No. 17-1727

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

THOMAS SAXTON; IDA SAXTON; BRADLEY PAYNTER,

Plaintiffs-Appellants

v.

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; UNITED STATES DEPARTMENT OF TREASURY,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA (No. 1:15-cv-0047)

REPLY BRIEF OF PLAINTIFFS-APPELLANTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

<u>Statutes and Legislative Materials</u>

Other

INTRODUCTION

Defendants' briefs fail to advance a consistent or coherent reading of the Housing and Economic Recovery Act of 2008 ("HERA"). FHFA, at one point, insists that HERA does not impose *any* "judicially-enforceable obligations on the Conservator." Brief of Defendants-Appellees FHFA & Dir. Melvin L. Watt 25 (June 27, 2017) ("FHFA Br."). But elsewhere in its brief, FHFA admits that before applying HERA's restriction on judicial remedies, "[t]he court must first determine whether the challenged action is within the [Conservator's] power or function under HERA," *id.* at 16 (brackets in original) (quotation marks omitted), and concedes that as conservator it "must balance various, potentially competing, high-level goals and priorities set forth by Congress"—including the conservator's mission to preserve and conserve assets, *id.* at 25.

In other respects, Defendants' arguments would make HERA itself internally inconsistent. Treasury, for example, contends that 12 U.S.C. § 4617(b)(2)(D)'s use of the word "may" leaves FHFA free to opt out of a traditional conservator's mission to "preserve and conserve" assets. Brief for the Treasury Department 25 (June 27, 2017) ("Treas. Br."). But only two pages later, in a bid to identify an intelligible principle that guides FHFA's exercise of discretion, Treasury concedes that parallel language in 12 U.S.C. § 4617(b)(2)(J) "*instruct[s]* the conservator to act in the best interests of the regulated entity or the Agency" by saying that this is something

FHFA "may" do. Treas. Br. 27 (emphasis added) (quotation marks omitted). HERA specifies that one of FHFA's "principal duties" as regulator is "to ensure that . . . each regulated entity operates in a safe and sound manner," 12 U.S.C. § 4513(a)(1)(B), yet Defendants contend that seeking to restore the Companies to soundness and solvency is entirely optional when FHFA acts as conservator. *See* Brief of Plaintiffs-Appellants 20 (May 24, 2017) ("Pls.' Br."). And Defendants never attempt to explain why Congress would have exhaustively articulated procedural and substantive rules to govern the Companies' potential wind down during receivership only to permit FHFA to nullify these rules by winding down the Companies and gifting their assets to a single, favored investor (i.e., Treasury) during conservatorship. *See* 12 U.S.C. § 4617(b)(3)-(9), (c); Pls.' Br. 33-35. Indeed, "FHFA may choose to behave either as a conservator or as a receiver, but it may not do both simultaneously," for "[t]here is no such thing as a hybrid conservator-receiver capable of governing the Companies in any manner it chooses up to the very moment of liquidation." *Perry Capital LLC v. Mnuchin*, 848 F.3d 1072, 1117, 1119 (D.C. Cir. 2017) (Brown, J., dissenting). "The two roles simply do not overlap, and any conservator who 'winds up the affairs of an institution' rather than operate it 'as a going concern'—within the context of a formal liquidation or not—does so outside its authority as conservator under the statute." *Id.* at 1121.

Plaintiffs submit that the inconsistencies in Defendants' arguments are symptoms of an even more fundamental flaw in their position. When Congress enacted HERA, it borrowed heavily from the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") in an effort to reassure markets that any conservatorship for the Companies would follow the familiar pattern used by the FDIC and its predecessors hundreds of times in the past. *See Perry Capital*, 848 F.3d at 1127 (Brown, J., dissenting). FIRREA, in turn, confers conservatorship powers that "parallel" those granted conservators under prior statutes. *RTC v. CedarMinn Bldg. Ltd. P'ship*, 956 F.2d 1446, 1453-54 (8th Cir. 1992). In the lengthy history of federal conservatorships, there has *never* before been a case in which the conservator donated the residual value of its ward to the federal government or traded it away in exchange for essentially nothing. Neither FIRREA's text nor past practice gave Congress any reason to believe it was authorizing such action when it enacted HERA, and that is why Defendants find it so difficult to maintain a consistent position or to reconcile their actions with a coherent reading of the statute.

ARGUMENT

I. Plaintiffs May Sue FHFA for Abandoning Its Conservatorship Mission To Preserve and Conserve the Companies' Assets and Rehabilitate Them to Soundness and Solvency.

A. Section 4617(f) Does Not Bar Claims that the Conservator Exceeded Its Statutory Powers and Functions.

This Court has already ruled when interpreting the provision of FIRREA on which Section 4617(f) was modeled that this provision only applies when "the challenged action is within the [conservator's] power or function." *Dittmer Props., LP v. FDIC*, 708 F.3d 1011, 1017 (8th Cir. 2013). Thus, while "*[t]he exercise of [a conservator's] powers* may not be restrained by any court, regardless of the claimant's likelihood of success on the merits," *Hanson v. FDIC*, 113 F.3d 866, 871 (8th Cir. 1997) (emphasis added), there is no bar to judicial review when a conservator *exceeds* those powers. To be sure, within its ambit Section 4617(f) "effect[s] a sweeping ouster of courts' power to grant equitable remedies"—barring not only injunctions but also constructive trusts and declaratory relief. *Id.* at 871 (quoting *Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995)). But there is no limitation on equitable remedies of any kind when FHFA exceeds its powers and functions, as both the *Perry Capital* majority and dissent agreed. *Perry Capital LLC v. Mnuchin*, 848 F.3d 1072, 1087 (D.C. Cir. 2017); *id.* at 1119-20 (Brown, J., dissenting).

Despite these precedents, FHFA argues that even provisions of HERA that set out the conservator's mandatory duties are not "judicially enforceable." FHFA Br. 25-28, 46. Although it is possible to imagine a statute that would "bar[ ] courts from *policing*" the bounds of FHFA's conservatorship powers, FHFA Br. 46, that is not how Section 4617(f) or its predecessors have been interpreted. Instead, when FHFA purports to exercise a power it does not have—by, for example, permanently abandoning its central conservatorship mission to preserve and conserve assets—equitable relief is available because FHFA has failed to "exercise [its] powers or functions . . . as a conservator." 12 U.S.C. § 4617(f); *see Coit Indep. Joint Venture v. Federal Sav. & Loan Ins. Corp.*, 489 U.S. 561, 572-79 (1989).

FHFA is also wrong when it contends that Section 4617(f) requires the Court to blind itself to the purpose of the conservator's actions when determining whether it has exceeded its powers and functions. FHFA Br. 30-31. As Defendants themselves acknowledge, HERA defines the scope of FHFA's powers in part by reference to the "purpose" of conservatorship and receivership. 12 U.S.C. § 4617(a)(2) (FHFA may "be appointed conservator or receiver for the *purpose* of reorganizing, rehabilitating, or winding up the affairs of a regulated entity." (emphasis added)); *see* FHFA Br. 46; Treas. Br. 27. Accordingly, when 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 v. FHFA, 700 F.3d 1273, 1278 (11th Cir. 2012) (emphasis added). To be clear, the Court need not examine the Net Worth Sweep's purpose to determine that this action exceeded FHFA's powers as conservator; regardless of purpose, "divesting the Companies of their near-entire net worth is plainly antithetical" to FHFA's conservatorship mission. *Perry Capital*, 848 F.3d at 1124-25 (Brown, J., dissenting). Nevertheless, judicial inquiry into the Net Worth Sweep's purpose would be entirely appropriate.

A ruling that FHFA may be enjoined from permanently and completely abandoning its statutory mission would not prompt "a flood of litigation aimed at 'second-guessing' the Conservator's operational decisions." *See* FHFA Br. 26. Federal conservators and receivers have benefited from limitations on judicial remedies that would "restrain or affect" their actions since 1966. Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028, 1033. Yet in the hundreds of federal conservatorships and receiverships that have occurred over the last five decades, Plaintiffs are aware of no other instance in which a conservator or receiver has donated all of its ward's assets and future profits to the federal government or "exchanged" them for essentially nothing. It is the rare case in which a federal conservator can be plausibly alleged to have abandoned its core statutory mission, and the precedents Defendants cite in which courts have refused to review routine conservatorship or receivership actions do not dictate the result here.

B. FHFA May Not Abandon Its Conservatorship Mission To Preserve and Conserve the Companies' Assets, and Restore the Companies to a Sound and Solvent Condition.

1. This Court's decision in *RTC v. CedarMinn Building Limited Partnership* could not be more clear: a conservator's "mission[ ]" is "to take action necessary to restore the failed [financial institution] to a solvent position and 'to carry on the business of the institution and preserve and conserve the assets and property of the institution.' " 956 F.2d 1446, 1453 (8th Cir. 1992) (quoting 12 U.S.C. § 1821(d)(2)(D)). FHFA's senior leadership wholeheartedly agrees that pursuing this mission is mandatory. Even after the D.C. Circuit's *Perry Capital* ruling, FHFA's Director reiterated his agency's long-held position that its "statutory *mandates obligate*" it to "[c]onserve and preserve the assets of the Enterprises while they are in conservatorship." Statement of Melvin L. Watt, Director, FHFA, Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (May 11, 2017), https://goo.gl/dUC0oj (emphasis added). This statutory mission "parallel[s]" the duties that have long been imposed on common law conservators. *CedarMinn*, 956 F.2d at 1453-54.

In the face of these and other similar authorities cited in Plaintiffs' opening brief, FHFA responds that they only show that "the Conservator must balance various, potentially competing, high-level goals and priorities" specified by statute. FHFA Br. 25. FHFA never says what other "goals and priorities" HERA requires it to pursue or how the Net Worth Sweep furthered them, but in any event it makes a telling concession when it acknowledges that the goals set forth in 12 U.S.C. § 4617(b)(2)(D)—preserving and conserving assets and restoring the Companies to soundness and solvency—are among those that as conservator it "*must* balance." FHFA Br. 25 (emphasis added). This understanding of Section 4617(b)(2)(D) cannot be reconciled with the *Perry Capital* majority's conclusion that the provision's use of the word "may" renders the words that follow "permissive rather than obligatory." *Perry Capital*, 848 F.3d at 1088.

Treasury makes a similar concession when, in an attempt to identify an intelligible principle that guides FHFA's exercise of discretion, it acknowledges that HERA "*instruct[s]* the conservator to act in 'the best interests of the regulated entity or the Agency.' " Treas. Br. 27 (emphasis added) (quoting 12 U.S.C. § 4617(b)(2)(J)). This is what the provision that Treasury admits imposes a mandatory duty says: "*The Agency may, as conservator* . . . 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) (emphasis added). Section 4617(b)(2)(J) and Section 4617(b)(2)(D) both begin with the same words, specifying what FHFA "may" do "as conservator." There is no basis for interpreting one of these provisions as mandatory while treating the other as merely conferring a permissive power. *See Powerex Corp. v. Reliant Energy Servs., Inc.*, 551 U.S. 224, 232 (2007) ("A standard principle of statutory construction provides that identical words and phrases within the same statute should normally be given the same meaning.").

2. Both Defendants dismiss concerns that their interpretation of HERA would create a nondelegation problem by emphasizing that it has been many years since the Supreme Court struck down a statute under the nondelegation doctrine. FHFA Br. 45; Treas. Br. 26. But that is because under the cannon of constitutional avoidance courts strive to interpret statutes in a manner that *avoids* a nondelegation issue. *Mistretta v. United States*, 488 U.S. 361, 373 n.7 (1989) (citing numerous Supreme Court decisions "giving narrow constructions to statutory delegations that might otherwise be thought to be unconstitutional"). Indeed, in *Fahey v. Malonee*, 332 U.S. 245, 250-53 (1947), the Supreme Court went much further than this Court would need to go to rule in Plaintiffs' favor on constitutional avoidance grounds, reading background legal principles that govern conservatorships into a statute that was silent as to when a conservator could be appointed. FHFA and Treasury's interpretation of HERA would *invite*, rather than avoid, a nondelegation issue, and it should be rejected.

“The open-ended discretion to choose ends is the essence of legislative power; it is *this* power which Congress possesses but its agents necessarily lack and with which its agents could not be endowed by mere legislation.” 1 LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 982 (3d ed. 2000). To the extent that the Court follows the *Perry Capital* majority in interpreting HERA as setting forth an open-ended list of ends that FHFA may but need not pursue as conservator, its interpretation will raise grave doubts about the statute’s constitutionality. *See Perry Capital*, 848 F.3d at 1115 (Brown, J., dissenting) (“[A] nation governed by the rule of law cannot transfer broad and unreviewable power to a government entity to do whatsoever it wishes with the assets of these Companies.”).[1]

3. An essential part of FHFA’s conservatorship “mission[ ]” is “to carry on the business of the institution[s]” under its care, *CedarMinn*, 956 F.2d at 1453, and FHFA may not do the opposite by winding up the Companies without first placing them into receivership. FHFA’s contrary interpretation of HERA is based almost entirely on 12 U.S.C. § 4617(a)(2), which gives FHFA’s Director discretion to appoint the agency as “conservator or receiver for the purpose of reorganizing,

[1] FHFA begs the question when it argues that, irrespective of whether HERA includes an intelligible principle, “Plaintiffs are not challenging any purported legislative acts.” FHFA Br. 45. The intelligible principle standard is the test for determining whether an executive agency has exercised legislative power, and all delegations of legislative power are unconstitutional. *Whitman v. American Trucking Ass’ns*, 531 U.S. 457, 474 (2001).

rehabilitating, or winding up the affairs of [the] regulated entity." The *Perry Capital* dissent explained why FHFA's reading of this provision is wrong: "Between the conservator and receiver roles, FHFA surely has the power to accomplish each of the enumerated functions; nonetheless, a conservator can no more 'wind[ ] up' a company than a receiver can 'rehabilitat[e]' it." *Perry Capital*, 848 F.3d at 1119 n.2 (Brown, J., dissenting).

Recognizing that a necessary implication of its interpretation of Section 4617(a)(2) is that as receiver it may "rehabilitate" the Companies, FHFA seeks support for that counter-intuitive conclusion in provisions of HERA that instruct the receiver to establish a "limited-life regulated entity." FHFA Br. 38 (citing 12 U.S.C. § 4617(i)(2)(A)). But as its name suggests, this receivership entity has a limited life; a provision of HERA that FHFA ignores requires the receiver to "wind up the affairs" of the entity within five years. 12 U.S.C. § 4617(i)(6). Elsewhere, HERA says that "[i]n any case in which the Agency is acting as receiver, the Agency shall place the regulated entity in liquidation." 12 U.S.C. § 4617(b)(2)(E). FHFA cannot "rehabilitate" the Companies while simultaneously winding them up.

Plaintiffs explained in their opening brief that, if credited, FHFA's contention that it is free to wind up the Companies during conservatorship would enable the agency to evade the order of priorities and procedures HERA says that FHFA must follow when winding up the Companies during receivership. Pls.' Br. 33-35. Far from disputing this point, FHFA embraces it, declaring the statutory order of priorities "inapplicable" because "the Enterprises are not in receivership." FHFA Br. 39. But what FHFA cannot explain is why Congress would have exhaustively enumerated substantive and procedural rules for the distribution of assets during receivership only to permit FHFA to nullify these rules by winding up the Companies during conservatorship. The only reasonable inference from Congress's silence about any potential conservatorship wind up procedures is that no such wind up is permitted.

The Seventh Circuit's decision in *Courtney v. Halleran*, 485 F.3d 942, 948 (7th Cir. 2007), is not to the contrary. In that case, 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 the statutory priority distribution scheme. *Id.* at 949. In other words, the "glaring problem" with the *Courtney* plaintiffs' claim was that they failed to show that the receiver's actions were *ultra vires* in light of a statutory exception to the usual order of priorities—an exception that Defendants have never argued applies here. *Id.* at 948.

Treasury attacks a straw man when it declares that a "premise" of Plaintiffs' position is that FHFA must "return the enterprises to the same state that existed prior to the conservatorship." Treas. Br. 23. To say that FHFA is required as conservator to seek to "preserve and conserve" the Companies' assets and restore them to a "sound and solvent condition" is not to deny the discretion FHFA enjoys when pursuing those ends. 12 U.S.C. § 4617(b)(2)(D). And if FHFA deems it appropriate to wind up the Companies, it has the authority to do that as well—so long as it lawfully places the Companies into receivership and follows the order of priorities and procedures HERA specifies for distributing the Companies' assets. Whatever the scope of FHFA's authority to change the Companies' business model and risk profile during conservatorship, this authority does not encompass the power to permanently dissipate assets the conservator is charged with preserving and conserving.

4. Defendants are wrong when they argue that a 2016 appropriations rider ratified the Net Worth Sweep. When interpreting a federal statute, the actions of subsequent Congresses have "little probative value because a post-enactment legislative body has no special insight regarding the intent of a past legislative body." *Laborers' Local 265 Pension Fund v. iShares Tr.*, 769 F.3d 399, 409 (6th Cir. 2014); *see also Solid Waste Agency of N. Cook Cty. v. United States Army Corps of Eng'rs*, 531 U.S. 159, 169 (2001) (emphasizing need for "extreme care" before crediting arguments that Congress acquiesced in an agency's decision by failing to overturn it); *Cassidy v. Minihan*, 794 F.2d 340, 344 (8th Cir. 1986). Moreover, arguments

that an amendment to a federal statute implicitly ratified earlier agency action are especially weak where, as here, the amendment is both an appropriations act presumed not to alter substantive law, *see Tennessee Valley Auth. v. Hill*, 437 U.S. 153, 190-91 (1978), and an isolated rather than comprehensive amendment that cannot be understood to ratify all preceding agency interpretations, *see Alexander v. Sandoval*, 532 U.S. 275, 292 (2001). Notably, 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* 161 CONG. REC. S8760 (daily ed. Dec. 17, 2015) (statement of Sen. Corker).

C. The Net Worth Sweep Is a Permanent Abandonment of FHFA's Conservatorship Mission.

Defendants cannot deny that but for the Net Worth Sweep the Companies would today have $130 billion in additional capital to absorb any future losses, and they openly acknowledged when they announced the Net Worth Sweep that it was a step toward winding up the Companies. *See* Pls.' Br. 28-31. Permanently dissipating the Companies' net assets and income and requiring them to operate with no capital is the opposite of "preserv[ing] and conserve[ing]" their assets and rehabilitating them to soundness and solvency. *See* 12 U.S.C. § 4617(b)(2)(D).

Defendants nevertheless attempt to reconcile the Net Worth Sweep with

FHFA's conservatorship mission. As the following examples illustrate, most of Defendants' arguments directly contradict allegations in the Complaint:

Defendants' Assertion	**Complaint's Allegation**
"The enterprises were on the precipice of failure in 2008 . . . ." Treas. Br. 23.	"Neither Company was in danger of insolvency" in 2008, and both were able "to easily pay their debts and retained billions of dollars of capital that could be used to cover any future losses." JA32 ¶ 40.
"Had Treasury not cured each and every one of the post-conservatorship net-worth deficiencies reported by the Enterprises, one or both of the Enterprises would have been immediately forced into mandatory receivership and liquidation." FHFA Br. 9.	"[T]he 'losses' Fannie and Freddie experienced under conservatorship were driven primarily by temporary and overly pessimistic accounting decisions" made by Defendants, and the Companies' actual losses "were never so severe that they would have had a negative net worth." JA46 ¶ 75.
Prior to the Net Worth Sweep, dividend payments "threatened to diminish Treasury's remaining commitment." Treas. Br. 21.	When the Net Worth Sweep was announced, Defendants knew that the Companies "would generate earnings well in excess of the Companies' dividend obligations to Treasury." JA54 ¶ 87.
The Net Worth Sweep "relieved the enterprises of their obligation to pay a fixed 10% cash dividend to Treasury." Treas. Br. 28.	The Companies "never were required to pay a cash dividend to Treasury but rather had the discretion to pay dividends in kind." JA39 ¶ 59.
The Net Worth Sweep " 'ensures continued access to vital capital,' *Perry Capital*, 848 F.3d at 1091, and has been crucial to preserving the GSEs' financial stability and solvency." Treas. Br. 28.[2]	"[T]he Net Worth Sweep's reduction and eventual elimination of the Companies' capital reserves *increases* the likelihood" that the Companies will need additional money from Treasury, and "[b]ut for the Net Worth Sweep

[2] In seeking to bolster their disputed factual claims with quotations from the *Perry Capital* majority opinion, Defendants only demonstrate that the allegations in the Complaint make this appeal distinguishable from *Perry Capital* (or that the *Perry*

	Fannie and Freddie would have nearly $130 billion of additional capital to cushion them from any future downturn." JA64 ¶¶ 108, 109.

Not even the *Perry Capital* majority went so far as to rule that the Net Worth Sweep actually somehow preserved and conserved the Companies' assets, and at this stage of the litigation the Court is required to accept Plaintiffs' allegations to the contrary.

In addition to contradicting allegations in the Complaint, Defendants fundamentally misunderstand how the Net Worth Sweep altered the Companies' dividend obligations when they assert that Treasury accepted a "risk" that the Companies would earn less than the previous 10% cash dividend on Treasury's stock. FHFA Br. 12; Treas. Br. 11, 21. Even before the Net Worth Sweep, the Companies' net dividend payments to Treasury never exceeded their net worth—to the extent the Companies' net worth fell short of Treasury's 10% dividend, Treasury made up the difference by paying itself additional dividends via circular draws on its funding commitment. Indeed, it is impossible for the Companies' net dividend payments to Treasury to decline as a result of a change that forces them to hand over their net assets and all future profits in perpetuity. Furthermore, the "risk" of non-payment of dividends is inherent in the concept of equity since companies are never "obligated" to pay dividends and are in fact prohibited from doing so when it would

Capital majority erred by accepting a factual narrative that ran counter to the plaintiffs' allegations in that case).

render them insolvent. The original PSPAs recognized this reality by expressly authorizing the Companies to pay Treasury's dividends in kind with additional stock rather than in cash. And, of course, Treasury decided to embrace the risk that it would not receive cash dividends when it structured the original PSPAs as equity investments rather than as debt.

II. Section 4617(f) Does Not Apply When Treasury Violates Its Own Obligations Under HERA and the APA.

Unilaterally amending the PSPAs is not among FHFA's powers or functions. FHFA needed Treasury's consent to impose the Net Worth Sweep, and insisting that Treasury comply with its own independent legal obligations under HERA and the APA before consenting does not restrain *FHFA's* exercise of its conservatorship powers. Pls.' Br. 36-39.

Treasury does not deny that under its broader reading of Section 4617(f), FHFA could effectively suspend the application of any statute to any federal agency simply by entering into a contract requiring the other agency to violate the law. Especially in light of the presumption in favor of judicial review of administrative action, Congress should not be lightly understood to have authorized suspensions of its laws through "agreements" between federal agencies. Furthermore, the result that Treasury urges is especially anomalous in this case because Plaintiffs allege that Treasury violated HERA. Section 4617(f) does not apply when FHFA violates

HERA, and Treasury never explains why it should enjoy broader protection from judicial review than the conservator itself.

Dittmer and the other FIRREA cases cited by Treasury do not support a different conclusion. *See* Treas. Br. 32-33. In none of those cases was the "third party" another federal agency subject to the presumption in favor of judicial review, and none of the cases involved a claim that the third party had violated a provision of federal law unrelated to the conduct of the receivership. Despite Treasury's attempts to distinguish *281-300 Joint Venture v. Onion*, 938 F.2d 35, 38 (5th Cir. 1991), it remains the only FIRREA case cited by either party to touch on the reviewability of the decisions of a third-party federal agency that violates *its own* obligations in connection with a conservatorship or receivership.

III. Plaintiffs May Sue To Enjoin FHFA from Agreeing to the Net Worth Sweep at Treasury's Direction.

As Defendants' cases acknowledge, the zone of interests test focuses "not on those who Congress intended to benefit, but on those who in practice can be expected to police the interests that the statute protects." *Mova Pharm. Corp. v. Shalala*, 140 F.3d 1060, 1075 (D.C. Cir. 1998). Defendants thus answer the wrong question when they assert that Plaintiffs cannot sue because Section 4617(a)(7) "protects *the Conservator* from state and federal encroachment." FHFA Br. 41; *see* Treas. Br. 30. At an absolute minimum, Section 4617(a)(7) ensures that the conservatorships are not hijacked by another federal agency to further policy objectives that are inconsistent with FHFA's conservatorship mission. *See* Pls.' Br. 40-41. That is precisely the interest Plaintiffs' claim would vindicate, and the expansive zone of interests test requires no more.[3]

Defendants also argue that the Complaint's allegations are insufficient to assert a violation of Section 4617(a)(7). But the Complaint specifically describes evidence that Treasury has exerted significant influence over FHFA throughout the conservatorships, JA65-66, ¶ 112-13, and that both agencies had specific knowledge that the Net Worth Sweep would result in a massive windfall for Treasury without any corresponding benefit for the Companies, JA46-55, ¶¶ 75-90. Only a conservator that has given up the will to exercise its independent judgment could have agreed to forfeit so much, thus abandoning its statutory mission. Indeed, in light of Plaintiffs' allegations, at least one of the following must be true: (a) Treasury compelled FHFA to enter the Net Worth Sweep, or (b) FHFA agreed to abandon its conservatorship mission by entering the Net Worth Sweep. HERA was violated either way, and Plaintiffs' claims must be allowed to move forward.

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[3] FHFA further argues that "a financial interest in the enforcement of a statute does not confer prudential standing." FHFA Br. 42. But in a variety of contexts, the Supreme Court has held that plaintiffs whose interest in a case was financial satisfied the zone of interests requirement. *E.g.*, *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Patchak*, 567 U.S. 209, 227 (2012); *National Credit Union Admin. v. First Nat'l Bank & Tr. Co.*, 522 U.S. 479, 497-99 (1998).

IV. HERA's Succession Clause Does Not Foreclose Plaintiffs' APA Claims.

A. The Succession Clause Does Not Bar Direct Claims.

"No 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). As the *Perry Capital* court explained, to do so would be contrary to the statute's plain meaning, which terminates shareholder rights "against the assets or charter of the regulated entity" only during receivership. *Perry Capital*, 848 F.3d at 1105 (quoting 12 U.S.C. § 4617(b)(2)(K)(i)). FHFA's interpretation would also "pose the question whether . . . stockholders would be entitled to compensation for a taking" when conservatorship is imposed, and the Seventh Circuit accordingly rejected it on constitutional avoidance grounds. *Levin*, 763 F.3d at 672. Numerous other courts have likewise held that shareholders may pursue direct claims during conservatorship or receivership. *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). The district court decision in *Pagliara v. Federal Home Loan Mortgage Corp.*, 203 F. Supp. 3d 678, 687 (E.D. Va. 2016), concerned whether a shareholder may inspect the Companies' books and records during conservatorship—"a completely different question" from the one presented here.

B. Plaintiffs' APA Claims Are Direct Under Both Federal and Delaware Law.

As Treasury acknowledges, whether Plaintiffs' APA claims are direct or derivative for prudential standing purposes is a question "governed by federal law." Treas. Br. 36. Congress has the power to relax the prudential shareholder standing rule, and it did so when it directed the courts to take a generous approach to prudential standing in the APA. Pls.' Br. 44-45; *FAIC Sec., Inc. v. United States*, 768 F.2d 352, 357 (D.C. Cir. 1985). The APA gives Plaintiffs a direct, personal interest in this case because they are within the zone of interests protected by HERA. No more is required for Plaintiffs to sue directly.

Treasury responds by asserting that this argument "fundamentally misunderstands the distinction between direct and derivative suits," Treas. Br. 40, but the only cases Treasury cites in rebuttal concern shareholder standing under RICO. *See Craig Outdoor Advert., Inc. v. Viacom Outdoor, Inc.*, 528 F.3d 1001, 1024 (8th Cir. 2008); *Bixler v. Foster*, 596 F.3d 751, 758-59 (10th Cir. 2010). Treasury's cases are very far afield because, while the APA relaxes prudential standing, RICO imposes *heightened* prudential standing requirements. *See Regions Bank v. J.R. Oil Co.*, 387 F.3d 721, 728-29 (8th Cir. 2004); *Liquidation Comm'n of Banco Intercontinental, SA v. Renta*, 530 F.3d 1339, 1350 n.14 (11th Cir. 2008); *Motorola Credit Corp. v. Uzan*, 388 F.3d 39, 58 (2d Cir. 2004).

Furthermore, even if Delaware law were relevant, Plaintiffs' APA claims would still be direct without regard to the test set out in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). Where, as here, the substantive law that provides the plaintiffs' cause of action also gives the plaintiffs a direct interest in the claim, the plaintiffs' claim is direct without regard to *Tooley*. *Citigroup Inc. v. AHW Inv. P'ship*, 140 A.3d 1125, 1138 (Del. 2016); *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.*, 118 A.3d 175, 180 (Del. 2015). Treasury argues that these cases show only that a court "has no need to apply the *Tooley* test where a plaintiff's claim is self-evidently direct," Treas. Br. 37 n.11, but that is not correct. In *Citigroup*, it was not "self-evident" whether the plaintiffs' claims were direct or derivative under *Tooley* and its progeny, and that is why the Second Circuit certified the question to the Delaware Supreme Court. The Delaware Supreme Court responded that the claims at issue were direct because "under the laws governing those claims . . . the claims belong to the stockholder." *Citigroup*, 140 A.3d at 1126. The Delaware Supreme Court answered the Second Circuit's question as it did not because it was obvious how to apply *Tooley* but because *Tooley* was "not relevant" to the analysis. *Id.* at 1126-27.

Plaintiffs' APA claims are also direct under *Tooley*. *See* Pls.' Br. 48-51. Far from being "dependent on an injury to the corporation," *Tooley*, 845 A.2d at 1036, Plaintiffs were harmed by the transfer of their economic rights to Treasury even if one assumes—contrary to the allegations in the Complaint—that this action somehow helped the Companies. Treasury's corporate overpayment cases, including *Starr Int'l Co. v. United States*, 856 F.3d 953, 965-66 (Fed. Cir. 2017), and *El Paso Pipeline GP Co. v. Brinckerhoff*, 152 A.3d 1248, 1259 (Del. 2016), are not to the contrary. None of Treasury's cases concerned the transfer of *all* minority shareholder economic rights to a single, dominant shareholder. Minority shareholders are directly and uniquely harmed by such expropriations, and an order restoring Plaintiffs' economic rights would benefit them directly without regard to its effect on Fannie and Freddie.[4]

[4] Treasury contradicts the allegations in the Complaint when it contends that it is not the Companies' dominant shareholder. "Dominant shareholders" are those that "exercise[ ] control over the business affairs of the corporation," as demonstrated by "actual control of corporation conduct." *Kahn v. Lynch Commc'n Sys. Inc.*, 638 A.2d 1110, 1113-15 (Del. 1994) (emphasis omitted). The Complaint alleges that Treasury exercised actual control over FHFA (and thus the Companies) when the Net Worth Sweep was imposed. *See* JA76 ¶ 139; JA81 ¶ 160. At any rate, Plaintiffs' claims are direct whether or not Treasury is considered a dominant shareholder. The Net Worth Sweep uniquely harmed certain shareholders—Plaintiffs and the Companies' other private shareholders—while uniquely benefitting another shareholder—Treasury. This distinguishes this case from those in which the plaintiff simply asserts injuries that are derivative of those suffered by the corporation.

C. The Succession Clause Does Not Bar Derivative Claims When FHFA Is Conflicted.

Irrespective of whether Plaintiffs' APA claims are direct or derivative, HERA's Succession Clause does not bar these claims in light of FHFA's manifest conflict of interest.

1. Defendants contend that issue preclusion forecloses this argument because the D.C. Circuit rejected it in *Perry Capital*, but a prior judgment that other plaintiffs *lacked the capacity* to sue on behalf of the Companies cannot bind the Companies or shareholders who were not parties to the prior suit. *See* 7C CHARLES WRIGHT & ARTHUR MILLER, FEDERAL PRACTICE & PROCEDURE § 1840 (a judgment "that is not on the merits but that relates to the representative's capacity to bring the suit . . . will not bar other stockholders from bringing a derivative action"). To be sure, there is a division of authority over this issue in the demand futility context. *Compare In re EZCORP Inc.*, 130 A.3d 934, 948 (Del. Ch. 2016), *with In re Sonus Networks*, 499 F.3d 47, 64 (1st Cir. 2007). *See generally California State Teachers' Ret. Sys. v. Alvarez*, 2017 WL 239364, at *6-*7 (Del. Jan. 18, 2017) (unpublished). But the Supreme Court has held, partly for due process reasons, that where a putative class action is dismissed prior to certification, issue preclusion cannot bar an absent class member from relitigating the same issues in a subsequent suit. *Smith v. Bayer Corp.*, 564 U.S. 299, 314-18 (2011). In the same way here, due process does not permit the

Companies and their absent shareholders to be bound by the *Perry Capital* court's ruling that the plaintiffs in that case could not sue on the Companies' behalf.

2. When Congress reenacted language in HERA that also appears in FIRREA, two courts of appeals had already interpreted this language as permitting shareholder derivative suits when the conservator or receiver is subject to an inherent conflict of interest. *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). The Federal Circuit's resolution of this issue deserves particular weight given that court's prominent role in the extensive savings and loan crisis litigation that followed the Supreme Court's decision in *Winstar Corp. v. United States*, 518 U.S. 839 (1996). Furthermore, Congress modeled HERA on FIRREA in an effort to reassure markets that any conservatorship or receivership for the Companies would be consistent with the approach the FDIC uses with distressed banks. Under these circumstances, the Court should follow the prior interpretations adopted by the Federal and Ninth Circuits.

Defendants' efforts to distinguish *First Hartford* and *Delta Savings* are unpersuasive. FHFA notes that both cases involved receiverships and argues that a conflict of interest exception makes "less sense in the conservatorship context." FHFA Br. 53. But the opposite is true: Unlike the appointment of a receiver, the appointment of a conservator does not "terminate" shareholder claims and relegate them to a statutory claims process. *See* 12 U.S.C. § 4617(b)(2)(K)(i). And without the protections of this statutory claims process, there is an even greater need for a conflict-of-interest exception to protect the interests of shareholders during conservatorship than during receivership.

Treasury argues that *First Hartford* and *Delta Savings* only apply where a derivative claim concerns conduct that occurred prior to the conservatorship or receivership. Treas. Br. 50. But neither court's analysis turned on when or how the alleged misconduct occurred, but rather focused on the conflict faced by the receiver when determining whether to bring suit. *First Hartford*, 194 F.3d at 1295; *Delta Savings*, 265 F.3d at 1023-24. Moreover, limiting the conflict-of-interest exception to claims arising before the imposition of conservatorship would make little sense, given that claims arising after the imposition of a conservatorship are much more likely to involve the conduct of the conservator and thus to raise conflicts of interest.

3. The conflict of interest exception recognized in *First Hartford* and *Delta Savings* is also well supported by the statute's text. FHFA concedes that HERA's Succession Clause "does not *terminate* any rights upon conservatorship; instead, it transfers them to the Conservator during the conservatorship." FHFA Br. 51. FHFA is clearly correct that conservatorship does not terminate any shareholder rights. The Succession Clause provides that as conservator FHFA "succeed[s] to" certain rights, and it is only receivership that "terminate[s]" shareholder rights. *Compare* 12 U.S.C.

§ 4617(b)(2)(A), *with id.* § 4617(b)(2)(K)(i). Yet Defendants urge an interpretation of HERA that would terminate shareholders' right to derivatively sue FHFA, for FHFA is powerless to sue itself. *See* Pls.' Br. 52-53; *SEC v. Federal Labor Relations Auth.*, 568 F.3d 990, 997 (D.C. Cir. 2009) (Kavanaugh, J., concurring). FHFA plainly cannot be the "successor" to rights it is unable to exercise.

Perhaps recognizing the force of this point, Treasury would have the Court turn the presumption in favor of judicial review on its head by asking whether HERA "expressly granted shareholders" the right to sue Defendants derivatively. Treas. Br. 49. But the question is whether conservatorship *terminates* shareholders' right to sue derivatively when FHFA is conflicted, not whether HERA conferred on shareholders a right that they already enjoyed under longstanding background principles of corporate law. FHFA is plainly conflicted here, and Congress did not bar shareholder derivative suits against the conservator when it exceeds its powers and functions.

CONCLUSION

For the foregoing reasons, the district court's judgment should be reversed.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure because this brief contains 6,500 words, excluding the parts of the brief exempted by Rule 32(f) of the Federal Rules of Appellate Procedure.

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As required by Eighth Cir. R. 28A(h), this brief has been scanned for viruses and is virus-free.

/s/ Charles J. Cooper
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CERTIFICATE OF SERVICE

I hereby certify that on July 11, 2017, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Eighth Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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