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

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

PLAINTIFFS' RESPONSE TO DEFENDANTS' NOTICE OF NEW AUTHORITY CONCERNING THE D.C. CIRCUIT'S *PERRY CAPITAL* DECISION

Although Defendants do not mention it in their Notice of New Authority, Doc. 99, Judge Brown's dissenting opinion in *Perry Capital* reached the conclusion and embraced many of the arguments that Plaintiffs urge here. The fact that Judge Brown was outvoted does not mean that she was wrong, and Plaintiffs submit that her analysis is more persuasive than that of the *Perry Capital* majority.

As an initial matter, it was common ground between the majority and dissenting opinions that "the bar on judicial review" in Section 4617(f) does not apply in cases in which FHFA exceeds its "statutory conservatorship powers." *Perry Capital, LLC v. Mnuchin*, 848 F.3d 1072, 1087 (D.C. Cir. 2017); *see also id.* at 1119–20 (Brown, J., dissenting). Thus, contrary to arguments advanced by the Defendants in this case, Plaintiffs can prevail simply by showing that FHFA acted beyond its conservatorship powers under HERA; the conservator need not "clearly"

exceed its authority for this Court to intervene. Plaintiffs' Response to Defendants' Motions to Dismiss 21 (June 30, 2016), Doc. 86 ("MTD Response").

In determining the scope of FHFA's conservatorship powers for purposes of this analysis, the *Perry Capital* dissent correctly concluded that Section 4617(b)(2)(D) "mark[s] the bounds of FHFA's conservator . . . powers." 848 F.3d at 1118. FHFA's mission as conservator is to put the Companies "in a sound and solvent condition" and to "preserve and conserve [their] assets and property," 12 U.S.C. § 4617(b)(2)(D), and actions by FHFA that are antithetical to that mission may—indeed, must—be enjoined. This reading of HERA is supported by "the long history of fiduciary conservatorships at common law baked into" the provisions of FIRREA on which HERA was modeled. *Perry Capital*, 848 F.3d at 1121 (Brown, J., dissenting). It is also consistent with decades of FDIC conservatorship practice under FIRREA, *id.* at 1127–28, as well as FHFA's own repeatedly expressed understanding of its statutory conservatorship mission. Those statements demonstrate beyond a doubt that outside the context of litigation FHFA itself interprets Section 4617(b)(2)(D) as imposing binding mandates, not optional suggestions. *See* Exhibit A. No federal agency acting as "conservator" has ever been permitted to expropriate for the federal government the entire net worth of the financial institutions under its care, and Congress gave FHFA no such power when it enacted HERA.

The *Perry Capital* majority did not disagree with the dissent's premise that FHFA may be enjoined from exceeding its conservatorship powers, nor did it hold that the Net Worth Sweep was consistent with FHFA's statutory charge to preserve and conserve Fannie's and Freddie's assets and return them to a sound and solvent condition. Rather, the *Perry Capital* majority concluded that Section 4617(b)(2)(D) does not place any limits on how FHFA exercises those powers. The majority based this conclusion almost entirely on the statute's use of the word

"may," reasoning that FHFA has "permissive, discretionary authority" to preserve and conserve the Companies' assets and to restore them to a sound and solvent condition but that it is not *required* to do so. 848 F.3d at 1087–90. But as the dissent correctly argued, HERA's use of "may" in Section 4617(b)(2)(D) "is best understood as a simple concession to the practical reality that a conservator may not always succeed in rehabilitating its ward," and it does not leave FHFA as conservator free to "affirmatively sabotage the Companies' recovery." *Id.* at 1118 n.1 (Brown, J., dissenting). Furthermore, the *Perry Capital* majority's contrary interpretation is inconsistent with the overall statutory design, which specifically enumerates what FHFA "may" do as conservator and does not empower it to do anything else. *See* MTD Response 31–32. "[A]n agency literally has no power to act . . . unless and until Congress confers power upon it," *New York v. FERC*, 535 U.S. 1, 18 (2002), and by authorizing FHFA to return Fannie and Freddie to soundness and solvency and preserve and conserve their assets, Congress did not authorize FHFA to do the opposite. Indeed, as explained above, outside of litigation FHFA has repeatedly recognized that these authorizations are binding mandates, not mere suggestions.

The *Perry Capital* majority also sought support for its interpretation in HERA's incidental powers provision, which provides that FHFA "as conservator or receiver" may "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); *see* 848 F.3d at 1094. But as the dissent explained, this incidental power is granted "*to conservators or receivers*"—terms that have a well-established common law meaning—and Congress's conferral of authority that is "incidental" to others specifically enumerated should not be understood to "erase[ ] any outer limit to FHFA's statutory powers." 848 F.3d at 1123; *see* MTD Response 45–46. Supreme Court precedent "requires *an affirmative act by Congress* . . . to authorize departure from a common

law definition," 848 F.3d at 1123 (citing *Morissette v. United States*, 342 U.S. 246, 263 (1952)), and HERA's incidental powers provision does not come close to satisfying that requirement.

Troublingly, the *Perry Capital* majority's sweeping conclusion that FHFA need not pursue the ends of a traditional conservator—and, indeed, may effectively do whatever it wants—raises grave doubts about Section 4617's constitutionality under the nondelegation doctrine. Virtually every provision in HERA that discusses the conservator's responsibilities begins with the word "may," and if that word makes everything that follows optional there is nothing left in the statute instructing FHFA as to how it should exercise its discretion as conservator. A statute that provides "literally no guidance for the exercise of discretion" violates the nondelegation doctrine, *Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 472 (2001), and the Supreme Court has repeatedly adopted "narrow constructions to statutory delegations that might otherwise" run afoul of that principle, *Mistretta v. United States*, 488 U.S. 361, 373 n.7 (1989); *see South Dakota v. United States Dep't of Interior*, 423 F.3d 790, 795 (8th Cir. 2005). In *Fahey v. Mallonee*, 332 U.S. 245, 250–53 (1947), for example, a statute did not specify the criteria a bank regulator should use when deciding whether to place banks into receivership. In rejecting a nondelegation challenge to this statutory scheme, the *Fahey* Court interpreted the statute as implicitly adopting the "many precedents [that] have crystallized into well-known and generally acceptable standards" for the appointment of receivers. *Id.* at 250. While *Fahey* read background principles of receivership *into* a statute to *avoid* a nondelegation problem, the *Perry Capital* majority did the opposite—reading the word "may" to nullify conservatorship duties actually enumerated in the statute and thus leaving the conservator with no guidance from Congress as to how it should exercise its powers. This constitutional flaw in the statute as interpreted by the *Perry Capital* majority is made even more problematic by Section 4617(f)'s

restriction on judicial review. *See United States v. Garfinkel*, 29 F.3d 451, 459 (8th Cir. 1994) (observing that the availability of judicial review "is a factor weighing in favor of upholding a statute against a nondelegation challenge"). The Court should avoid these constitutional problems by adopting the *Perry Capital* dissent's interpretation.

As the *Perry Capital* dissent illustrates, this Court need not consider FHFA's motivations for imposing the Net Worth Sweep or whether the Companies are in a de facto liquidation to conclude that the conservator exceeded its statutory powers. "The capital depletion accomplished in the Third Amendment . . . is patently incompatible with any definition of the conservator role," regardless of the motivations for adopting it. 848 F.3d at 1126. That is because "divesting the Companies of their near-entire net worth is plainly antithetical to a conservator's charge to 'preserve and conserve' the Companies' assets," *id.* at 1125, as well as the charge to rehabilitate the Companies by restoring them to soundness and solvency. In all events, the text of HERA fully supports considering the Net Worth Sweep's purpose as well as its inevitable consequences for the Companies' soundness and solvency. *See* MTD Response 48–49. There is accordingly no reason for this Court to blind itself to the fact that Defendants imposed the Net Worth Sweep with the expressed aim of "expedit[ing] the wind down of Fannie Mae and Freddie Mac" while making sure "that every dollar of earnings that Fannie Mae and Freddie Mac generate" would go to Treasury. Amended Complaint ¶ 117 ("Compl.") (quoting Treasury Press Release).

Plaintiffs disagree with the *Perry Capital* majority's conclusion that Section 4617(f) bars claims for equitable relief against Treasury when that agency contracts with FHFA as conservator. 848 F.3d at 1096–97. The upshot of the *Perry Capital* majority's analysis is that, while courts may enjoin FHFA from exceeding its powers under HERA, the conservator can by contract authorize another federal agency to violate its own separate obligations under the same

statute. Nothing in HERA's text supports this counterintuitive conclusion, much less speaks with the clarity necessary to rebut the strong presumption in favor of the reviewability of administrative action. *See* MTD Response 51. The *Perry Capital* majority's expansive interpretation of Section 4617(f) makes the time limits Congress placed on Treasury's authority to invest in the Companies completely unenforceable—a result that Congress plainly did not envision or intend. Neither is this result required by *Dittmer Properties, LP v. FDIC*, 708 F.3d 1011 (8th Cir. 2013). In that case the third party was a private entity not subject to the presumption in favor of the reviewability of administrative action, and the alleged wrongdoing "relate[d] to the act or omission of a failed banking institution"—not the third party itself. *Id.* at 1019; MTD Response 52.

Although Plaintiffs disagree with much of the *Perry Capital* majority's legal analysis and its ultimate conclusion, it should be noted that the court rejected several of the arguments Defendants advance here. In particular, the majority ruled that 12 U.S.C. § 4623(d) does not deprive courts of subject matter jurisdiction to hear challenges to the Net Worth Sweep. 848 F.3d at 1085; *see* MTD Response 82–88. The *Perry Capital* majority also ruled that HERA's succession provision, 12 U.S.C. § 4617(b)(2)(A)(i), does not prevent shareholders from pressing direct claims during conservatorship. 848 F.3d at 1104–05; *see* MTD Response 63–67.

Finally, Plaintiffs note that the *Perry Capital* majority opinion is peppered with assertions that in 2008 Fannie and Freddie were on "the brink of collapse," 848 F.3d at 1078, that the Net Worth Sweep prevented the Companies from falling into a "dividend-driven downward debt spiral," *id.* at 1083, and that Treasury provided a "$200 billion-plus lifeline" that "saved the Companies," *id.* at 1094. These assertions were instrumental to the *Perry Capital* majority's decision, as the majority reasoned that FHFA had not strayed outside of its conservator role by

entering "an agreement that ensures continued access to vital capital" by "divert[ing] all dividends to the lender, who had singlehandedly saved the Companies from collapse . . . ." *Id*. at 1091. Plaintiffs vehemently disagree with these statements, and, more importantly, they are flatly contrary to allegations in the Complaint. *See* Compl. ¶¶ 15–20 (alleging that Defendants knew that Companies were never in a dividend "death spiral" and that at all times the Companies were free to pay dividends in kind with additional preferred stock); *id.* ¶¶ 40–41 (alleging that the Companies were not in financial distress when they were forced into conservatorship and that they generated sufficient cash to cover their obligations throughout the financial crisis); *id.* ¶¶ 75–88 (describing the Companies' dramatic return to profitability just before the Net Worth Sweep was imposed). This Court is of course required to accept as true Plaintiffs' factual allegations—not contrary statements in the *Perry Capital* majority opinion—for purposes of ruling on Defendants' motions to dismiss.

Dated: March 16, 2017

Respectfully submitted,

/s/ Alexander M. Johnson

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CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of March 2017, I caused a true and correct copy of the foregoing to be filed electronically using the Court's CM/ECF system, causing a true and correct copy to be served on all counsel of record.

/s/ Alexander M. Johnson
Alexander M. Johnson

EXHIBIT A

Below, we have provided a sample of the public statements in which FHFA has repeatedly acknowledged that HERA mandates that as conservator it seek to preserve and conserve the Companies' assets while returning them to a sound and solvent condition.

1. "The statutory role of FHFA as conservator **requires** FHFA to take actions to preserve and conserve the assets of the Enterprises and restore them to safety and soundness. To fulfill the statutory **mandate** of conservator, FHFA must follow governance and risk management practices associated with private-sector disciplines." FHFA, Report to Congress 2009 at 99 (May 25, 2010) (emphasis added).

2. "As Conservator, FHFA is **charged with** taking such action as may be 'necessary to put the regulated entity in a sound and solvent condition' and 'appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.' 12 U.S.C. 4617(b)(2)(D)." Conservatorship & Receivership, 75 Fed. Reg. 39462, 39463 (July 9, 2010) (emphasis added).

3. "In exercising FHFA's discretion to consider whether to make an exception to permit payment of certain Securities Litigation Claims on a case-by-case basis, the Director will be guided primarily by whether payment of the claim would be consistent with the Conservator's **mandate** to put the regulated entity in a sound and solvent condition and to preserve and conserve the assets and property of the regulated entity." Conservatorship & Receivership, 75 Fed. Reg. 39462, 39469 (July 9, 2010) (emphasis added).

4. "[T]he **essential function** of a conservator is to preserve and conserve the institution's assets . . . . Under the Safety and Soundness Act and HERA, FHFA **has a statutory charge** to work to restore a regulated entity in conservatorship to a sound and solvent condition . . ." Conservatorship & Receivership, 76 Fed. Reg. 35724, 35727 (June 20, 2011) (emphasis added).

5. "In particular, with the conservatorships operating for more than three years and no near-term resolution in sight, it is time to assess the goals and directions of the conservatorships. This assessment has been made in light of FHFA's **statutory mandate** to 'take such action as may be necessary to put [Fannie Mae and Freddie Mac] in a sound and solvent condition.' " FHFA, A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS: THE NEXT CHAPTER IN A STORY THAT NEEDS AN ENDING 2 (Feb. 21, 2012) (emphasis added).

6. "HERA specified **two conservator powers**, stating that the agency may 'take such action as may be (i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.' " FHFA, A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS: THE NEXT CHAPTER IN A STORY THAT NEEDS AN ENDING 7 (Feb. 21, 2012) (emphasis added).

7. "Without further statutory direction, FHFA views the **mandate** to restore the Enterprises to a sound and solvent condition as best accomplished not only through aggressive loss mitigation efforts, but also by reducing the risk exposure of the companies, through appropriate underwriting and pricing of mortgages." FHFA, A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS: THE NEXT CHAPTER IN A STORY THAT NEEDS AN ENDING 9 (Feb. 21, 2012) (emphasis added).

8. "FHFA's authority as both conservator and regulator of the Enterprises is based upon **statutory mandates** enacted by Congress, which include the following conservatorship authorities granted by HERA: '(D) . . . take such action as may be—(i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.' " FHFA STRATEGIC PLAN: FISCAL YEARS 2015-2019 5 (Aug. 15, 2014) (emphasis added).

9. "FHFA, acting as conservator and regulator, must follow the **mandates** assigned to it by statute and the missions assigned to the Enterprises by their charters until such time as Congress revises those mandates and missions. . . . FHFA's authority as both conservator and regulator of the Enterprises is based upon **statutory mandates** enacted by Congress to ensure a liquid, efficient, competitive and resilient national housing finance market, ensure safe and sound Enterprise operations, as well as to preserve and conserve their assets." FHFA STRATEGIC PLAN: FISCAL YEARS 2015-2019 5, 14 (Aug. 15, 2014) (emphasis added).