No. 17-1880

**IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

CHRISTOPHER M. ROBERTS and THOMAS P. FISCHER,
Plaintiffs-Appellants

v.

FEDERAL HOUSING FINANCE AGENCY; MELVIN L. WATT, in his official capacity as Director of the Federal Housing Finance Agency; UNITED STATES DEPARTMENT OF TREASURY; and STEVEN T. MNUCHIN, in his official capacity as Secretary of the Treasury,
Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS (No. 1:16-cv-02107)
HONORABLE EDMOND E. CHANG

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INTRODUCTION

Defendants do not deny that the Net Worth Sweep is without precedent in the history of federal conservatorships and receiverships—hundreds of which have occurred under statutory schemes materially identical to the one at issue here. And while they seek to justify this extraordinary action by invoking the financial crisis of 2008, Defendants elide the fact that the Net Worth Sweep was imposed *in 2012*, at a time when the Complaint alleges that Defendants knew that the Companies were on the verge of reporting the largest profits in their history. Defendants' attempts to contest the Complaint's factual allegations cannot obscure the rule of law they ask this Court to adopt: that a federal conservator is free to take action that is facially antithetical to its statutorily prescribed rehabilitative mission. Congress authorized no such thing when it enacted the Housing and Economic Recovery Act ("HERA"). Treasury and FHFA both violated HERA when they imposed the Net Worth Sweep, and this doubly unlawful action must be enjoined.

ARGUMENT

I. The Court Must Enjoin Treasury's Violations of HERA and the APA.

A. Treasury Exceeded Its Statutory Authority Under HERA.

1. Treasury concedes that the Third Amendment involved an exchange of value but argues that it was not an impermissible "purchase" under HERA's sunset provision because the transaction was structured so that Treasury "obtained no new

shares of the enterprises' stock." Treas. Br. 51. But it is precisely to prevent such evasions of legal obligations relating to purchases that courts and Treasury itself consistently refuse to elevate form over substance when determining whether a "purchase" has occurred.

Treasury says nothing about the IRS's ruling 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, at *1 (1956), and it dismisses other authorities cited in Plaintiffs' opening brief as irrelevant in the absence of evidence that Congress had them "in mind" when it enacted HERA, Treas. Br. 53 n.10. But the underlying rationale for these authorities is that parties must not be permitted to avoid legal restrictions on securities "purchases" by creatively structuring what is in substance an exchange of value. That rationale applies with just as much force here as it does in the securities and tax contexts in which courts consistently look to a transaction's substance rather than its form.

Treasury also argues that the fundamental change doctrine that some courts apply in Rule 10b-5 cases is "dubious." Treas. Br. 52. But the cases Treasury cites do not call into question the principle that a fundamental amendment to the most basic terms of an investment should be treated as the creation of a new security. Dicta in *Isquith ex rel. Isquith v. Caremark Int'l, 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 likewise rely on the limited reach of Rule 10b-5 and do not support a definition of "purchase" that would make it easy for Treasury to evade its obligations under HERA.

2. Irrespective of whether the Net Worth Sweep is considered a "purchase," Treasury exceeded its authority under HERA because it did not "exercise a[ ] right[ ] received in connection with" its original acquisition of the securities when it agreed with FHFA to modify the securities to impose the Net Worth Sweep. 12 U.S.C. § 1719(g)(2)(D).

A "right" is a legal entitlement, and a contractual right allows one party to compel its counterparty to perform. *See* Pls. Br. 23-24. One does not amend a contract in order to exercise a right it purports to already have, and Treasury certainly had no "right" to compel FHFA to agree to impose the Net Worth Sweep. *Cf.* 12 U.S.C. § 4617(a)(7). Indeed, HERA itself shows that agreeing to amend or modify a contract is distinct from exercising a right under that contract. Section 1719(g)(3) refers to "funds expended for the purchase of, or *modifications* to, obligations and securities, or the *exercise of any rights* received in connection with such purchases."

(emphases added). "[E]xercis[ing] any rights" thus cannot include "modifications," otherwise HERA's reference to modifications would be superfluous.[1]

Public Service Co. of N.H. v. Hudson Light & Power Dep't, 938 F.2d 338 (1st Cir. 1991), is not to the contrary. That case held that because the appellants were not third-party beneficiaries to a bilateral contract, they could not impede the contracting parties' "exclusive right to modify the [agreement] at any time." *Id.* at 343. Thus, *Public Service* addresses only a "joint[ly]" exercisable—not unilateral—ability to modify a contract, which is possessed by all natural persons and business associations as part of the right to contract. *See* 11 WILLISTON ON CONTRACTS § 31:5 (4th ed. 2014). The power to join with its counterparty to modify the contract—a background feature of contract law—is not a *"right"* that Treasury "*received* in connection with its purchase" of stock.

B. 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 was powerless to impose the Net Worth Sweep without Treasury's consent, and insisting that Treasury comply with its own independent legal obligations under

[1] Treasury attempts to find in Section 1719(g)(3)'s reference to "modifications" an "inherent authority" to amend the PSPAs, Treas. Br. 54, but Congress did not include "modifications" within the limited exception to the sunset provision, *see* 12 U.S.C. § 1719(g)(2)(D).

HERA and the APA before consenting does not restrain or affect FHFA's exercise of its powers. Pls. Br. 24-29.

Defendants do not deny that under their broader reading of Section 4617(f), FHFA could suspend the application of *any* statute to *any* federal agency by entering into a contract requiring the other agency to violate the law. Given 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 executive agencies. Furthermore, the result that Defendants urge is especially anomalous because Plaintiffs allege that Treasury violated HERA. Section 4617(f) does not apply when FHFA violates HERA, and Defendants cannot explain why Treasury should enjoy broader protection from judicial review than the conservator itself.

Dittmer Props., L.P. v. FDIC, 708 F.3d 1011 (8th Cir. 2013) and the other FIRREA cases cited by Defendants do not support a different conclusion. *See* Treas. Br. 32-33; FHFA Br. 31. 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 in any of the briefs 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. The Fifth Circuit said in that case that the Bank Board's decision was subject to APA review.

II. 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.

Every court to examine the issue has ruled that Section 4617(f) and its FIRREA analogue only apply when the conservator acts within the scope of its statutory powers and functions. *See, e.g.*, *Courtney v. Halleran*, 485 F.3d 942, 948 (7th Cir. 2007); Pls. Br. 29-30. 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," *Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995) (emphasis added), there is no bar to judicial review when a conservator *exceeds* those powers.

Despite the precedents, FHFA argues that even provisions of HERA that set out the conservator's mandatory duties are not "judicially enforceable." FHFA Br. 24-28, 51. Although it is possible to imagine a statute that would "bar[ ] courts from *policing*" the bounds of FHFA's conservatorship powers, FHFA Br. 51, that is not what Section 4617(f) or its predecessors say or how they have been interpreted. Instead, when FHFA purports to exercise a power it does not have, 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. 34-36. As FHFA acknowledges, 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); *see* FHFA Br. 50. 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 LLC v. Mnuchin*, 848 F.3d 1072, 1124-25 (D.C. Cir. 2017) (Brown, J., dissenting). Nevertheless, judicial inquiry into the Net Worth Sweep's purpose would be entirely appropriate.

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. "[A] conservator, like a trustee in a reorganization under Chapter 11 of the Bankruptcy Code, tries to return the bankrupt party to solvency, rather than liquidating it." *DeKalb Cty. v. FHFA*, 741 F.3d 795, 798 (7th Cir. 2013). FHFA's senior leadership has repeatedly acknowledged that pursuing this rehabilitative

statutory mission is mandatory. *See* Pls. Br. 35-37; Edward DeMarco, Acting Dir., FHFA, The Conservatorships of Fannie Mae and Freddie Mac – Current and Future Operations (Sept. 19, 2011), https://goo.gl/SCK16s ("FHFA has a statutory responsibility as conservator of the Enterprises to 'take 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.' " (quoting 12 U.S.C. § 4617(b)(2)(D)).

FHFA responds that these statements show only that "the Conservator must balance various, potentially competing, high-level goals and priorities" specified by statute. FHFA Br. 26. FHFA never says what other "goals and priorities" HERA requires it to pursue or how the Net Worth Sweep furthered them, but 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.

2. Defendants likewise miss the mark when they invoke FHFA's "[i]ncidental power[ ] . . . as conservator" 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). This provision authorizes FHFA to act in its own interests "as conservator," and FHFA does not advance its conservatorship interests when it permanently dissipates assets it is charged with preserving and conserving and makes it impossible for the Companies to operate in a sound manner. Any other interpretation of the general incidental powers provision would nullify the specific rehabilitative mission assigned to the conservator in Section 4617(b)(2)(D). *See RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2071 (2012) ("It is a commonplace of statutory construction that the specific governs the general."). That the power in Section 4617(b)(2)(J) is labeled "[i]ncidental" further reinforces this conclusion. Confronted with a similarly structured statute in *Brannan v. Stark*, 342 U.S. 451, 463 (1952), the Supreme Court rejected an interpretation of an "incidental" powers provision that would have swallowed much of the rest of the statute: "We do not think it likely that Congress, in fashioning this intricate . . . machinery, would thus hang one of the main gears on the tail pipe."

Defendants' position is also at odds with the longstanding interpretation of materially identical provisions of FIRREA and its predecessors. The Supreme Court has said that when "the FDIC is acting only as a receiver of a failed institution" "it

is *not* pursuing the interest of the Federal Government as a bank insurer," *Atherton v. FDIC*, 519 U.S. 213, 225 (1997) (emphasis added), despite FIRREA's similar authorization of the receiver to pursue "the best interests of . . . the [FDIC]," 12 U.S.C. § 1821(d)(2)(J). Indeed, even though the FDIC may consider its own best interests when it acts as conservator, FIRREA elsewhere refers to "the conservator's fiduciary duty to minimize the institution's losses." 12 U.S.C. § 1831f(d)(3). And despite hundreds of federal conservatorships and receiverships that have occurred over the decades, Defendants cannot identify a single instance in which another conservator or receiver has drained its ward's assets for the exclusive benefit of the federal government. That is not surprising, for legislative history makes clear that when Congress first authorized federal receivers to take their own "best interests" into account, it anticipated that they would "give due consideration to the interest of all the claimants upon the assets of the association, including general creditors, uninsured depositors*, and association stockholders*." H.R. REP. NO. 1263, at 10 (1968) (emphasis added).

Defendants' interpretation of Section 4617(b)(2)(J) would also mean that the imposition of conservatorship itself nullifies the economic rights of shareholders, thus exposing the federal government to takings liability. This Court has in the past rejected interpretations of FIRREA that would have caused conservatorship to trigger a shareholder right to just compensation, and it should do the same here.

Levin v. Miller, 763 F.3d 667, 672 (7th Cir. 2014); *see American Cont'l Corp. v. United States*, 22 Cl. Ct. 692, 698 (1991) (FIRREA receivership was not a taking because incidental powers provision does not "sanction arbitrary action" or nullify receiver's obligation "ultimately to turn all remaining proceeds over to . . . shareholders after making payments to depositors, creditors, and other claimants and after paying expenses").

3. Defendants' interpretation of HERA would leave FHFA with no intelligible principle to guide its exercise of discretion when it acts as conservator, thus rendering the statute unconstitutional under the nondelegation doctrine. Pls. Br. 41-42. Both Defendants seek to find an intelligible principle in Section 4617(a)(2)'s statement 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 at most describes the "boundaries" of FHFA's discretion and does not "supply an 'intelligible principle' for the exercise of that discretion within those boundaries," *see United States v. Nichols*, 784 F.3d 666, 676 (10th Cir. 2015) (Gorsuch, J., concurring)—particularly when Defendants (wrongly) insist that FHFA as conservator is free to pursue *any* of these purposes, not just the rehabilitative one that the statute assigns to it. In other litigation, Treasury has contended that there is no nondelegation problem because Section 4617(b)(2)(J) "instruct[s]" FHFA "to act in the best interests of the regulated entity or the Agency."

Treas. Br. 27, *Saxton v. FHFA*, No. 17-1727 (8th Cir. June 27, 2017) (quotation marks omitted). But Section 4617(b)(2)(J) begins with the very same words—"[t]he Agency may, as conservator"—that Treasury says make Section 4617(b)(2)(D) entirely optional.

Defendants also emphasize that it has been many years since the Supreme Court struck down a statute under the nondelegation doctrine. FHFA Br. 50; Treas. Br. 25. But that is because under the cannon of constitutional avoidance courts strive to interpret statutes in a manner that *avoids* a nondelegation issue. *See Mistretta v. United States*, 488 U.S. 361, 373 n.7 (1989). The Supreme Court took that approach in *Fahey v. Malonee*, 332 U.S. 245, 250-53 (1947), and FHFA candidly asserts that it believes its conservatorship powers go far beyond those of the conservator in that case, FHFA Br. 30 n.9.

4. An essential part of FHFA's conservatorship "mission[ ]" is "to carry on the business of the institution[s]" under its care, *RTC v. CedarMinn Bldg. Ltd. P'ship*, 956 F.2d 1446, 1453 (8th Cir. 1992), 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, 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 conclusion in provisions of HERA that instruct the receiver to establish a "limited-life regulated entity." FHFA Br. 43 (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). Indeed, the limited time within which FHFA is required to *complete* "wind up" of the entity shows that HERA uses this term as a synonym for "liquidate."

This Court's decision in *Courtney*, 485 F.3d at 948, does not suggest that a conservator is free to evade the statutory order of priorities by winding up its ward during conservatorship. In *Courtney*, 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 Court 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. 21. 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 that authority as well—so long as it lawfully places the Companies into receivership and follows the procedures HERA specifies for distributing the Companies' assets. Whatever the scope of FHFA's authority to change the Companies' business model during conservatorship, this authority does not encompass the power to permanently dissipate assets the conservator is charged with preserving and conserving.

5. 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). 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. 46-47. Indeed, since the Net Worth Sweep went into effect, FHFA has described the Companies as "effectively balance sheet insolvent" and "a textbook illustration of financial instability." Defs. Mot. to Dismiss 19, *Samuels v. FHFA*, No. 13-cv-22399 (S.D. Fla. Dec. 6, 2013), ECF No. 38. Permanently dissipating the Companies' assets and income and requiring them to operate with no capital is the opposite of "preserv[ing] and

conserv[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, which must be taken as true at this stage of the litigation:

Defendants' Assertion	Complaint's Allegation
"The enterprises were on the precipice of failure in 2008 . . . ." Treas. Br. 22.	"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." A19 ¶ 42.
Treasury "was the only entity willing to invest the billions of dollars the Entreprises needed." FHFA Br. 2.	In 2008 the Companies "retained billions of dollars of capital that could be used to cover any future losses" and "held hundreds of billions of dollars in unencumbered assets that could be pledged as collateral if necessary." A5, A19 ¶¶ 8, 42.
"Had Treasury not cured [the Companies'] net-worth deficiencies, one or both of the [Companies] would have been forced into mandatory receivership and liquidation." FHFA Br. 9.	"[T]he paper losses Fannie and Freddie reported during the early years of conservatorship were the result of temporary and unrealistic accounting decisions" made at Defendants' behest, and the Companies' losses "were never so severe that they would have had a negative net worth" but for these unjustified decisions. A43 ¶ 91.
"In 2013 and 2014, . . . the enterprises' net worth was substantially higher than expected." Treas. Br. 11.	"[T]he Agencies knew that the Net Worth Sweep would result in a massive financial windfall for the federal government . . . ." A62 ¶ 129.

The Companies "anticipated that they would not be able to pay their 10% dividends to Treasury without drawing on Treasury's funding commitment in the future." Treas. Br. 10.	When the Net Worth Sweep was announced, Defendants "fully understood that the Companies would be generating huge profits, far in excess of the dividends owed" under the prior arrangement. A10 ¶ 15.
The Net Worth Sweep "relieved the enterprises of their obligation to pay a fixed 10% cash dividend to Treasury." Treas. Br. 27.	The Companies "never were required to pay a cash dividend to Treasury but rather had the discretion to pay dividends in kind." A28 ¶ 65.
Prior to the Net Worth Sweep, dividend payments "threatened to diminish Treasury's remaining commitment." Treas. Br. 19.	"[T]here was never any risk that payments of dividends would render the Companies insolvent," A30 ¶ 70, and in August 2012 the risk that the Companies would exhaust Treasury's funding commitment "was at its lowest point since the start of the conservatorships," A49-50 ¶ 103.
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. 26.[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. A63 ¶ 130.

Defendants contradict numerous allegations in the Complaint, including the allegation that the Companies had returned to sustained profitability in 2012. Defendants also misunderstand how the Net Worth Sweep altered the Companies' dividend payments when they assert that Treasury accepted a "risk" that the

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

Companies would earn less than the previous 10% cash dividend on Treasury's stock. FHFA Br. 12; Treas. Br. 11, 27. 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. Even before the Net Worth Sweep, the Companies' net dividend payments to Treasury never exceeded their net worth. Furthermore, the "risk" of non-payment of dividends is inherent in the concept of equity since companies are never obligated to pay undeclared dividends and are in fact prohibited from doing so when it would render them insolvent. The original PSPAs recognized this reality by authorizing the Companies to pay Treasury's dividends in kind with additional stock rather than in cash.

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

Plaintiffs' opening brief explains why FHFA violated Section 4617(a)(7) by agreeing to transfer some of its conservatorship powers to Treasury in the PSPAs and subsequently agreeing to the Net Worth Sweep at Treasury's direction. Pls. Br. 52-55.

Defendants contend that Plaintiffs' Section 4617(a)(7) claims fail under the zone of interests test, but this test is "not . . . especially demanding" and requires only that Plaintiffs' interests be "*arguably* within the zone of interests" protected by the statute. *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Patchak*, 567 U.S. 209, 224-25 (2012) (emphasis added). As Defendants' own 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 under a provision that "protects *the Conservator* from state and federal encroachment." FHFA Br. 45; *see* Treas. Br. 29-30. 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. That is precisely the interest Plaintiffs' Section 4617(a)(7) claims would vindicate, and the expansive zone of interests test requires no more.

Treasury also argues in passing that Plaintiffs' claims are time barred to the extent they challenge provisions of the original 2008 PSPAs. Treas. Br. 30. But when a plaintiff's injury "becomes apparent only in light of later events," *Macklin v. United States*, 300 F.3d 814, 824 (7th Cir. 2002), or "a series of wrongful acts blossoms into an injury on which suit can be brought," *Limestone Dev. Corp. v. Village of Lemont*, 520 F.3d 797, 801 (7th Cir. 2008), the plaintiff's time to file suit does not begin to run until he or she is actually injured. This doctrine has especially broad application where unlawful agency action is concerned: subsequent agency decisions that give "new significance" to an earlier action or that "significantly alter[ ] the stakes of judicial review" will restart the statute of limitations. *Kennecott*

Utah Copper Corp. v. Department of Interior, 88 F.3d 1191, 1227 (D.C. Cir. 1996); *Illinois Cent. Gulf R.R. Co. v. I.C.C.*, 720 F.2d 958, 961 (7th Cir. 1983). It was not until the Net Worth Sweep was announced that it became apparent that Treasury would exercise the conservatorship powers unlawfully conferred upon it by the PSPAs in a way that would nullify the economic rights of minority shareholders. All of Plaintiffs' claims are therefore timely.

III. HERA's Succession Clause Does Not Strip Plaintiffs of Their Ability To Sue To Vindicate Their Personal Rights Under the APA.

Defendants ask the Court to affirm on the theory that Plaintiffs' APA claims cannot go forward during conservatorship due to HERA's Succession Clause, 12 U.S.C. § 4617(b)(2)(A). The *Perry Capital* court did not embrace this argument even though it was pressed by Treasury and, had it been accepted, would have obviated the divided panel's need to prepare lengthy competing opinions on the meaning of Section 4617(f). This Court should not accept it either.[3]

A. The Succession Clause Does Not Bar Direct Claims, and Plaintiffs' APA Claims Are Direct.

"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*, 763 F.3d at 672. This Court has already rejected

[3] Of course, this is an issue that the district court did not reach, and this Court need not address it in the first instance.

FHFA's interpretation of the materially identical provision of FIRREA on constitutional avoidance grounds, explaining that it would "pose the question whether . . . stockholders would be entitled to compensation for a taking." *Id.* Every other court of appeals to consider this question has likewise concluded that the Succession Clause does not transfer direct shareholder claims. *Perry Capital*, 848 F.3d at 1105; *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).

Whether a shareholder is asserting claims "with respect to" the Companies within the meaning of Section 4617(b)(2)(A) is thus a question of federal law that depends on the distinction between direct and derivative claims. The closely related shareholder standing rule "generally prohibits shareholders from initiating actions to enforce the rights of the corporation unless the corporation's management has refused to pursue the same action for reasons other than good-faith business judgment." *Franchise Tax Bd. v. Alcan Aluminium Ltd.*, 493 U.S. 331, 336 (1990). "There is, however, an exception to this rule allowing a shareholder with a direct, personal interest in a cause of action to bring suit even if the corporation's rights are also implicated." *Id.* As with other applications of third-party standing doctrine, determining whether a litigant has a sufficiently direct, personal interest to obviate the need to sue derivatively is "closely related to the question whether a person in

the litigant's position would have a right of action on the claim." *Department of Labor v. Triplett*, 494 U.S. 715, 721 n.** (1990).

The direct or derivative nature of Plaintiffs' claims thus ultimately turns on whether Plaintiffs are entitled to sue on behalf of themselves under the APA's "generous review provisions." *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 395 (1987). They are. The APA confers a cause of action on any person "adversely affected or aggrieved by agency action within the meaning of a relevant statute," 5 U.S.C. § 702, thus sweeping away more demanding third-party standing requirements and giving *personal* rights to anyone who is "arguably within the zone of interests to be protected or regulated by the statute that he says was violated." *Patchak*, 567 U.S. at 224 (quotations omitted); *see FAIC Sec., Inc. v. United States*, 768 F.2d 352, 357 (D.C. Cir. 1985) (explaining that through the APA "Congress itself has pared back traditional prudential limitations" on standing). Litigants who fall within the zone of interests have direct, personal rights under the APA and thus need not demonstrate third-party standing or comply with the procedural requirements for suing derivatively. *Cf. Haitian Refugee Ctr. v. Gracey*, 809 F.2d 794, 811 (D.C. Cir. 1987); *FAIC*, 768 F.2d at 357.[4] Because Plaintiffs' *personal*

[4] Treasury's reliance on *Flynn v. Merrick*, 881 F.2d 446, 450 (7th Cir. 1989), a RICO case, is misplaced. While the APA relaxes the usual standards for determining who may sue, RICO imposes *heightened* requirements. *See 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).

interests are within the zone of interests protected by HERA, they are not limited to challenging the Net Worth Sweep on the Companies' behalf.

Treasury resists this argument and urges the Court to look to Delaware law to determine whether Plaintiffs' claims are direct. But the Court should not lightly read state corporation law to limit Congress's sweeping conferral of standing in the APA. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 99 (1991). In any event, Delaware courts tasked with deciding whether a claim is direct or derivative begin by looking to "the laws governing" the claim in question. *Citigroup Inc. v. AHW Inv. P'ship*, 140 A.3d 1125, 1126 (Del. 2016). Where, as here, the substantive law that gives rise to a claim provides that the claim "belong[s] to the stockholder," the claim is direct without the need for further inquiry. *Id.*

Treasury skips over this threshold issue in favor of applying the test from *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). But *Tooley* is not "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). "Before evaluating a claim under *Tooley*," under Delaware law "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?" *Citigroup*, 140 A.3d at 1127

(quotation marks omitted); *see Perry Capital*, 848 F.3d at 1108 (ruling that contract claims were direct because they "belong to" shareholders and therefore declining to "subject them to the two-part test set forth in *Tooley*").

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.9, 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 in this manner not because it was obvious how to apply *Tooley* but because *Tooley* was "not relevant" to the analysis. *Id.* at 1126-27. In the same way here, because Plaintiffs seek to assert their personal rights under the APA, their claims are direct without regard to *Tooley*.

Even if the *Tooley* test did apply, Plaintiffs' claims would still be direct. 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—was suffered by Plaintiffs directly. That injury "is not dependent on an injury to [either] corporation." *Tooley*, 845 A.2d at 1036. Indeed, even if the Net Worth Sweep had somehow benefited the

Companies, Plaintiffs would still be directly injured. Furthermore, Delaware courts are "more prepared to permit the plaintiff to characterize the action as direct when the plaintiff is seeking only injunctive or prospective relief," as in this case. *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 Gatz v. Ponsoldt*, 925 A.2d 1265, 1278 (Del. 2007).

B. Shareholders May Bring Derivative Claims Where the Conservator Has a Manifest Conflict of Interest.

Even if Plaintiffs' APA claims were construed to be derivative, they could still assert them 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 suit. *See* 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 Wal-Mart Stores, Inc. Del. Derivative Litig.*, 2017 WL 3138201 (Del. Ch. July 25, 2017), *with In re Sonus Networks*, 499 F.3d 47, 64 (1st Cir. 2007). But the Supreme Court has held 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). Due process compels the same conclusion here and 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. Before Congress enacted HERA, both the Federal and Ninth Circuits had interpreted 12 U.S.C. § 1821(d)(2)(A)(i), the provision of FIRREA on which HERA's Succession Clause was modeled, as permitting shareholders to maintain a derivative suit when the conservator or receiver has a manifest 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). When Congress reenacted substantially the same language in HERA, it must be presumed to have adopted these consistent judicial constructions. *See Bragdon v. Abbott*, 524 U.S. 624, 645 (1998); *Firstar Bank v. Faul*, 253 F.3d 982, 988 (7th Cir. 2001).

In declining to follow *First Hartford* and *Delta Savings Bank* and dismissing derivative fiduciary duty claims, the *Perry Capital* majority concluded that "two circuit court decisions" are not enough to "settle the meaning of the existing statutory provision." 848 F.3d at 1106 (alterations omitted). But in light of the importance of financial markets' "settled expectations" in this sensitive area and Congress's

manifest intent to reassure investors by including in HERA conservatorship provisions modeled on the familiar provisions of FIRREA, *see Perry Capital*, 848 F.3d at 1127 (Brown, J., dissenting), prior constructions of FIRREA deserve great weight. That is particularly so for the Federal Circuit's resolution of this issue given the path-making role the *First Hartford* decision played in the extensive savings and loan crisis litigation that followed the Supreme Court's decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996).

In any event, *First Hartford* and *Delta Savings Bank* were correctly decided. HERA explicitly contemplates that during conservatorship a "regulated entity" may sue "for an order requiring the Agency to remove itself as conservator." 12 U.S.C. § 4617(a)(5)(A). Since FHFA controls the Companies during conservatorship and cannot sue itself, this provision would be meaningless if shareholders were unable to sue the conservator derivatively on behalf of the Companies when FHFA is conflicted. *See United States v. I.C.C.*, 337 U.S. 426, 430 (1949) (recognizing the "general principle that no person may sue himself"). Moreover, HERA's Succession Clause does not purport to *eliminate* any shareholder rights but only provides that FHFA temporarily "succeed[s]" to them. *See* FHFA Br. 56 (conceding that "the Succession Provision does not *terminate* any rights upon conservatorship"); *Levin*, 763 F.3d at 671 (analogous FIRREA provision "is designed to allocate claims between the FDIC and other injured parties; it is not designed to vaporize claims that

otherwise exist"). For this reason as well, HERA should not be read as making FHFA the "successor" to rights it is powerless to exercise. *See Delta Savings*, 265 F.3d at 1024.

3. Defendants' efforts to distinguish *First Hartford* and *Delta Savings* are unpersuasive. FHFA argues that a conflict of interest exception makes "less sense in the conservatorship context." FHFA Br. 57. 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. Treasury argues that *First Hartford* and *Delta Savings* only apply where a derivative claim concerns conduct that occurred prior to the conservatorship. Treas. Br. 49. But neither court's analysis turned on when 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.

CONCLUSION

The district court's judgment should be reversed.

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Respectfully submitted,

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This brief complies with the type-volume limitation of Seventh Circuit Rule 32(c) because this brief contains 7,000 words, excluding the parts of the brief exempted by Rule 32(f) of the Federal Rules of Appellate Procedure.

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CERTIFICATE OF SERVICE

I hereby certify that on August 21, 2017, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Seventh 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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