IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

J. PATRICK COLLINS, *et al.*, Plaintiffs, vs. THE FEDERAL HOUSING FINANCE AGENCY, *et al.*, Defendants.	No. 4:16-cv-03113

PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS AND IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDMENT ON CONSTITUTIONAL CLAIM

February 9, 2017

Beck Redden LLP
Chad Flores, Attorney-in-charge
Texas Bar No. 24059759
S.D. Tex. Bar No. 1060324
Owen J. McGovern, Of counsel
Texas Bar No. 24092804
S.D. Tex. Bar No. 2523814
Parth S. Gejji, Of counsel
Texas Bar No. 24087575
S.D. Tex. Bar No. 2917332
1221 McKinney St., Suite 4500
Houston, TX 77010
(713) 951-3700 Telephone
(713) 951-3720 Facsimile
Counsel for Plaintiffs

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

NATURE AND STAGE OF PROCEEDINGS 1

STATEMENT OF FACTS 3

STATEMENT OF ISSUES AND STANDARD OF REVIEW 9

ARGUMENT 10

I. Section 4617(f) Does Not Bar Plaintiffs' Claims 10

A. Section 4617(f) Does Not Bar Plaintiffs' Claims Against FHFA. 10

1. Section 4617(f) Does Not Insulate Conduct that Exceeds or Contravenes FHFA's Authority Under HERA. 10

2. The Challenged Actions Exceeded FHFA's Statutory Authority. 14

a. As Conservator, FHFA Is Obligated to Preserve and Conserve Assets with the Aim of Rehabilitation to Soundness and Solvency. 14

b. The Net Worth Sweep Violated FHFA's Mandates As Conservator. 17

c. Defendants' Justifications for the Net Worth Sweep Lack Merit. 20

d. The *Perry Capital* Court Erred in Holding that FHFA Acted Within Its Authorities in Executing the Net Worth Sweep. 27

B. Section 4617(f) Does Not Bar Plaintiffs' Claims Against Treasury. 30

1. Section 4617(f) Does Not Bar Review of Treasury's Violation of HERA. 30

2. Treasury Exceeded Its Authority When It Agreed to the Net Worth Sweep. 33

II. Section 4617(b)(2)(A) Does Not Strip Plaintiffs of Their Rights in Their Stock. 40

A. Plaintiffs May Bring Direct Claims Arising from Their Ownership of Stock. 40

1. Section 4617(b)(2) Does Not Apply to Direct Claims. 40

2. Plaintiffs' Claims Are Direct, Not Derivative. 44

a. Plaintiffs' Claims Are Direct Under Federal Law. 44

b. Plaintiffs' Claims Are Direct Under State Law. 45

B. Plaintiffs May Bring Even Derivative Claims Where, as Here, the Conservator Has a Manifest Conflict of Interest. 51

III. Plaintiffs' Claims Are Not Precluded. 55

IV. Section 4623(d) Does Not Bar Plaintiffs' Challenge to the Net Worth Sweep. 57

A. Section 4623(d) Applies Only to Certain Classifications and Supervisory Actions Taken by FHFA in Its Regulatory Capacity. 58

B. Section 4623(d) Has No Application Here. 60

V. The Net Worth Sweep Must Be Vacated Because FHFA's Structure Violates the Separation of Powers. 61

A. The Constitutional Separation of Powers Does Not Permit FHFA to Operate as an Independent Agency Headed by a Single Director. 61

B. The Constitutional Violation Inherent in FHFA's Structure Requires Vacatur of the Net Worth Sweep. 68

1. Administrative Actions Taken in Violation of the Separation of Powers Must Be Vacated. 68

2. FHFA Cannot Evade the Separation of Powers by Labeling Its Actions as Those of a "Conservator." 70

3. FHFA's Acting Director Was Removable Only for Cause or by the Appointment of a Senate-Confirmed Successor. 73

CONCLUSION 75

TABLE OF AUTHORITIES

Cases	**Page**
281-300 Joint Venture v. Onion, 938 F.2d 35 (5th Cir. 1991)	32
7547 Corp. v. Parker & Parsley Dev. Partners, LP, 38 F.3d 211 (5th Cir. 1994)	36
Auction Co. of America v. FDIC, 132 F.3d 746 (D.C. Cir. 1997)	71, 72
Bank of America Nat'l Ass'n v. Colonial Bank, 604 F.3d 1239 (11th Cir. 2010)	14
Bank of Manhattan, NA v. FDIC, 778 F.3d 1133 (9th Cir. 2015)	11, 12
Bank One, Texas, NA v. Taylor, 970 F.2d 16 (5th Cir. 1992)	71, 72
Barnes v. Harris, 783 F.3d 1185, 1193 (10th Cir. 2015)	42
Bass v. Stryker Corp., 669 F.3d 501 (5th Cir. 2012)	9
Battista v. FDIC, 195 F.3d 1113 (9th Cir. 1999)	72
Bowen v. Michigan Acad. of Family Physicians, 476 U.S. 667 (1986)	10
Bowsher v. Synar, 478 U.S. 714 (1986)	65, 66
Bragdon v. Abbott, 524 U.S. 624 (1998)	14
Bruesewitz v. Wyeth LLC, 562 U.S. 223 (2011)	26
Cantu v. Plainscapital Bank, 2016 WL 1107842 (S.D. Tex. Mar. 21, 2016)	12
Citigroup, Inc. v. AHW Inv. P'ship, 140 A.3d 1125 (Del. 2016)	46
Citizens Nat'l Bank of Denton v. Cockrell, 850 S.W.2d 462 (Tex. 1993)	72
City of Arlington v. FCC, 133 S. Ct. 1863 (2013)	13
Cobell v. Norton, 240 F.3d 1081 (D.C. Cir. 2001)	38
Coit Independence Joint Venture v. Federal Sav. & Loan Ins. Corp., 489 U.S. 561 (1989)	12, 33
Continental W. Ins. Co. v. FHFA, 83 F. Supp. 3d 828 (S.D. Iowa 2015)	30, 42, 55
County of Sonoma v. FHFA, 710 F.3d 987 (9th Cir. 2013)	10, 11, 14
Courtney v. Halleran, 485 F.3d 942 (7th Cir. 2007)	12, 23, 24
Cowin v. Bresler, 741 F.2d 410 (D.C. Cir. 1984)	50
Dart v. United States, 848 F.2d 217 (D.C. Cir. 1988)	58
DeKalb Cty. v. FHFA, 741 F.3d 795 (7th Cir. 2013)	14, 15
Del E. Webb McQueen Dev. Corp. v. RTC, 69 F.3d 355 (9th Cir. 1995)	15
Delaware Cty. v. FHFA, 747 F.3d 215 (3d Cir. 2014)	15
Delta Sav. Bank v. United States, 265 F.3d 1017 (9th Cir. 2001)	51, 52, 54

Department of Transp. v. Association of American Railroads, 135 S. Ct. 1225 (2015) 70, 71

Dittmer Props., LP v. FDIC, 708 F.3d 1011 (8th Cir. 2013) 32

Dresser-Rand Co. v. NLRB, 576 F. App'x 332 (5th Cir. 2014) 69

El Paso Pipeline GP Co. v. Brinckerhoff, 2016 WL 7380418 (Del. Dec. 20, 2016) 49

Elmco Props., Inc. v. Second Nat'l Fed. Sav. Ass'n, 94 F.3d 914 (4th Cir. 1996) 15, 22

Esther Sadowsky Testamentary Trust v. Syron, 639 F. Supp. 2d 347 (S.D.N.Y. 2009) 42, 52

FAIC Sec., Inc. v. United States, 768 F.2d 352 (D.C. Cir. 1985) 45

FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120 (2000) 20

FDIC v. Bank of Coushatta, 930 F.2d 1122 (5th Cir. 1991) 26

FDIC v. Hartford Ins. Co., 877 F.2d 590 (7th Cir. 1989) 72

FDIC v. Meyer, 510 U.S. 471 (1994) 71, 72

FDIC v. OneBeacon Midwest Ins. Co., 883 F. Supp. 2d 754 (N.D. Ill. 2012) 12

FEC v. NRA Political Victory Fund, 6 F.3d 821 (D.C. Cir. 1993) 69

Feldman v. Cutaia, 951 A.2d 727 (Del. 2008) 50

FHFA v. City of Chicago, 962 F. Supp. 2d 1044 (N.D. Ill. 2013) 25

First Hartford Corp. Pension Plan & Tr. v. United States, 194 F.3d 1279 (Fed. Cir. 1999) 51, 54

Franchise Tax Bd. of Cal. v. Alcan Aluminium Ltd., 493 U.S. 331 (1990) 48

Free Enter. Fund v. Public Co. Accounting Oversight Bd., 561 U.S. 477 (2010) 62, 65, 69, 72

Freeman v. FDIC, 56 F.3d 1394 (D.C. Cir. 1995) 12, 16, 21, 22

Gail C. Sweeney Estate Marital Tr. v. United States Treasury Dep't, 68 F. Supp. 3d 116 (D.D.C. 2014) 11, 42

Gatz v. Ponsoldt, 2004 WL 3029868 (Del. Ch. Nov. 5, 2004) 50, 51

Gatz v. Ponsoldt, 925 A.2d 1265 (Del. 2007) 47, 49

Gelles v. TDA Indus., Inc., 44 F.3d 102 (2d Cir. 1994) 36

Gentile v. Rossette, 906 A.2d 91 (Del. 2006) 47, 49, 50

Golden Pac. Bancorp v. FDIC, 375 F.3d 196 (2d Cir. 2004) 45

Gosnell v. FDIC, 1991 WL 533637 (W.D.N.Y. Feb. 4, 1991) 23, 24

Gradient OC Master, Ltd. v. NBC Universal, Inc., 930 A.2d 104 (Del. Ch. 2007) 49

Grayson v. Imagination Station, Inc., 2010 WL 3221951 (Del. Ch. Aug. 16, 2010) 51

Greater Slidell Auto Auction, Inc. v. American Bank & Tr. Co. of Baton Rouge, 32 F.3d 939 (5th Cir. 1994) 22

Grimes v. Donald, 673 A.2d 1207 (Del. 1996) 50

Gross v. Bell Sav. Bank PaSA, 974 F.2d 403 (3d Cir. 1992) 13

Guenther v. Pacific Telecom, Inc., 123 F.R.D. 341 (D. Or. 1987) 55

Gulf Stream Restoration Network v. McCarthy, 783 F.3d 227 (5th Cir. 2015) 26

Heckler v. Chaney, 470 U.S. 821 (1985) 26

Henik ex rel. LaBranche & Co., Inc. v. LaBranche, 433 F. Supp. 2d 372 (S.D.N.Y. 2006) 56

Hennepin Cty. v. Federal Nat'l Mortg. Ass'n, 742 F.3d 818 (8th Cir. 2008) 42

Herron v. Fannie Mae, 857 F. Supp. 2d 87 (D.D.C. 2012) 73

Hindes v. FDIC, 137 F.3d 148 (3d Cir. 1998) 31

Humphrey's Ex'r v. United States, 295 U.S. 602 (1935) 62, 63

IBC, Inc. v. Copyright Royalty Bd., 796 F.3d 111 (D.C. Cir. 2015) 70

IBC, Inc. v. Copyright Royalty Bd., 684 F.3d 1332 (D.C. Cir. 2012) 69

In re Activision Blizzard, Inc. Stockholder Litig., 124 A.3d 1025 (Del. Ch. 2015) 49

In re Aiken Cty., 645 F.3d 428 (D.C. Cir. 2011) 63

In re Beach First Nat'l Bancshares, Inc., 702 F.3d 772 (4th Cir. 2012) 42

In re Fed. Home Loan Mortg. Corp. Derivative Litig., 643 F. Supp. 2d 790 (E.D. Va. 2009) 42, 43, 52

In re Fed. Nat'l Mortg. Ass'n Sec. Derivative & ERISA Litig., 629 F. Supp. 2d 1 (D.D.C. 2009) 42, 52

In re Sonus Networks, Inc., S'holder Derivative Litig., 499 F.3d 47 (1st Cir. 2007) 57

In re Tri-Star Pictures, Inc. Litig., 634 A.2d 319 (Del. 1993) 49

Isquith ex rel. Isquith v. Caremark Int'l, Inc., 136 F.3d 531 (7th Cir. 1998) 36

James Madison Ltd. by Hecht v. Ludwig, 82 F.3d 1085 (D.C. Cir. 1996) 15

James Steward & Co. v. Sadrakula, 309 U.S. 94 (1940) 39

Kahn v. Lynch Commc'n Sys. Inc., 638 A.2d 1110 (Del. 1994) 38

Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90 (1991) 45

Katz v. Gerardi, 655 F.3d 1212 (10th Cir. 2011) 36

Kellmer v. Raines, 674 F.3d 848 (D.C. Cir. 2012) 42, 52

Keys v. Wolfe, 709 F.2d 413 (5th Cir. 1983) 36, 37

King v. Burwell, 135 S. Ct. 2480 (2015) 20

Kucana v. Holder, 558 U.S. 233 (2010) 31

Lebron v. National R.R. Passenger Corp., 513 U.S. 374 (1995) 71

Leon Cty. v. FHFA, 816 F. Supp. 2d 1205 (N.D. Fla. 2011) 27, 28

Leon Cty. v. FHFA, 700 F.3d 1273 (11th Cir. 2012) 11, 25, 28

Levin v. Miller, 763 F.3d 667 (7th Cir. 2014) 41, 42, 43

Lexmark Int'l., Inc. v. Static Control Components, Inc., 134 S. Ct. 1377 (2014) 44

LNV Corp. v. Outsource Serv. Mgmt., LLC,
2014 WL 834977 (D. Minn. Mar. 4, 2014) 33

Lubin v. Skow, 382 F. App'x 866 (11th Cir. 2010) 42

Massachusetts v. FHFA, 54 F. Supp. 3d 94 (D. Mass. 2014) 11, 25, 28

Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Patchak,
132 S. Ct. 2199 (2012) 44

MBIA Ins. Corp. v. FDIC, 816 F. Supp. 2d 81 (D.D.C. 2011) 16

McAllister v. RTC, 201 F.3d 570 (5th Cir. 2000) 16, 20

Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006) 52

Montana v. United States, 440 U.S. 147 (1979) 57

Morrison v. Olson, 487 U.S. 654 (1988) 62, 63, 67

Motor Vehicles Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.,
463 U.S. 29 (1983) 38

NAF Holdings, LLC v. Li & Fung (Trading) Ltd., 118 A.3d 175 (Del. 2015) 46

National Tr. for Historic Pres. v. FDIC, 995 F.2d 238 (D.C. Cir. 1993) 14

National Tr. for Historic Pres. v. FDIC, 21 F.3d 469 (D.C. Cir. 1994) 11, 13

Nguyen v. United States, 539 U.S. 69 (2003) 69

NLRB v. Noel Canning, 134 S. Ct. 2550 (2014) 68

Noel Canning v. NLRB, 705 F.3d 490 (D.C. Cir. 2013) 68, 69

North Dakota ex rel. Bd. of Univ. and Sch. Lands v. Yeutter, 914 F.2d 1031
(8th Cir. 1990) 26

Pacific Coast Dairy v. Department of Agric. of Cal., 318 U.S. 285 (1943) 39

Pareto v. FDIC, 139 F.3d 696 (9th Cir. 1998) 46, 50

Parsch v. Massey, 79 Va. Cir. 446, 2009 WL 7416040 (Va. Cir. Ct. Nov. 5, 2009) 38

Patterson v. McLean Credit Union, 491 U.S. 164 (1989) 26, 27

Perry Capital v. Lew, 70 F. Supp. 3d 208 (D.D.C. 2014) .... *passim*

PHH Corp. v. CFPB, 839 F.3d 1, 20 (D.C. Cir. 2016) .... *passim*

Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985) 43

Pirelli Armstrong Tire Corp. Retiree Med. Benefits Tr. v. Raines, 534 F.3d 779 (D.C. Cir. 2008) 39

Plaintiffs in All Winstar-Related Cases v. United States, 44 Fed. Cl. 3 (1999) 42

Rathborne v. Rathborne, 683 F.2d 914 (5th Cir. 1982) 36

Reno v. Catholic Soc. Servs. Inc., 509 U.S. 43 (1993) 10, 31

Richards v. Jefferson Cty., 517 U.S. 793 (1996) 43

Robinson v. FHFA, 2016 WL 4726555 (E.D. Ky. Sept. 9, 2016) 11, 27

RTC v. CedarMinn Bldg. Ltd. P'ship, 956 F.2d 1446 (8th Cir. 1992) 16

RTC v. United Tr. Fund, 57 F.3d 1025 (11th Cir. 1995) 28, 29

Ryder v. United States, 515 U.S. 177 (1995) 69

San Antonio Fire & Police Pension Fund v. Bradbury, 2010 WL 4273171 (Del. Ch. Oct. 28, 2010) 51

Sax v. World Wide Press, Inc., 809 F.2d 610 (9th Cir. 1987) 46, 50

SEC v. Associated Gas & Elec. Co., 24 F. Supp. 899 (S.D.N.Y. 1938) 37

SEC v. National Sec., Inc., 393 U.S. 453 (1969) 34, 36

Sharpe v. FDIC, 126 F.3d 1147 (9th Cir. 1997) 11

Slattery v. United States, 583 F.3d 800 (Fed. Cir. 2009) 72, 73

Solid Waste Agency of N. Cook Cty. v. United States Army Corps of Eng'rs, 531 U.S. 159 (2001) 26

Starr Int'l Co. v. United States, 106 Fed. Cl. 50 (2012) 49

Stommel v. LNV Corp., 2014 WL 1340676 (D. Utah Apr. 4, 2014) 32, 33

Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362 (Del. 2006) 56

Stone v. FDIC, 179 F.3d 1368 (Fed. Cir. 1999) 73

Suero v. Federal Home Loan Mortg. Corp., 123 F. Supp. 3d 162 (D. Mass. 2015) 11

Suess v. FDIC, 770 F. Supp. 2d 32 (D.D.C 2011) 45

Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co., 2006 WL 2521426 (Del. Ch. Aug. 25, 2006) 38

Swan v. Clinton, 100 F.3d 973 (D.C. Cir. 1996) 64

Taylor v. Sturgell, 553 U.S. 880 (2008) 57
Telematics Int'l, Inc. v. NEMLC Leasing Corp., 967 F.2d 703 (1st Cir. 1992) 32
Tennessee Gas Pipeline Co. v. FERC, 926 F.2d 1206 (D.C. Cir. 1991) 19
Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004) 46, 47, 48, 50
Town of Babylon v. FHFA, 699 F.3d 221 (2d Cir. 2012) 11
U.S. Inspect Inc. v. McGreevy, 2000 WL 33232337 (Va. Cir. Ct. Nov. 27, 2000) 45, 46
United Liberty Life Ins. Co. v. Ryan, 985 F.2d 1320 (6th Cir. 1993) 23
United States v. Beszborn, 21 F.3d 62 (5th Cir. 1994) 73
United States v. Guzek, 527 F.2d 552 (8th Cir. 1975) 74
United States v. LTV Corp., 746 F.2d 51 (D.C. Cir. 1984) 56
United States v. Petty Motor Co., 327 U.S. 372 (1946) 34
United States v. Sarabia, 661 F.3d 225 (5th Cir. 2011) 55
United States v. Security Indus. Bank, 459 U.S. 70 (1982) 23
Volges v. RTC, 32 F.3d 50 (2d Cir. 1994) 23
Ward v. RTC, 996 F.2d 99 (5th Cir. 1993) 12, 13
Waterview Mgmt. Co. v. FDIC, 105 F.3d 696 (D.C. Cir. 1997) 23, 43
Whatley v. RTC, 32 F.3d 905 (5th Cir. 1994) 22
Williamson v. United States Dep't of Agric., 815 F.2d 368 (5th Cir. 1987) 72
Wilson v. First Gibraltar Bank, 22 F.3d 1095 (5th Cir. 1994) 32
Yates v. United States, 135 S. Ct. 1074 (2015) 60

Constitutional, Statutory, Legislative, and Executive Materials

U.S. CONST. art. II, § 3 62

5 U.S.C.
§ 701 26
§ 702 44
§ 706 .... 9, 10

12 U.S.C.
§ 1455(*l*) 2, 33
§ 1464(d)(6)(C) 12
§ 1719(g) 2, 35

§ 1719(g)(1)(A) 34
§ 1719(g)(1)(C) 40
§ 1719(g)(2)(D) 33, 34
§ 1821(j) 11
§ 1821(n) 24
§ 4511(a) 74
§ 4511(b)(2) 58
§ 4512 .... 73, 74, 75
§ 4513a(a) 67
§ 4513(a) 58
§ 4523 59
§ 4526 63
§ 4581 67
§ 4585 67
§ 4588 67
§ 4614(a) 59, 60
§ 4615 .... 59, 60
§ 4616 .... 59, 60
§ 4617(a)(1) 70
§ 4617(a)(2) 20, 21, 28
§ 4617(a)(3)(K) 59
§ 4617(a)(5)(A) 52
§ 4617(b) 41, 58
§ 4617(b)(2) 28, 43
§ 4617(b)(2)(A) 42, 43, 42
§ 4617(b)(2)(A)(i) 40, 41, 67, 24
§ 4617(b)(2)(B)(i) 24, 25, 41
§ 4617(b)(2)(D) .... *passim*
§ 4617(b)(2)(E) 21
§ 4617(b)(2)(G) 23, 28
§ 4617(b)(2)(K)(i) 53

§ 4617(b)(2)(J)(ii) 24, 25
§ 4617(b)(3)(B) 21
§ 4617(b)(3)-(9) 22
§ 4617(b)(5)(E) 67
§ 4617(b)(11) 22, 67
§ 4617(c) 23, 44, 45
§ 4617(f) .... *passim*
§ 4623(a) 59, 60
§ 4623(d) .... *passim*
§ 5494(a) 68
15 U.S.C.
§ 41 63
§ 78j(b) 35
U.C.C. § 1-201(b)(29) 34
Act of June 3, 1864, ch. 106, § 1, 13 Stat. 99, 100 64
Consolidated Appropriations Act of 2016, H.R. 2029, 114th Cong. § 702, Tit. VII, Div. O, 129 Stat. 2242 (2015) 26, 27
161 CONG. REC. S8760 (daily ed. Dec. 17, 2015) 27
161 CONG. REC. S8857 (daily ed. Dec. 18, 2015) 27
12 C.F.R.
§ 1237.3(b) 21
§ 1237.3(c) 60
§ 1239.3 39
26 C.F.R.
§ 1.1001-3(b) 37, 38
§ 1.1001-3(e) 37, 38
76 Fed. Reg. 35,724 .... 17, 19, 29, 30
FED. R. CIV. P. 23.1 56

<u>Other</u>

1 E. Allen Farnsworth, *Farnsworth on Contracts* (3d ed. 2004) 34
3 Michael P. Malloy, *Banking Law and Regulation* (2011) 15

11 *Fletcher Cyclopedia of the Law of Corporations* (2011 rev. vol.) 37

Allied-Carson Corp., SEC No-Action Letter, Fed. Sec. L. Rep., 1976 WL 10614 (Mar. 12, 1976) 36

BLACK'S LAW DICTIONARY (10th ed. 2014) 21, 34

Bylaws of the Federal Home Loan Mortgage Corporation, Corporate Governance Practices & Procedures & Governing Law, http://goo.gl/3XIGw9 39

DAVID H. CARPENTER & M. MAUREEN MURPHY, CONG. RESEARCH SERV., RL34657, FINANCIAL INSTITUTION INSOLVENCY: FEDERAL AUTHORITY OVER FANNIE MAE, FREDDIE MAC, AND DEPOSITORY INSTITUTIONS (2008), https://goo.gl/mgFwQr 14, 16

Donald Resseguie, *Banks & Thrifts: Government Enforcement & Receivership* (2013) 15, 21

Fannie Mae Bylaws, Corporate Governance Practices & Procedures, http://goo.gl/973DZI 39

FDIC, MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE (1998), https://goo.gl/qjIjTh 15

FHFA, STRATEGIC PLAN 2009–2014, http://goo.gl/UjCxf6 .... 15, 16

FHFA, TABLE 2: DIVIDENDS ON ENTERPRISE DRAWS FROM TREASURY, http://goo.gl/vHl8V0 .... 1, 9, 18

General Counsel, SEC Release No. 33-929, 1936 WL 28873 (July 29, 1936) 36

GPO, UNITED STATES GOVERNMENT POLICY AND SUPPORTING POSITIONS (Dec. 1, 2012) 73, 74

Letter from Edward DeMarco, Acting Director, FHFA, to Senators (Nov. 10, 2011), http://goo.gl/hbBe25 16

Letter from Timothy F. Geithner, Secretary of the Treasury, to Edward DeMarco (July 31, 2012), goo.gl/BGbWJR 75

Melvin L. Watt, Dir., FHFA, Prepared Remarks at the Bipartisan Policy Center (Feb. 18, 2016), http://goo.gl/A8QSy8 61

OXFORD ENGLISH DICTIONARY ONLINE (Dec. 2013) 21, 34

Rev. Rul. 56-564, 1956-2 C.B. 216, 1956 WL 10781 37

Rob Blackwell, *HUD Chief: Obama Can't Fire FHFA's DeMarco*, NAT'L MORTGAGE NEWS (Aug. 3, 2012), goo.gl/Ql039i 75

NATURE AND STAGE OF PROCEEDINGS

In August 2012, just as Fannie and Freddie (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 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 (i.e., in additional stock). 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 has collected over *$200 billion* from the Companies—approximately $125 billion more than they would have paid under the prior arrangement. Pls.' Compl. for Declaratory & Injunctive Relief ¶ 25 (Oct. 20, 2016), Doc. 1 ("Compl."); FHFA, TABLE 2: DIVIDENDS ON ENTERPRISE DRAWS FROM TREASURY, http://goo.gl/vHl8V0 ("TABLE 2"). Because the Agencies treat these enormous cash payments as mere "dividends," not pay-downs of principal, moreover, the face value of Treas-

ury'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 comparable to the Net Worth Sweep. Rather, 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) (emphases 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.

FHFA's decision to give the Companies' net assets and future income in perpetuity

to Treasury points to an even more fundamental problem with the Net Worth Sweep: FHFA's status as an independent agency headed by a single Director departs from settled historical practice, poses a grave threat to individual liberty, and thus violates the constitutional separation of powers. The D.C. Circuit recently held unconstitutional materially identical features of the structure of the Consumer Financial Protection Bureau. *PHH Corp. v. CFPB*, 839 F.3d 1 (D.C. Cir. 2016). FHFA fails in its attempts to distinguish that thorough and well-reasoned decision or to show that as applied to this case it does not require that the Net Worth Sweep be vacated.

Plaintiffs own shares of the Companies' stock. They filed this suit challenging Defendants' expropriation of their property through the Net Worth Sweep on October 20, 2016. The Defendants moved to dismiss the complaint on January 9, 2017, and Plaintiffs have now moved for summary judgment on their claim that FHFA's structure violates the separation of powers.

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, the economic value of which the Net Worth Sweep expropriates for the federal government. Compl. ¶¶ 35-37, 42-43; Declaration of Patrick J. Collins (Exhibit 1, A02); Declaration of Marcus J. Liotta (Exhibit 2, A04); Declaration of William M. Hitchcock (Exhibit 3, A06).

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, 46-48.

The Agencies nevertheless implemented a deliberate strategy to seize the Companies and operate them for the exclusive benefit of the federal government. Despite prior statements assuring investors that the Companies were in sound financial shape, FHFA forced the Companies into conservatorship on September 6, 2008. *Id.* ¶ 58. 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. ¶* 55. As FHFA publicly confirmed, conservatorship is necessarily temporary, and FHFA may act as conservator for the Companies only until they are stabilized. *Id.* ¶ 60. Neither Company was experiencing a liquidity crisis or a short-term fall in operating revenue at the time. *Id.* ¶¶ 7, 46, 88.

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.* ¶¶ 62-63. The PSPAs created a new class of securities with very favorable terms to the Government, 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.* ¶¶ 66-67. Treasury's equity in each Company had an initial liquidation preference of $1 billion. *Id.* ¶ 68. 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. If the Companies liquidate, Treasury is entitled to recover its entire liquidation preference before any other shareholder receives anything. *Id.* ¶ 68.

The PSPAs required the Companies to pay quarterly dividends on the outstanding liquidation preference. These dividends could 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*. ¶¶ 70-73.

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 shareholders. *See id.* ¶ 11, 67. 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." *Id*. ¶ 59.

Under FHFA's supervision, the Companies were forced 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 FHFA's

[1] Loan loss reserves reduce reported net worth to reflect anticipated future losses.

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.* ¶¶ 12, 83-86.

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

---

Id. ¶ 85. 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.* ¶ 84.

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.* ¶¶ 96, 99.

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.* ¶¶ 22, 100. 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.* ¶¶ 22, 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.* ¶¶ 88-103. 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.* ¶ 136. 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." *Id.* ¶ 109. 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.

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.* ¶ 17. 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.

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, 106. 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. 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.* ¶ 111.

As the Agencies expected, 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 third quarter of 2016, the most recently reported fiscal quarter, the Companies generated over $200 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 $125 billion more than Treasury would have received under the original PSPAs. *See id.* ¶ 25; TABLE 2. Altogether, Treasury has recouped nearly $69 billion *more* than it disbursed to the Companies. Yet Treasury insists that the outstanding liquidation preference of its stock remains firmly fixed at $189 billion and that it has the right to all of the Companies' net worth *in perpetuity*.

STATEMENT OF ISSUES AND STANDARD OF REVIEW

With respect to defendants' motions to dismiss, the Court is required to "accept all well-pleaded facts as true." *Bass v. Stryker Corp.*, 669 F.3d 501, 507 (5th Cir. 2012). Under the APA, this Court shall "hold unlawful and set aside agency action" that is "in excess of

statutory jurisdiction, authority, or limitations" or is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A) & (C). With respect to Plaintiff's motion for summary judgment, the court should "draw all reasonable inferences in favor of the nonmoving party." *Adhikari v. Kellogg Brown & Root, Inc.*, 845 F.3d 184, 212 (5th Cir. 2017).

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 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 conserva-

tor 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* 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. v. FDIC*, 21 F.3d 469, 472 (D.C. Cir. 1994)); *see also Robinson v. FHFA*, 2016 WL 4726555, at *3 (E.D. Ky. Sept. 9, 2016) (equitable relief available against FHFA when it acts "beyond the scope of its conservator power" (quotation marks omitted)), *appeal pending*, No. 16-6680 (6th Cir.). Thus, "FHFA cannot evade judicial scrutiny by merely labeling its actions with a conservator stamp." *Leon County*, 700 F.3d at 1278; *see also County of Sonoma*, 710 F.3d at 994.

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. *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; *see Bank of Manhattan, NA v. FDIC*, 778 F.3d 1133, 1136-37 (9th Cir.

[2] *See, e.g.*, *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).

2015).

This interpretation, in turn, tracks the Supreme Court's interpretation of Section 1821(j)'s predecessor, 12 U.S.C. § 1464(d)(6)(C). In *Coit Independence Joint Venture v. Federal Savings & Loan Insurance 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).[3]

Citing isolated language from *Ward v. RTC*, 996 F.2d 99 (5th Cir. 1993), FHFA argues that Section 4617(f) permits relief only when FHFA's actions as Conservator fall "clearly outside" its statutory powers and functions. Mem. of Defs. FHFA and Melvin L. Watt in Supp. of Motion to Dismiss at 19 (Jan. 9, 2017), Doc. 24 ("FHFA Br."); *see also* Mem. in Supp. of Motion to Dismiss by the Department of the Treasury and Jacob J. Lew at 16 (Jan. 9, 2017), Doc. 26 ("Treas. Br."). But *Ward* simply affirmed that federal courts *do* have the ability to restrain a federal conservator or receiver acting "clearly outside its statutory powers," 996 F.2d at 102, and it cannot 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*

[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)); *see 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*"); *Cantu v. Plainscapital Bank*, 2016 WL 1107842, at *3 (S.D. Tex. Mar. 21, 2016) (similar). 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.

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 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.[4]

Ward, at any rate, was nothing like this case. It concerned a plaintiff's attempt to thwart the sale of a single property as part of a larger group sale—an action the court determined was clearly authorized by statute. 996 F.2d at 103-04; *see also id.* at 103 (case involved challenge to "method, terms and conditions" of sale). Here, by contrast, Plaintiffs challenge FHFA's decision to enter the Net Worth Sweep, which effectively nationalizes Fannie and Freddie and ensures that the Companies will never be rehabilitated and returned to private control—an action that both exceeds and directly contravenes the authority

[4] Plaintiffs' claim that the Net Worth Sweep violates HERA—the very statute from which FHFA derives its conservatorship authority—distinguishes the many cases Defendants cite in which courts refused to hear challenges to decisions by a federal conservator or receiver that were alleged to violate some law *other* than FIRREA. *See, e.g.*, *Gross v. Bell Sav. Bank PaSA*, 974 F.2d 403, 407 (3d Cir. 1992) (explaining that "where the RTC performs functions assigned it under the statute, injunctive relief will be denied even where the RTC acts in violation of *other* statutory schemes" (emphasis added)); *National Tr. for Historic Pres.*, 21 F.3d 469. These cases are best understood to mean only that Section 1821(j) applies even when a conservator or receiver violates a law other than the one that defines (and thus limits) the scope of its powers.

granted FHFA as conservator under HERA, including the authority to sell assets.

Plaintiffs allege that FHFA acted *outside* of its statutory authority, not that it exercised that authority in an improper manner or that it might make a mistake in the future. *See Bank of America Nat'l Ass'n v. Colonial Bank*, 604 F.3d 1239, 1244 (11th Cir. 2010). And HERA does not prohibit courts from enjoining FHFA if it exceeds its statutory authority as conservator. *See County of Sonoma*, 710 F.3d at 992; *National Tr. for Historic Pres. v. FDIC*, 995 F.2d 238, 240 (D.C. Cir. 1993).

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

a. 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), https://goo.gl/mgFwQr.

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.[5] The FDIC likewise 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), 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. ¶ 53. FHFA repeatedly reiterated this understanding.[6] An internal Treasury document from 2011 likewise recognized that

---

[5] *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.").

[6] *See, e.g.*, Compl. ¶¶ 55, 57; 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. ¶ 134 ("[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

"the path laid out under HERA" was for Fannie and Freddie to "becom[e] adequately capitalized" and "exit conservatorship as private companies." Compl. ¶ 136.

This defining purpose informs the scope of a conservator's power. 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); *see also RTC v. CedarMinn Bldg. Ltd. P'ship*, 956 F.2d 1446, 1454 (8th Cir. 1992); *MBIA Ins. Corp. v. FDIC*, 816 F. Supp. 2d 81, 97 (D.D.C. 2011).

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. "[O]nly receivers have the power to liquidate a failed [financial institution]," *McAllister*, 201 F.3d at 578, and their mission is to "liquidat[e] the 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]

. . . 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.").

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.

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

The Net Worth Sweep contravenes FHFA's conservatorship obligations under HERA. 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 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." Compl. ¶ 55. 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." *Id.* ¶ 135. 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. Fannie has acknowledged that the Net Worth Sweep prohibits it from "retain[ing] capital to withstand a sudden, unexpected economic shock," thereby condemning it into the ranks of the undercapitalized on a permanent basis. Compl. ¶ 127. The Companies have also described the Net Worth Sweep as a "risk factor," *see id.*, and the Director of FHFA has acknowledged the Companies' resulting lack of capital is a "serious risk" for the Companies since they have "no ability to weather quarterly losses," *id.* ¶ 114. 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 $125 billion in capital that they have instead been forced to turn over to Treasury. *See* TABLE 2. 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. Although Treasury now disputes this reading of the PSPAs, *see* Treas. Br. 16 n.9, it has repeatedly acknowledged the viability

of the payment in kind option outside of litigation. *See* Compl. ¶¶ 70-71. The Companies were likewise authorized to pay in kind any commitment fee that Treasury might have decided to charge. *See id.* ¶ 76.

Second, the Net Worth Sweep guarantees that the Companies will never resume "normal business operations." "Normal" companies recovering from financial distress save their profits to withstand the next downturn. But today the Companies cannot operate as normal, private companies because the Net Worth Sweep depletes every dollar of their net worth, depriving them of the "future income flows" that represent a company's "fundamental value." *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. ¶ 127; 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. ¶¶ 145-47. 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. ¶ 135. 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.* ¶ 140.

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

i. Defendants argue that even if the Net Worth Sweep was intended as a step toward winding up the Companies' affairs, FHFA had authority to take this step. *See* FHFA Br. 22; Treas. Br. 15. But under Fifth Circuit precedent, "only receivers have the power to liquidate" the financial institutions under their care. *McAllister*, 201 F.3d at 578.

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.[7] 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 also lays out procedures for resolving claims against the Companies during

[7] 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").

liquidation that apply only during receivership. *See* 12 U.S.C. § 4617(b)(3)-(9). These procedures 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 Greater Slidell Auto Auction, Inc. v. American Bank & Tr. Co. of Baton Rouge*, 32 F.3d 939, 942 (5th Cir. 1994); *Freeman*, 56 F.3d at 1403 n.2; *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.[8]

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. FHFA Br. 17 (quoting 12 U.S.C. § 4617(b)(2)(G)); *see also* Treas. Br. 14. 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

[8] FHFA also claims that it is not winding up Fannie and Freddie through the Net Worth Sweep. *See* FHFA Br. 22. 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. ¶ 135 (quoting Treasury Net Worth Sweep Press Release); *see also id.* ¶ 140 (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")).

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).

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). 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 14-17. FHFA lacks the authority to "transfer assets" to *prevent*, rather than to *promote* these statutory mandates.

Third, FHFA's contention that the law "does not provide any limitation" on its authority to transfer the Companies' assets, FHFA Br. 18 (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).

FHFA invokes a handful of cases in which courts ruled that FIRREA barred plaintiffs from suing receivers to enjoin specific transfers of assets. FHFA Br. 18 & 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 may flout its duty as conservator to preserve Fannie's and Freddie's assets while restoring them to a sound financial condition 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").[9]

iii. FHFA further claims that the Net Worth Sweep was within its statutory authority to "carry on the business" of Fannie and Freddie, to "operate the [Companies]," and to "conduct all business of the [Companies]" in the manner the Conservator "determines is in the [Companies' or FHFA's] best interests." FHFA Br. 15-16 (emphasis omitted) (quoting 12 U.S.C. §§ 4617(b)(2)(B)(i), 4617(b)(2)(B)(iv), 4617(b)(2)(J)(ii)); *see also* Treas. Br. 16.[10] But FHFA offers no support for the stunning proposition that these specific statutory

---

[9] 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.

[10] FHFA also invokes in passing what it describes as its authority to " 'contract' on behalf of the GSEs." FHFA Br. 15 (citing 12 U.S.C. § 4617(b)(2)(B)(v)). But apart from

authorities give it "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 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

---

the single word "contract," FHFA 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.

to actions otherwise authorized by HERA and, as demonstrated above, the Net Worth Sweep is not.[11]

iv. FHFA argues in a footnote 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 "circumscribe[s] Treasury's authority in one area [the right to sell Treasury's Stock] but . . . leave[s] intact other provisions of the PSPAs." FHFA Br. 18 n.10. But 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

---

[11] 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* FHFA Br. 23 n.12; Treas. Br. 21-22. As demonstrated elsewhere, 12 U.S.C. § 4617(f) does not bar review of Defendants' actions here. Accordingly, Section 701(a)(1) has no application in this case. And as Defendants' 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); *FDIC v. Bank of Coushatta*, 930 F.2d 1122, 1128 (5th Cir. 1991); *North Dakota ex rel. Bd. of Univ. & Sch. Lands v. Yeutter*, 914 F.2d 1031, 1033 (8th Cir. 1990). Furthermore, "agency decisions to affirmatively do something"—including the decision to impose the Net Worth Sweep—"are presumptively reviewable." *Gulf Stream Restoration Network v. McCarthy*, 783 F.3d 227, 234 (5th Cir. 2015); *see also id.* at 240 (statute did not commit decision to agency discretion where it required EPA to act "in any case where the Administrator determines that a revised or new standard is necessary to meet" specified standards). This case does not present a "rare instance" where "there is no law to apply." As demonstrated elsewhere, HERA, regulations, precedent, and historical practice provide clear limits on a conservator's authority, and the statutory powers invoked by Defendants are tied, both expressly and implicitly, to these limits.

(1989). 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).

d. The *Perry Capital* Court Erred in Holding that FHFA Acted Within Its Authorities in Executing the Net Worth Sweep.

Defendants repeatedly trumpet the district court decision in *Perry Capital*, an appeal of which is pending in the D.C. Circuit. But Defendants' reliance on that decision—as well as the district court's decision in *Robinson v. FHFA*, which adopted the *Perry Capital* court's reasoning without further analysis and is currently on appeal to the Sixth Circuit—is unavailing.

First, 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; *see also Robinson*, 2016 WL 4726555, at *6-*7. While the court cited language from the district court's decision in *Leon County v. FHFA*, 816 F. Supp. 2d 1205, 1208 (N.D.

Fla. 2011), in support of its approach, it disregarded the Eleventh Circuit's later statement in the same case that in deciding whether FHFA acted within its statutory powers, a court "must consider *all* relevant factors," including the action's "subject matter, *its purpose*, [and] its outcome," *Leon County*, 700 F.3d at 1278 (emphasis added); *see also Massachusetts v. FHFA*, 54 F. Supp. 3d at 100 ("[P]urpose, rather than labels, determines whether the FHFA in any given instance is acting . . . as a conservator.").

In blinding itself to the purpose of the Net Worth Sweep, the *Perry Capital* court went astray. 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 id.* § 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." *RTC v. United Tr. Fund*, 57 F.3d 1025, 1033 (11th Cir. 1995). Had it considered FHFA's purpose, the *Perry Capital* court would have found that FHFA adopted the Net Worth Sweep to implement Treasury's goal to "wind down" Fannie and Freddie by ensuring that they would not "retain profits, rebuild capital, and return to the market in their prior form." Compl. ¶ 135. That is clearly inconsistent with FHFA's mandate as a conservator.

Second, 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.

Third, 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).[12]

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. 17-18. This is a bold argument: if it were adopted, FHFA could effectively suspend any independent legal obligation of 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.

[12] Defendants also 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* and *Robinson*.

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 does not even address, much less prohibit, claims against Treasury. Congress's "silence" cannot be construed "as a denial of authority . . . to seek appropriate relief in the federal courts." *See Reno*, 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. 18. In each of these cases, the plaintiffs were at bottom challenging the conduct or attempting to enforce the legal obligations of the federal conservator or receiver or its ward. *Hindes v. FDIC*, 137 F.3d 148, 160-61 (3d Cir. 1998), is illustrative. In that case, the plaintiffs sought 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. That makes Plaintiffs' claims against Treasury similar to the APA claims against the Federal Home Loan Bank Board that the Fifth Circuit said could go forward in *281-300 Joint Venture v. Onion*, 938 F.2d 35, 38 (5th Cir. 1991). In that case, the Bank Board determined that a failed financial institution did not have sufficient assets to pay unsecured creditors. Although the Fifth Circuit ruled that the plaintiff could not collaterally attack the Bank Board's determination by suing the federal conservator for its refusal to pay unsecured creditors, it nevertheless said that the Bank Board's determinations "are subject to review under the Administrative Procedure Act." *Id.*; *see also Wilson v. First Gibraltar Bank*, 22 F.3d 1095, at *5 (5th Cir. 1994) (unpublished) (reiterating availability of APA review of Bank Board decision when financial institution is in receivership); *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).

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. 19 (citing 12 U.S.C. § 1719(g)(4)).[13] 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. ¶ 82. Treasury violated HERA by entering into the Net Worth Sweep in 2012, long after its authority to take such action had expired.

Treasury argues that the Net Worth Sweep was authorized as a mere "amendment" to securities Treasury already owned rather than a purchase of new securities. Treas. Br.

[13] We refer to the statutory provisions governing Treasury's authority to purchase Fannie's stock, but the same analysis applies to the parallel provisions governing Treasury's authority to purchase Freddie's stock. *See* 12 U.S.C. § 1455(*l*).

19-20. 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; 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*, at 1430 (emphasis added). The Net Worth Sweep clearly meets these definitions of "purchase." Purchases are not confined to cash. *See SEC v. National Sec., Inc.*, 393 U.S. 453, 467 (1969). The Companies sold Treasury a new security—one that hands over their net worth each quarter—in exchange for canceling the securities issued to Treasury in 2008. Indeed, this is precisely how FHFA describes the transaction: "By executing the Third Amendment, the Conservator . . . *trad[ed]* the [Companies'] annual fixed dividend and periodic commitment fee obligations *for* the payment of a variable dividend based on net

worth at the time." FHFA Br. 16 (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. 19. 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 $125 billion to date) most certainly constitutes a new investment in the Companies—Treasury now essentially owns 100% of the Companies' equity value. Indeed, the Government itself has argued in other litigation that "an 'interest in residual profits' is the defining feature of an equity interest in a corporation." Reply Brief for the United States at 24, *Starr Int'l Co. v. United States*, No. 2015-5103 (Fed. Cir. June 1, 2016), ECF No. 100.

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 Securities*, 393 U.S. at 467.[14] 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 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

[14] Treasury's characterization of the fundamental change doctrine as "dubious" is puzzling given that the Fifth Circuit has squarely adopted it. *Rathborne v. Rathborne*, 683 F.2d 914, 921 (5th Cir. 1982); *Keys*, 709 F.2d at 417; *see* Treas. Br. 20. In any event, the out-of-circuit precedents 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.

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 also 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, it 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—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 does not exercise actual control over the Companies. Treas. Br. 23. But the extensive contractual rights that Treasury enjoys under the PSPAs, together with the one-sided nature of a transaction that effectively awarded Treasury all other shareholders' interests in the Companies, make it a dominant shareholder under Delaware law. *See Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, 2006 WL 2521426, at *5 (Del. Ch. Aug. 25, 2006).

Treasury also asserts that under the intergovernmental immunity doctrine, "state law"—including otherwise applicable fiduciary duties imposed by state law—"does not apply *of its own force* to the federal government." Treas. Br. 22 (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 Tr. v. Raines*, 534 F.3d 779, 783 n.1 (D.C. Cir. 2008). Accordingly, Treasury's argument fails even on its own terms.

Treasury further argues that the fiduciary obligations that normally govern dominant shareholders are inconsistent with its powers and obligations under HERA. Treas. Br. 23. 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).

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* FHFA Br. 23-29; Treas. Br. 24-27. 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 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 . . . ." *Id.* § 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. ¶ 59.[15]

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

[15] 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.

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*. Numerous other authorities are to similar effect. *See Barnes v. Harris*, 783 F.3d 1185, 1193, 1195 (10th Cir. 2015); *In re Beach First Nat'l Bancshares, Inc.*, 702 F.3d 772, 778, 780 (4th Cir. 2012); *Lubin v. Skow*, 382 F. App'x 866, 870-71 (11th Cir. 2010); *Plaintiffs in All Winstar-Related Cases v. United States*, 44 Fed. Cl. 3, 9-10 (1999).[16] FHFA attempts to sidestep *Levin* by observing that the FDIC in that case was not willing to defend the interpretation that they press here. FHFA Br. 26.[17] But Judge Easterbrook's opinion for the majority makes clear that the *Levin* Court considered and rejected the alternative interpretation Defendants favor.

In support of their contrary position, Defendants rely on Section 4617(b)(2)'s use of the word "all." *See* FHFA Br. 24; Treas. Br. 27. But "all" this provision transfers are

[16] 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 Tr. v. Syron*, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009); *In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 795 (E.D. Va. 2009); *In re Fed. Nat'l Mortg. Ass'n Sec. Derivative & ERISA Litig.*, 629 F. Supp. 2d 1, 4 (D.D.C. 2009), *aff'd sub nom. Kellmer*, 674 F.3d 848. FHFA also cites *Hennepin County v. Federal National Mortgage Association*, 742 F.3d 818, 822 (8th Cir. 2008), but that case does not even address the statutory language or subrogation issues disputed here.

[17] 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 . . . .").

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); *see Levin*, 763 F.3d at 672. Nor does our interpretation render this provision's reference to the "rights . . . of any stockholder" meaningless. *See* FHFA Br. 26-27. 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. *Cf. Richards v. Jefferson Cty.*, 517 U.S. 793, 801 (1996); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985). 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.*, 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.

2. Plaintiffs' Claims Are Direct, Not Derivative.

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); *see also Lexmark Int'l., Inc. v. Static Control Components, Inc.*, 134 S. Ct. 1377, 1389 (2014).

Plaintiffs' claims easily satisfy these requirements. Plaintiffs have suffered injury in fact 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 v. FDIC*, 770 F. Supp. 2d 32, 38 (D.D.C 2011). Plaintiffs' claims are thus squarely within the zone of interests protected by HERA.

Because Plaintiffs have a valid federal cause of action under the APA, inquiry into whether their claims would be considered direct or derivative under state law is unnecessary. *See FAIC Sec., Inc. v. United States*, 768 F.2d 352, 357 (D.C. Cir. 1985) (explaining that "[t]he zone of interests adequate to sustain judicial review is particularly broad in suits to compel federal agency compliance with the law"). This Court should not lightly read state corporate law to limit Congress's sweeping conferral of standing. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 99 (1991) ("gaps" in federal statutes "bearing on the allocation of governing power within the corporation should be filled with state law 'unless . . . [its] application would be inconsistent with the federal policy underlying the cause of action.' ").

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 39. 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).[18]

As a matter of Delaware law, the fact that Plaintiffs have a valid federal cause of action establishes that their claims are direct without regard for the test set forth in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). For as the Delaware Supreme Court has 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*, 140 A.3d 1125, 1139 & n.70 (Del. 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 1127. 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 1139-40. In answering this question, Delaware courts look to the "laws that govern the claims," *id.* at 1127—here, federal law and the

[18] 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.*, *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.

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. 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. 26, 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.

In this case, the basic harm for which Plaintiffs seek redress—the unlawful transfer of the entire value of their stock to a dominant shareholder, in violation of HERA and the APA—was suffered by Plaintiffs directly. 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 Treasury's 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.*, Treas. Br. 8-9, 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 voting power that belonged to the minority stockholders." *Gentile*, 906 A.2d at 102.[19] 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

[19] *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); *Gatz*, 925 A.2d at 1278, 1280-81; *Gradient OC Master, Ltd. v. NBC Universal, Inc.*, 930 A.2d 104, 130 (Del. Ch. 2007). Although the Delaware Supreme Court has declined to apply *Gentile* to corporate overpayment cases in which minority shareholders' voting rights are not diluted, *El Paso Pipeline GP Co. v. Brinckerhoff*, 2016 WL 7380418 (Del. Dec. 20, 2016), this is not a corporate overpayment case. Instead, this case involves a controlling shareholder agreeing with the Companies to amend its preferred shareholder agreement to expropriate 100% of the economic rights of all minority shareholders. Under these circumstances, and with the Companies operating under conservatorship, Delaware law's distinction between direct and derivative claims does not depend on the "voting power [of] the minority stockholders." *Id.* at *12.

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.[20]

3. Given that Plaintiffs' claims 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, "courts 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

[20] Treasury's 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. 25-26. The authorities Treasury cites expressly or implicitly recognize that a shareholder may assert a direct claim when he suffers "some individualized harm not suffered by all of the stockholders at large." *E.g.*, *Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008); *see also Pareto*, 139 F.3d at 699-700 (plaintiff "did not allege a majority stockholders' breach of a fiduciary duty to minority stockholders, which resulted in the majority stockholders retaining a disproportionate share of the corporation's ongoing value."); *Sax*, 809 F.2d at 614 ("A direct action can be brought . . . when the shareholder suffers injury separate and distinct from that suffered by other shareholders."); *Cowin v. Bresler*, 741 F.2d 410, 414 (D.C. Cir. 1984) (claim derivative when "an injury to corporate stock falls equally upon all stockholders").

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 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 & Tr. 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). 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). And in the context of HERA, even Defendants' own authorities generally recognize a "conflict of interest exception."[21]

To be sure, the district court in *Perry Capital* rejected these precedents, but its reasoning is faulty. First, HERA's text 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 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, another provision of the statute says that the Companies "may, within 30 days of . . . appointment [of FHFA as conservator or receiver], bring an action . . . for an order requiring [FHFA] to remove itself as conservator or receiver." *Id.* § 4617(a)(5)(A). This provision would be meaningless if only FHFA could invoke it because, as conservator, FHFA "immediately succeed[s] to all rights" of the Companies and their shareholders. *Id.* § 4617(b)(2)(A).

Second, a conflict-of-interest "exception would [not] swallow the rule" against

[21] *See Kellmer*, 674 F.3d at 850; *In re Fed. Nat'l Mortg. Ass'n*, 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.

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 exclusive control over actions relating to corporate mismanagement leading to the appointment of the conservator in the first place, as it would not permit shareholders to bring derivative actions asserting such claims during conservatorship.

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.

Relying on *Perry Capital*, FHFA suggests that a conflict-of-interest exception is less suited to the conservatorship context than to the receivership context. *See* FHFA Br. 28-29. 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* 21-22, there is an even greater need for a conflict-of-interest exception to protect the interests of shareholders.

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. With respect to Plaintiffs' claims against FHFA, FHFA plainly has a "manifest conflict of interest" within the meaning of *First Hartford*, 194 F.3d at 1295. FHFA is likewise conflicted with respect to Plaintiffs' claims against Treasury. The Net Worth Sweep reflects joint FHFA-Treasury action, 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[22]—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.

---

[22] 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. 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 them. *Id.* 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." *Id.*

III. Plaintiffs' Claims Are Not Precluded.

Treasury also argues that Plaintiffs' APA claims are precluded by the decision in *Perry Capital*, 70 F. Supp. 3d 208. *See* Treas. Br. 27-30. While *Perry Capital* did involve APA claims similar to those at issue here, Treasury does not dispute that Plaintiffs were not parties to that case. *See United States v. Sarabia*, 661 F.3d 225, 229 (5th Cir. 2011) ("Issue preclusion means that when an issue of ultimate fact has once been determined by a valid and final judgment, that issue cannot again be litigated *between the same parties* in any future lawsuit." (emphasis added) (quotation marks omitted)). Treasury nevertheless argues that although the APA claims rejected in *Perry Capital* were indisputably asserted and prosecuted as direct claims on behalf of different plaintiffs, 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.[23]

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").

---

[23] This case is 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.

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.[24] 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. *See, e.g.*, *Stone ex rel. AmSouth Bancorp. v. 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,

[24] 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), ECF No. 20.

"[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 24. 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").[25]

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. 29-33. This provision, however, applies only to certain

[25] 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.

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.[26]

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

[26] 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).

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."[27] Specifically, Section 4614 requires "the Director" to "classify the enterprises" as "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized." *Id.* § 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 id.* § 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

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

or a discretionary supervisory action taken under this subchapter"). This reading is confirmed by Section 4623(d)'s reference to "classification[s] or action[s] . . . *under this subchapter*." To read this reference to refer to something other than the classifications and supervisory actions referenced in Section 4623(a) and detailed in Sections 4614 through 4616 would divorce this phrase from context and violate the familiar interpretive principle that words are known by the company they keep. *See Yates v. United States*, 135 S. Ct. 1074, 1085 (2015).

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

FHFA'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. 31. 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." News Release, FHFA, FHFA Announces Suspension of Capital Classifications During Conservatorship at 1, attached to FHFA Br. as Ex. E. Indeed, FHFA's Director has 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. The Net Worth Sweep Must Be Vacated Because FHFA's Structure Violates the Separation of Powers.

A. The Constitutional Separation of Powers Does Not Permit FHFA to Operate as an Independent Agency Headed by a Single Director.

"Congress's 2008 creation of a single head of the new Federal Housing Finance

Agency . . . raises the same question" that was decided in *PHH Corp. v. Consumer Financial Protection Bureau*, 839 F.3d 1, 20 (D.C. Cir. 2016). No less than the CFPB, FHFA's status as an independent agency headed by a single Director "represents a gross departure from settled historical practice" and "poses a far greater risk of arbitrary decisionmaking and abuse of power, and a far greater threat to individual liberty, than does a multi-member independent agency." *Id.* at 8. The *PHH* court correctly ruled that the CFPB's structure violates the separation of powers, and this Court should do the same with respect to FHFA.

The Constitution vests the Executive power in the President, who must "take Care that the Laws be faithfully executed." U.S. CONST. art. II, § 3. Restrictions on the President's removal power are presumptively unconstitutional, and the Supreme Court has recognized only two exceptions: Congress may limit the President's ability to remove (1) a multimember "body of experts," *see Humphrey's Ex'r v. United States*, 295 U.S. 602, 624 (1935), and (2) inferior officers with a narrow scope of powers, *see Morrison v. Olson*, 487 U.S. 654, 671-73, 695-97 (1988).

When a court is asked "to consider a new situation not yet encountered by the [Supreme] Court," there must be special "circumstances" to justify "restrict[ing the President] in his ability to remove" an officer. *Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 483-84 (2010). FHFA is precisely such a "new situation." Unlike the Federal Trade Commission, which was at issue in *Humphrey's Executor*, FHFA is headed not by a multimember commission that contains its own internal checks, but by a single unchecked Director. Moreover, FHFA's Director is not meant to be "nonpartisan" or to "act with entire impartiality," nor is he "called upon to exercise the trained judgment of a

body of experts 'appointed by law and informed by experience.' " *Humphrey's Ex'r*, 295 U.S. at 624 (citation omitted); *see* 15 U.S.C. § 41 (mandating that no more than three of FTC's five commissioners be members of the same political party). FHFA's structure is thus very different from the multi-member independent commission approved in *Humphrey's Executor*, and FHFA's heavy reliance on that decision is misplaced.[28]

Neither do the powers of FHFA's Director bear resemblance to those of the independent counsel whose authority the Supreme Court upheld in *Morrison*. The independent counsel was an inferior officer who had only "limited jurisdiction" for defined investigations, 487 U.S. at 691; *see also id.* at 671-72, and "lack[ed] policymaking or significant administrative authority," *id.* at 691. FHFA's Director, in contrast, has broad regulatory power over the Nation's multi-trillion dollar housing finance system, *see* 12 U.S.C. § 4526, and its Director at the time of the Net Worth Sweep has written that "the entire housing system . . . rel[ies] almost entirely on [its] decisions," MICHAEL BRIGHT & ED DEMARCO, WHY HOUSING REFORM STILL MATTERS, MILKEN INSTITUTE CENTER FOR FINANCIAL MARKETS 3 (June 2016) (Exhibit 4, A10).[29]

---

[28] The continued viability of *Humphrey's Executor* after *Free Enterprise Fund* has been questioned. *See*, *e.g.*, *In re Aiken Cty*., 645 F.3d 428, 444, 446 (D.C. Cir. 2011) (Kavanaugh, J., concurring) ("The [*Free Enterprise Fund*] Court's rhetoric and reasoning are notably in tension with *Humphrey's Executor*."). Accordingly, *Humphrey's Executor* should be read narrowly and not extended. Further, Plaintiffs respectfully preserve the argument that the Supreme Court should revisit *Humphrey's Executor*.

[29] *Morrison*, moreover, "did not expressly consider whether an independent agency could be headed by a single director," and there is now "nearly universal consensus" that the independent counsel statute was a mistake. *PHH*, 839 F.3d at 20. Accordingly, "[t]he independent counsel experience, if anything, strongly counsels caution with respect to single-Director independent agencies." *Id.*

FHFA's status as an independent agency headed by a single Director with broad regulatory authority over a large sector of the national economy is without precedent not only in the United States Reports but also the annals of American history. The lone historical analogue FHFA identifies is the Office of the Comptroller of the Currency, FHFA Br. 36, but the *PHH* court correctly observed that the Comptroller of the Currency "is removable at will by the President" for any reasons the President communicates to the Senate. *PHH*, 839 F.3d at 20 n.6; *see* Act of June 3, 1864, ch. 106, § 1, 13 Stat. 99, 100 (attached to FHFA Br. as Ex. G) (permitting removal for any "reasons" "communicated" "to the Senate"). And while FHFA attempts to bolster its position by quoting the D.C. Circuit's observation in *Swan v. Clinton*, 100 F.3d 973, 983-84 (D.C. Cir. 1996), that "[i]ndependence from presidential control is arguably [more] important [for] agencies charged with regulating financial institutions," FHFA Br. 35, in the very next breath the *Swan* court recognized that Congress did not follow that approach with the Comptroller of the Currency. The Comptroller of the Currency "is subject to the general oversight of the Secretary of the Treasury, and, although appointed for a five year term, can be removed by the President upon reasons to be communicated by him to the Senate." *Swan*, 100 F.3d at 983 n.6 (quotation marks omitted). In any event, the Comptroller of the Currency represents at most a single historical anomaly, and in separation of powers cases "a 'handful of isolated' examples does not count for much when assessed against an otherwise settled historical practice." *PHH*, 839 F.3d at 21 (quoting *Free Enterprise Fund*, 561 U.S. at 505).

FHFA argues that focusing on the absence of historical precedent for its structure "confuses infrequency with unconstitutionality." FHFA Br. 39. But as the *PHH* court

demonstrated at length, "[a] long line of Supreme Court precedent tells us that history and tradition are important guides in separation of powers cases that, like this one, are not resolved by the constitutional text alone." *PHH*, 839 F.3d at 21; *see id.* at 21-25. As with the novel agency structure at issue in *Free Enterprise Fund*, "the lack of historical precedent" is "[p]erhaps the most telling indication of the severe constitutional problem" that FHFA's structure presents. 561 U.S. at 505.

Furthermore, the *PHH* court correctly concluded that an independent agency headed by a single Director is not only historically anomalous but also a grave threat to the individual liberty that the separation of powers safeguards:

> The basic constitutional concern with independent agencies is that the agencies are unchecked by the President, the official who is accountable to the people and who is made responsible by Article II for the exercise of executive power . . . . In the absence of Presidential control, the multi-member structure of independent agencies acts as a critical substitute check on the excesses of any individual independent agency head—a check that helps to prevent arbitrary decisionmaking and abuse of power, and thereby to protect individual liberty.

PHH, 839 F.3d at 26. Multi-member independent agencies better protect individual liberty because they do not concentrate power in the hands of any one individual, must necessarily account for multiple viewpoints, tend to make decisions that are less extreme, and better resist capture by interest groups. *Id.* at 26-28. FHFA dismisses such considerations as irrelevant to the separation of powers analysis, FHFA Br. 38, but the ultimate aim of the separation of powers is to safeguard individual liberty. *See, e.g.*, *Bowsher v. Synar*, 478 U.S. 714, 721 (1986) ("The declared purpose of separating and dividing the powers of government, of course, was to 'diffus[e] power the better to secure liberty.' " (quoting

Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 635 (1952) (Jackson, J., concurring) (alteration in original)). "[N]either *Humphrey's Executor* nor any later case gave Congress a free pass, without any boundaries, to create independent agencies that depart from history and threaten individual liberty." *PHH*, 839 F.3d at 33.

Although FHFA's structure violates the separation of powers without regard to the agency's relative importance in national life, there can be no serious dispute that it, like the CFPB, "wields vast power over the U.S. economy." *Id.* at 8. FHFA is "responsible for the oversight of vital components of the secondary mortgage markets," regulates entities that "provide more than $5.8 trillion in funding for the U.S. mortgage markets and financial institutions," and oversees programs that "have helped millions of Americans remain in their homes." FHFA, *About FHFA: Who We Are & What We Do* (Exhibit 5, A13). It "is charged with directing the largest conservatorships in U.S. history in support of the Nation's multi-trillion dollar mortgage finance system," Declaration of FHFA Director Melvin L. Watt ¶ 7 (May 29, 2014) (Exhibit 6, A17)—a system that underpins the entire housing sector and thus directly affects every American. FHFA exercises broad powers over an industry that is responsible for roughly 15% of the Nation's Gross Domestic Product, *see* David Logan, *Housing Share of GDP Expands*, NATIONAL ASSOCIATION OF HOME BUILDERS (June 28, 2016) (Exhibit 7, A23), and there can thus be no doubt that its decisions "have an almost unrivaled effect on a broad swath of the economy," Joe Light, *Fannie-Freddie Regulator Said to Plan to Stay On Under Trump*, BLOOMBERG NEWS (Dec. 15, 2016) (Exhibit 8, A26).

The character of the powers FHFA exercises within its domain make the agency's

structure even more constitutionally problematic. FHFA is both conservator and regulator to two of the Nation's largest privately owned financial institutions and has statutory authority to issue subpoenas, bring enforcement actions, and impose civil penalties to give effect to its decisions. *See* 12 U.S.C. §§ 4581, 4585, 4588. It thus sets rules that affect private rights and exercises powers that are not limited to the "quasi-judicial" task of distributing public benefits. *See Morrison*, 487 U.S. at 690-91 & n.30. Furthermore, when FHFA exercises its powers under HERA, it benefits from a variety of statutory restrictions on judicial review. *See* 12 U.S.C. § 4617(f); *id.* § 4617(b)(2)(A)(i); *id.* § 4617(b)(5)(E); *id.* § 4617(b)(11)(D); *id.* § 4623(d). Plaintiffs' position is that none of those provisions forecloses judicial review of the Net Worth Sweep. But if the Court accepts FHFA's contrary contention that it enjoys "plenary power under HERA," FHFA Br. 16, there will be particular reason for concern about a single individual exercising that power without the internal checks provided by a multi-member board. The *PHH* court found it significant to the separation of powers analysis that CFPB decisions "occur[ ] in the twilight of judicially unreviewable discretion," 839 F.3d at 35, and FHFA in this case argues for restrictions on the reviewability of its actions that are more sweeping than any that apply to the CFPB.

FHFA also attempts to distinguish *PHH* on the ground that its Director "benefits from the guidance and advice of the Federal Housing Finance Oversight Board." FHFA Br. 40; *see* 12 U.S.C. § 4513a(a). But the *PHH* court correctly held that the existence of a similar advisory board was not enough to save the CFPB's unconstitutional structure. 839 F.3d at 16 ("Without the formal authority to prevent unilateral action by the Director, the

Advisory Board does not come close to equating to the check provided by the multi-member structure of traditional independent commissions."); *see* 12 U.S.C. § 5494(a). Notably, in other litigation FHFA and Treasury have both vehemently denied that the Federal Housing Finance Oversight Board exercises any control over FHFA's Director. *See* FHFA Reply in Support of Renewed Motion to Substitute at 1, *Gail C. Sweeney Estate Marital Trust v. United States Treasury Dep't*, No. 13-206 (D.D.C. Dec. 16, 2013), ECF No. 43 ("FHFA is an independent agency that operates autonomously and with full legislative authority.") (Exhibit 9, A30); *see also* Declaration of Deputy Assistant Treasury Secretary Timothy Bowler ¶ 9 (Oct. 28, 2013) ("The FHFOB has not and does not control the Director of FHFA.") (Exhibit 10, A34). Consistent with those denials, the "Document Compilation" FHFA submitted in the *Perry Capital* case in lieu of an administrative record contained no materials suggesting that the Federal Housing Finance Oversight Board had any input into FHFA's decision to impose the Net Worth Sweep. *See* FHFA's Notice of Filing Document Compilation at 2, *Perry Capital v. Lew*, No. 13-1025 (D.D.C. Dec. 17, 2013), ECF No. 24 (Exhibit 11, A37).

B. The Constitutional Violation Inherent in FHFA's Structure Requires Vacatur of the Net Worth Sweep.

1. Administrative Actions Taken in Violation of the Separation of Powers Must Be Vacated.

When a government official acts on behalf of an agency that is structured in violation of the separation of powers, the official's action is *ultra vires* and must be vacated. That is what the Supreme Court did in *NLRB v. Noel Canning*, 134 S. Ct. 2550 (2014), which affirmed a ruling of the D.C. Circuit that an NLRB decision was "void *ab initio*"

because the Board "lacked authority to act" due to a violation of the Recess Appointments Clause, *Noel Canning v. NLRB*, 705 F.3d 490, 493 (D.C. Cir. 2013). The Fifth Circuit subsequently deployed the same remedy with respect to other past NLRB actions that suffered from the same structural constitutional infirmity, observing that "nearly every circuit has vacated and remanded the Board's decisions during the applicable time period in light of the Supreme Court's decision." *Dresser-Rand Co. v. NLRB*, 576 F. App'x 332, 333 (5th Cir. 2014). Numerous other authorities support the same approach. *See, e.g.*, *Nguyen v. United States*, 539 U.S. 69, 83 (2003); *Ryder v. United States*, 515 U.S. 177, 182-83 (1995); *IBC, Inc. v. Copyright Royalty Bd.*, 684 F.3d 1332, 1334 (D.C. Cir. 2012); *FEC v. NRA Political Victory Fund*, 6 F.3d 821, 828 (D.C. Cir. 1993).

FHFA cites *PHH* as support for its contrary argument, FHFA Br. 41-42, but it neglects to mention that in that case the D.C. Circuit vacated the enforcement order at issue. 839 F.3d at 10. The same result would have also obtained in *Free Enterprise Fund* except that there was nothing to vacate; the plaintiff challenged an ongoing investigation of the Public Company Accounting Oversight Board with respect to which the Board had not yet made a final decision. 561 U.S. at 487.

To be sure, the remedies adopted in *Free Enterprise Fund* and *PHH* suggest that if Plaintiffs prevail on the merits of their constitutional arguments the Court should consider excising HERA's for-cause removal provision rather than invalidating in their entirety the provisions of HERA that create FHFA. *Free Enterprise Fund*, 561 U.S. at 508-09; *PHH*, 839 F.3d at 39. But the possibility that Plaintiffs might only be entitled to a remand to

FHFA for reconsideration of the Net Worth Sweep once the agency is structured in a manner that comports with the Constitution is not a basis for simply dismissing Plaintiffs' suit. *See IBC, Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 124 (D.C. Cir. 2015).

2. FHFA Cannot Evade the Separation of Powers by Labeling Its Actions as Those of a "Conservator."

FHFA's argument that its actions as conservator are not subject to attack on separation of powers grounds fails for multiple reasons. *See* FHFA Br. 42-44. As an initial matter, FHFA errs when it assumes that the constitutional flaw in its structure as regulator does not infect its decisions as conservator. FHFA acted in its *regulatory* capacity when it appointed itself conservator, and it exercises regulatory authority to oversee the conservatorship's operations. *See* 12 U.S.C. § 4617(a)(1) (stating that "the Director," i.e., FHFA as regulator, "may appoint the Agency as conservator or receiver for a regulated entity"); *id.* § 4617(f) (permitting "the Director" to sue "to restrain or affect the exercise of powers or functions of the Agency as a conservator"). With the conservator's authority entirely dependent upon a regulator that is operating without legal authority and in violation of the separation of powers, whether the conservator is *itself* bound by the Constitution is beside the point. FHFA's actions as conservator—including the Net Worth Sweep—can be no more lawful than those of the regulator that permitted it to take control of the Companies in the first place.[30]

[30] FHFA does not cite any authority to support its suggestion that the separation of powers is only offended by removal restrictions that interfere with the President's control over "executive law enforcement function[s]," FHFA Br. 42-43, and Supreme Court precedent is to the contrary, *see Department of Transp. v. Association of American R.R.*, 135 S.

FHFA's argument is also flawed because the question whether it is bound by the *constitutional* separation of powers cannot depend on whether the Net Worth Sweep fits within the *statutory* category of actions HERA permits FHFA to take as "conservator." The Supreme Court has made clear that "Congressional pronouncements . . . are not dispositive of [a defendant's] status as a governmental entity for purposes of separation of powers analysis under the Constitution." *Association of American R.R.*, 135 S. Ct. at 1231; *see also Lebron v. National R.R. Passenger Corp.*, 513 U.S. 374, 397 (1995). FHFA is an agency of the federal government, it has disavowed any obligation to operate the conservatorship in the interest of the Companies or their shareholders, and this case concerns FHFA's decision to donate all of the Companies' net assets and future profits to the federal government in perpetuity. Whether a federal conservator "should be treated as the United States depends on the context," *Auction Co. of America v. FDIC*, 132 F.3d 746, 748 (D.C. Cir. 1997), and under these circumstances FHFA's actions are attributable to the federal government without regard to statutory labels.

FHFA implies that the precedents uniformly treat federal conservators and receivers as private parties, but numerous courts—including the Supreme Court and the Fifth Circuit—have treated such entities as the federal government in a variety of contexts.[31] Alt-

---

Ct. 1225, 1232-33 (2015) (concluding that Amtrak was subject to the Constitution's separation of powers after considering, among other things, the federal government's control over Amtrak's "priorities, operations, and decisions").

[31] *See, e.g.*, *FDIC v. Meyer*, 510 U.S. 471, 475-83 (1994) (sovereign immunity); *Bank One, Texas, NA v. Taylor*, 970 F.2d 16, 33-34 (5th Cir. 1992) (sovereign immunity);

hough no court appears to have directly decided whether a federal conservator is the government for purposes of the Constitution's "structural protections against abuse of power," *Free Enterprise Fund*, 561 U.S. at 501, the Supreme Court and Fifth Circuit have held that in certain circumstances a federal agency sued in its capacity as conservator or receiver is entitled to sovereign immunity, *Meyer*, 510 U.S. at 475-83; *Taylor*, 970 F.2d at 33-34; *see also Citizens Nat'l Bank of Denton v. Cockrell*, 850 S.W.2d 462, 467-68 (Tex. 1993) (Gonzalez, J., concurring). Like the constitutional doctrines at issue in this case, federal sovereign immunity is grounded "in our constitutional structure." *Williamson v. United States Dep't of Agric.*, 815 F.2d 368, 373 (5th Cir. 1987). If the Constitution's structure may confer sovereign immunity on a federal conservator, it must also subject the conservator to the strictures that ensure that all other organs of the federal government remain accountable to the people.

Moreover, regardless of whether the requirements imposed on the government by the separation of powers apply to federal conservators and receivers in all contexts, they must at least apply here given the fundamental nature of the Net Worth Sweep—an expropriation of private property for the benefit of the federal government. Confronted with similar allegations that as receiver the FDIC had retained a failed bank's liquidation surplus for itself rather than distributing the surplus to shareholders, the Federal Circuit held that the FDIC could be sued in its receivership capacity under the Tucker Act for a Fifth

---

Slattery v. United States, 583 F.3d 800, 827-29 (Fed. Cir. 2009) (Tucker Act); *Auction Co.*, 132 F.3d at 749 (statute of limitations); *Battista v. FDIC*, 195 F.3d 1113, 1120-21 & n.9 (9th Cir. 1999) (liability for prejudgment interest); *FDIC v. Hartford Ins. Co.*, 877 F.2d 590, 591-94 (7th Cir. 1989) (Federal Tort Claims Act and venue statute).

Amendment taking. *Slattery*, 583 F.3d at 826-29. The Federal Circuit observed that "whether the FDIC as receiver is 'the government' depends on the context of the claim" and allowed the constitutional claim to go forward because the facts before it were "unlike the standard receivership situation in which the receiver is enforcing the rights or defending claims and paying the bills of the seized bank." *Id.* at 827-28. So too here, Plaintiffs' claims do not concern the ordinary management decisions of a conservator but rather a blatant deprivation of private property for the government's benefit.

The cases FHFA cites are not to the contrary. Indeed, the Fifth Circuit held in *United States v. Beszborn*, 21 F.3d 62, 68 (5th Cir. 1994), that a federal receiver's suit for civil penalties did not implicate the Double Jeopardy Clause because the penalties collected would "not go to the United States Treasury" but instead "benefit all stockholders and creditors of the bank." *See also Herron v. Fannie Mae*, 857 F. Supp. 2d 87, 94 (D.D.C. 2012), *appeal pending*, No. 16-5070 (D.C. Cir.) (declining to apply First Amendment to routine personnel decision by conservator and observing that "when acting as receiver, FDIC does not pursue the interests of the government").

3. FHFA's Acting Director Was Removable Only for Cause or by the Appointment of a Senate-Confirmed Successor.

Finally, FHFA argues that as *acting* Director, Mr. DeMarco was not subject to 12 U.S.C. § 4512's for-cause removal provision when he agreed to the Net Worth Sweep. FHFA Br. 44-45. But even if FHFA's reading of Section 4512 were correct, Mr. DeMarco was a career civil servant and therefore "could not be dismissed except for cause or unacceptable performance." *Stone v. FDIC*, 179 F.3d 1368, 1375 (Fed. Cir. 1999); *see* U.S.

GPO, UNITED STATES GOVERNMENT POLICY AND SUPPORTING POSITIONS 156 (Dec. 1, 2012).

In any case, the text of Section 4512(f) specifies the one and only way in which the rights and powers of an acting Director differ from those of a Director who has been confirmed by the Senate: an acting Director holds office "until the return of the Director, or the appointment of a successor." The acting Director serves as Director in all other respects and, absent appointment of a Senate-confirmed successor, may only be removed "for cause by the President." 12 U.S.C. § 4512(b)(2). This reading of the statute's text accords with the usual approach to acting agency heads, who normally "succeed[ ] to all the powers of the office." *See United States v. Guzek*, 527 F.2d 552, 560 (8th Cir. 1975).

FHFA's contrary reading of Section 4512(f) cannot be reconciled with other provisions of HERA or Congress's manifest intent to insulate the agency from presidential influence. A separate provision of HERA requires that FHFA operate as "an independent agency of the Federal Government"—a mandate that contains no exception for when FHFA is headed by an acting Director. 12 U.S.C. § 4511(a); *see PHH Corp.*, 839 F.3d at 6-7 ("An agency is considered 'independent' when the agency heads are removable by the President only for cause, not at will, and therefore are not supervised or directed by the President."). And when the President selects an acting Director, he is required to choose from among three Deputy Directors, all of whom must have been previously "designated by the Director." 12 U.S.C. § 4512(c)(1), (d)(1), (e)(1). By restricting the President's choice of acting Director to a list of individuals previously selected by the Director, who is removable only for cause, Congress plainly intended to preserve FHFA's independence

during the tenure of an acting Director. Moreover, since Section 4512 does not limit the duration of the tenure of the acting director, FHFA's interpretation would also lead to the anomalous result that the President could preserve indefinitely the power to dismiss an otherwise-independent agency's head by simply declining to nominate a permanent Director. That is plainly not what Congress intended.

Significantly, at the time of the Net Worth Sweep the Obama Administration did not believe that the President had the legal authority to remove Mr. DeMarco except for cause. Shortly before the Net Worth Sweep was announced, Housing and Urban Development Secretary Shaun Donovan acknowledged that "some ha[d] called for [Mr. DeMarco] to be fired" but told reporters "[t]hat is not authority that the president has." *See* Rob Blackwell, *HUD Chief: Obama Can't Fire FHFA's DeMarco*, NAT'L MORTGAGE NEWS (Aug. 3, 2012), http://goo.gl/Ql039i; *see also* Letter from Timothy F. Geithner, Secretary of the Treasury, to Edward DeMarco at 1 (July 31, 2012), http://goo.gl/BGbWJR (acknowledging that "FHFA is an independent federal agency, and . . . as its Acting Director, you have the sole legal authority" to decide whether to reduce principal on underwater mortgages). These statements are consistent with the plain meaning of Section 4512, and they show that Mr. DeMarco was operating as an independent agency head removable by the President only for cause when he approved to the Net Worth Sweep.

CONCLUSION

The Court should deny Defendants' motions to dismiss and grant summary judgment in Plaintiffs' favor with respect to Plaintiffs' constitutional claim.

Date: February 9, 2017

Respectfully submitted,

Beck Redden LLP

By: /s/ Chad Flores
Chad Flores, Attorney-in-charge
Texas Bar No. 24059759
S.D. Tex. Bar No. 1060324
cflores@beckredden.com
Owen J. McGovern, Of counsel
Texas Bar No. 24092804
S.D. Tex. Bar No. 2523814
omcgovern@beckredden.com
Parth S. Gejji, Of counsel
Texas Bar No. 24087575
S.D. Tex. Bar No. 2917332
pgejji@beckredden.com
1221 McKinney St., Suite 4500
Houston, TX 77010
(713) 951-3700 Telephone
(713) 951-3720 Facsimile
Counsel for Plaintiffs

CERTIFICATE OF SERVICE

I certify that this filing was served on all parties' counsel by the Court's Electronic Filing System on February 9, 2017.

/s/ Chad Flores
Chad Flores, Attorney-in-charge
Texas Bar No. 24059759
S.D. Tex. Bar No. 1060324
cflores@beckredden.com
1221 McKinney St., Suite 4500
Houston, TX 77010
(713) 951-3700 Telephone
(713) 951-3720 Facsimile
Counsel for Plaintiffs