA to shield the conservator's actions from judicial review even in situations not covered by its provision directly addressing that subject.

2. Plaintiffs challenge the Net Worth Sweep—an "agreement" between FHFA, the conservator, and Treasury, a sister federal agency that has acquired a direct and controlling interest in the Companies and with which FHFA has obediently coordinated its actions as conservator—as well as other actions of FHFA and Treasury. FHFA plainly has a "manifest conflict of interest" within the meaning of *First Hartford*, 194 F.3d at 1295, and the other authorities recognizing this common-sense exception, and Plaintiffs, rather than FHFA, are thus the proper parties bring suit.

Defendants, relying on *Perry Capital*, nevertheless argue that there is no conflict of interest here. *See* Joint Br. 25. But Defendants fail even to address the indisputable conflict of interest FHFA would face in suing *itself*. And although Defendants argue otherwise, the notion that FHFA would not face a conflict of interest in suing Treasury for the unlawful conduct at issue here is risible. Indeed, the Complaint alleges that Treasury *compelled* FHFA to enter the Net Worth Sweep and exercises substantial control over FHFA as conservator, *see, e.g.*, Compl. ¶¶ 14, 25–26, 133, 136–37, 157; in light of these allegations (which must be taken as true), there is no reason to believe that Treasury would even allow FHFA to initiate a lawsuit challenging Treasury's actions. And even putting that issue aside, the Net Worth Sweep and other challenged conduct reflect, at a minimum, joint FHFA-Treasury initiatives, and FHFA cannot reasonably be thought free from bias in evaluating claims that Treasury acted illegally in agreeing to them.

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* suggested[32]—the bottom line should be the same: FHFA "should not have the final say on whether it is in [the Companies'] best interests to sue" Treasury for acting illegally 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*, Defendants suggest that a conflict-of-interest exception is less suited to the conservatorship context than to the receivership context. *See* Joint Br. 24–25. But the opposite is true: Unlike 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 claims process, *see supra* 25–26, there is an even greater need for a conflict-of-interest exception to protect the interests of shareholders.

III. Plaintiffs' Claims Are Not Precluded.

Treasury also argues that Plaintiffs' claims are precluded by the decision in *Perry Capital*, 70 F. Supp. 3d 208. *See* Treas. Br. 15–23. While *Perry Capital* did involve APA claims similar to

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[32] 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 conduct challenged here. *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 the Companies, 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 conduct challenged here, "even when it is in the best interest of [the Companies] to do so." *Delta Savings*, 265 F.3d at 1023.

those at issue here, Treasury does not dispute that Plaintiffs were not parties to that case. Treasury nevertheless argues that although the APA claims rejected in *Perry Capital* were indisputably asserted and prosecuted as direct claims, they were actually derivative claims and that the judgment in that case thus binds Fannie and Freddie. And although Plaintiffs in this case likewise seek to assert only direct claims, Treasury maintains that the APA claims at issue here are in fact derivative claims that belong to the Companies and are thus foreclosed by the earlier judgments.[33]

Treasury's 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 Treasury's characterization of Plaintiffs' claims were correct, moreover, issue preclusion should not apply here. It is undisputed that the plaintiffs in *Perry Capital* did not assert or seek to prosecute their APA claims as derivative actions.[34] 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 the plaintiffs either made demands on the Companies' Boards 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.*

[33] This case is thus distinct from *Continental Western*, where the plaintiff was a subsidiary of one of the plaintiffs in *Perry Capital*. *See Continental Western*, 83 F. Supp. 3d at 833. The court in *Continental Western* did not find privity on the theory asserted here.

[34] 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 the Companies. *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.

Ritter, 911 A.2d 362, 366–67 (Del. 2006). Certainly, the plaintiffs did not "state with particularity" in their pleadings that they had done so, 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.

In these circumstances, even if Plaintiffs' claims in this case were derivative, issue preclusion 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 Treasury's 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 the Companies, let alone make any attempt to satisfy the requirements for doing so—cannot be said to have adequately represented the interests of the Companies. Third, it appears that the court in *Perry Capital* would not regard its judgment as precluding this claim. *See supra* note 34. Finally, and at a bare minimum, the unusual posture of this case and the district court proceedings on which Treasury relies 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").[35]

IV. Section 4623(d) Does Not Bar Plaintiffs' Challenge to the Net Worth Sweep.

FHFA argues that Plaintiffs' challenge to the Net Worth Sweep is barred by 12 U.S.C. § 4623(d). *See* FHFA Br. 2–6. This provision, however, 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 Plaintiffs' suit would somehow affect FHFA's 2008 decision to suspend the Companies' capital classifications during conservatorship. FHFA's argument fails for multiple reasons: Plaintiffs have not challenged FHFA's 2008 decision, that decision falls outside the scope of Section 4623(d), and this lawsuit will have no effect on that decision.[36]

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. The distinction between FHFA's separate roles is carefully reflected in the text of HERA. *Compare, e.g.*, 12 U.S.C. § 4511(b)(2) (providing that "[t]he Director shall have general regulatory authority over" Fannie and Freddie), *and* 12 U.S.C. § 4513(a) ("Duties and authorities of Director" as regulator and supervisor), *with* 12 U.S.C. § 4617(b) ("Powers and duties of the Agency as conservator or receiver"). As FHFA recognizes, unlike Section 4617(f), which limits review of "the exercise of powers or functions of *the Agency*

[35] None of Treasury's cases holds or even suggests 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.

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

as a conservator or a receiver," 12 U.S.C. § 4617(f) (emphasis added), Section 4623(d) applies only to actions taken by the "Director" in his supervisory or regulatory capacity.

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."[37] 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. ("[C]ritically 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

[37] Subchapter II of Chapter 46 of Title 12, comprising 12 U.S.C. §§ 4611 through 4624.

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's decision to suspend the Companies' capital classifications was not a "classification or action of the Director" subject to Section 4623(d). Suspending capital classifications is not one of the supervisory actions authorized under Section 4615 or Section 4616. Whatever authority FHFA may or may not have to take such action under *other* statutes, suspending capital classifications is not a "classification or action of the Director *under this subchapter*." Indeed, the only explicit mention of this power in statute or regulation that Plaintiffs have been able to identify claims 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). Accordingly, the decision to suspend capital classifications, if it is within FHFA's powers at all, may not be a regulatory "classification or action *of the Director*" at all.

In all events, Plaintiffs are not challenging the decision to suspend the Companies' capital classifications. Plaintiffs have not argued that that decision was unlawful nor asked this Court to vacate that decision. Nor would vacating the Net Worth Sweep reinstate capital classifications or otherwise affect their suspension. FHFA's decision in 2008 to suspend capital classifications was wholly distinct from the 2012 decision to expropriate the Companies' net worth.

In arguing otherwise, FHFA highlights Plaintiffs' argument that stripping the Companies of all of their capital cannot be reconciled with FHFA's mandate to put the Companies in a sound and solvent condition. *See* FHFA Br. 4–5. But it does not follow from this obvious practical point that the capital classifications should be reinstated, and Plaintiffs have not requested such relief.

FHFA's apparent claim that suspending capital classifications somehow amounted to a judgment that the Companies should operate with zero capital and instead rely solely on Treasury's funding commitment is untenable. The decision suspending 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." FHFA Br., Ex. A at 1. Indeed, FHFA has elsewhere argued 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 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.

V. Plaintiffs' Claims Are Timely.

Treasury argues that Plaintiffs' challenges to matters other than the Net Worth Sweep are barred by the general six-year statute of limitations, Treas. Br. 3–6 (citing 28 U.S.C. § 2401(a)), but it neglects two doctrines that make these challenges timely.

First, the availability of judicial review to challenge an agency's announcement of an unlawful policy does not foreclose subsequent judicial review of a specific application of that policy. *See Commonwealth Edison Co. v. Nuclear Regulatory Comm'n*, 830 F.2d 610, 615 (7th Cir. 1987); *Dunn-McCampbell Royalty Interest, Inc. v. Nat'l Park Serv.*, 112 F.3d 1283, 1287 (5th Cir. 1997). Defendants directed the Companies to make draws on Treasury's funding commitment to finance cash dividends in 2012. *See* FHFA, TABLE 1: QUARTERLY DRAWS ON TREASURY COMMITMENTS, http://goo.gl/801rWO. Accordingly, Plaintiffs did not wait too long to assert claims that Defendants violated HERA's sunset provision, 12 U.S.C. §§ 1455(*l*)(4), 1719(g)(4);

Compl. ¶ 178, and unlawfully compelled the Companies to pay dividends in cash, Compl. ¶ 165.[38]

All of Plaintiffs' challenges to the PSPAs are also timely under a second doctrine, which holds that when a plaintiff's injury "becomes apparent only in light of later events," *Macklin v. United States*, 300 F.3d 814, 824 (7th Cir. 2002), or "a series of wrongful acts blossoms into an injury on which suit can be brought," *Limestone Dev. Corp. v. Village of Lemont*, 520 F.3d 797, 801 (7th Cir. 2008), the plaintiff's time to file suit does not begin to run until he is actually injured. This doctrine has especially broad application where unlawful agency action is concerned: subsequent agency decisions that give "new significance" to an earlier action or that "significantly alter[ ] the stakes of judicial review" will restart the statute of limitations. *Kennecott Utah Copper Corp. v. Department of the Interior*, 88 F.3d 1191, 1227 (D.C. Cir. 1996); *Illinois Cent. Gulf Ry. Co. v. ICC*, 720 F.2d 958, 961 (7th Cir. 1983). Thus, an agency cannot evade judicial review by failing to "give adequate notice or incentive to contest" its actions and then later changing the surrounding regulatory regime in a way that makes its earlier actions newly important. *National Ass'n of Mfrs. v. Department of the Interior*, 134 F.3d 1095, 1104 (D.C. Cir. 1998); *accord Sierra Club v. EPA*, 551 F.3d 1019, 1025–26 (D.C. Cir. 2008).

Before the Net Worth Sweep, Plaintiffs had no reason to challenge the PSPAs' violation of HERA's sunset provision, for the Companies' return to stable profitability made the existence of Treasury's funding commitment after 2009 of little importance. It was only when Defendants adopted the Net Worth Seep—thus preventing the Companies from rebuilding capital and thereby making future draws on the commitment far more likely—that this feature of the PSPAs became sufficiently harmful to the Companies' private shareholders that they had reason to bring suit.

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[38] It is not clear that the Court need address the statute-of-limitations issue for the challenge to FHFA's payment of cash dividends, as FHFA has not raised a statute-of-limitations defense.

The Net Worth Sweep also gave "new significance" to the payment of cash dividends to Treasury, because as a result of the Net Worth Sweep the amount of capital stripped from the Companies increased substantially. *See Kennecott*, 88 F.3d at 1227. But for the Net Worth Sweep, payment of cash dividends at a 10% rate would have allowed the Companies to build substantial equity accounts in which Plaintiffs would have had an economic interest.

A similar analysis applies to provisions of the PSPAs that forbid the Companies to pay down Treasury's liquidation preference. *See* Compl. ¶ 166. It was only after the Net Worth Sweep was announced that it became clear that the Companies' earlier draws on Treasury's funding commitment were the result of improper accounting decisions and that because the Companies could not pay down the liquidation preference they would be forced to pay annual dividends in 2013 of almost 70% of Treasury's investment without reducing the principal on that investment. *See* Compl. ¶¶ 85, 127. The Net Worth Sweep transformed this feature of the original PSPAs into a mechanism for extracting immediate usurious returns for the federal government. Indeed, Plaintiffs' challenge to this feature of the PSPAs would not have been ripe until 2012, when it became evident that the Companies had the earning power to repay Treasury if permitted to do so.

Finally, although the original PSPAs wrongfully transferred FHFA's conservatorship powers to Treasury, it was not until the Net Worth Sweep was announced that it became apparent that Treasury would exercise these powers for its own benefit and in a way that is adverse to the interests of both the Companies and their minority shareholders. *See* Compl. ¶ 167. The Net Worth Sweep, for example, shows that Treasury intends to exercise its veto over when the Companies may exit conservatorship to guarantee that the Companies will never return to private control.

CONCLUSION

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

Date: August 12, 2016

Respectfully submitted,

/s/ Christian D. Ambler
Christian D. Ambler
ARDC No. 6228749
Stone & Johnson, Chtd.
111 West Washington St.
Suite 1800
Chicago, Illinois 60602
(312) 332-565 – tel.
(312) 556-5858 – fax
cambler@stonejohnsonlaw.com
Counsel for Plaintiffs

CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was served upon all counsel of record on this 12th day of August, 2016, via the Court's Electronic Case Filing system.

s/ Christian D. Ambler
Christian D. Ambler