UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

ATIF F. BHATTI, *et al.*, Plaintiffs, v. THE FEDERAL HOUSING FINANCE AGENCY, *et al.*, Defendants.	Case No. 0:17-cv-02185 (PJS/HB)

MEMORANDUM OF LAW IN SUPPORT OF FHFA DEFENDANTS' MOTION TO DISMISS

INTRODUCTION

This case is the latest in a protracted series of civil actions around the country in which shareholders of government-sponsored enterprises Fannie Mae and Freddie Mac (the "Enterprises") attack agreements between the Federal Housing Finance Agency ("FHFA"), as Conservator of those Enterprises, and the U.S. Department of the Treasury, providing for an extraordinary infusion of billions of dollars of capital into the Enterprises. Specifically, Plaintiffs challenge the Third Amendment to preferred stock purchase agreements between the Conservator and Treasury. Numerous courts have roundly rejected these claims.

Most of the prior lawsuits sought review of the Third Amendment under the Administrative Procedure Act. In this case, however, Plaintiffs refrain from any claim directly attacking the Third Amendment on its merits. Rather, the shareholders advance a panoply of novel theories that FHFA's structure and the statute creating FHFA are unconstitutional and therefore the Third Amendment must be vacated.

Those claims are entirely without merit, and one court has already rejected Plaintiffs' principal claim—that it is unconstitutional for FHFA to have a Director removable by the President only for cause. That claim fails under longstanding Supreme Court precedent, as do Plaintiffs' other claims. The Court should dismiss this case with prejudice.

FACTUAL AND PROCEDURAL BACKGROUND

A. Fannie Mae, Freddie Mac, and FHFA

Fannie Mae and Freddie Mac are chartered by Congress to provide liquidity to the mortgage market by purchasing residential loans. ECF No. 27, ¶ 10 ("Compl."). In early

2008, the Enterprises suffered multi-billion dollar losses on their mortgage portfolios and guarantees. *Id.* ¶ 25. In July 2008, "[c]oncerned that a default by Fannie and Freddie would imperil the already fragile national economy," *Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 599 (D.C. Cir. 2017), Congress enacted the Housing and Economic Recovery Act of 2008 ("HERA"), Pub. L. No. 110-289, 122 Stat. 2654, 2661 (codified at 12 U.S.C. § 4511 *et seq*.).

HERA created a new agency, FHFA, to supervise and regulate the Enterprises. 12 U.S.C. § 4511. Congress provided that FHFA would be headed by a Director appointed by the President and confirmed by the Senate to serve "for a term of 5 years, unless removed before the end of such term for cause by the President." *Id.* § 4512(b).

Congress also provided that FHFA would have three Deputy Directors. *Id.* § 4512(c)-(e). To ensure continuity of agency operations during a vacancy in the office of Director, Congress empowered "the President [to] designate [a Deputy Director] to serve as acting Director until ... the appointment of a successor pursuant to subsection (b)." *Id.* § 4512(f). Congress did not limit how long a Deputy Director could serve as acting Director, nor did it limit the President's power to withdraw such a designation.

Congress authorized FHFA to place the Enterprises in conservatorship "for the purpose of reorganizing, rehabilitating, or winding up [their] affairs." *Id.* § 4617(a)(2). HERA further authorized the Treasury Department to purchase securities from the Enterprises to "provide stability to the financial markets," "prevent disruptions in the availability of mortgage finance," and "protect the taxpayer." *Id.* §§ 1455(*l*), 1719(g).

B. The Conservatorships and Preferred Stock Purchase Agreements

In September 2008, having concluded that the Enterprises could not operate safely and soundly and fulfill their critical statutory mission, FHFA placed the Enterprises into conservatorships. Compl. ¶ 28. Simultaneously, Treasury entered into Senior Preferred Stock Purchase Agreements ("PSPAs") with the Enterprises, committing to advance funds to each Enterprise for each quarter in which that Enterprise's liabilities exceeded its assets, up to a cumulative amount of $100 billion per Enterprise. *Id.* ¶¶ 31, 32.[1] Each Enterprise committed to pay Treasury a 10% annual dividend, assessed quarterly, based on the total cumulative amount drawn from Treasury (known as the liquidation preference). *Id.* ¶¶ 36, 39. In the ensuing years, Treasury provided the Enterprises with tens of billions of dollars under this arrangement. *Id.* ¶ 51.

C. The Designation of Edward DeMarco as Acting FHFA Director and Unsuccessful Nomination of Joseph Smith for FHFA Director

In August 2009, the original FHFA Director, James B. Lockhart III, resigned. Compl. ¶ 42. Career civil servant Edward DeMarco was serving as one of FHFA's Deputy Directors. *Id.* ¶ 43. On August 25, 2009, the President designated Deputy Director DeMarco to serve as acting Director pursuant to 12 U.S.C. § 4512(f). *Id.*

On November 12, 2010, President Obama nominated Joseph Smith as FHFA Director. *Id.* ¶ 44; 156 Cong. Rec. S7911 (Nov. 15, 2010). Although the Senate Banking Committee approved the nomination, opposition blocked a vote in the full Senate, eventually forcing the President to withdraw the nomination. Compl. ¶ 44; 156 Cong. Rec. S11071 (Dec. 22, 2010).

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[1] The PSPAs were later amended to raise the cap to $200 billion and then to substitute an even higher cap to be calculated by a formula. Compl. ¶ 41.

D. The Third Amendment to the PSPAs

As Treasury's liquidation preferences climbed into the hundreds of billions, the Enterprises' 10% dividend obligations were substantial. Between 2009 and 2011, the Enterprises' net worths were insufficient to pay the dividends, and they drew billions more from Treasury to make their payments. Compl. ¶ 51. Those draws further increased Treasury's liquidation preferences and the Enterprises' future dividend obligations. *Id.* By June 2012, the Enterprises had collectively drawn $187 billion under the PSPAs. *Id.*

On August 17, 2012, FHFA, acting as the Enterprises' Conservator, and Treasury executed the Third Amendment to the PSPAs, which is the focus of this litigation. *Id.* ¶ 55. The Third Amendment replaced the fixed-rate 10% annual dividend with a quarterly variable dividend equal to each Enterprise's positive net worth (if any), subject to a declining capital reserve. *Id.* After the Third Amendment, if an Enterprise's net worth is negative in a given quarter, it owes no dividend. If an Enterprise's net worth is positive, it pays that amount as a dividend, whether greater or less than the prior 10% dividend obligation. *Id.*

E. The Nomination and Confirmation of FHFA Director Watt

On May 1, 2013, President Obama nominated Rep. Melvin L. Watt as FHFA Director. Compl. ¶ 44. The Senate Banking Committee approved the nomination, 159 Cong. Rec. S5799 (July 18, 2013), but it was filibustered in the full Senate, 159 Cong. Rec. S7706 (Oct. 31, 2013). After the Senate took the historic action of abolishing the filibuster for certain executive nominees, Rep. Watt was confirmed. 159 Cong. Rec. S8417-04 at 8417-18 (Nov. 21, 2013); 159 Cong. Rec. S8593 (Dec. 10, 2013). Over

eight months after being nominated, Mr. Watt was sworn in as FHFA Director on January 6, 2014 for a five-year term, which automatically ended Mr. DeMarco's tenure as Acting Director. Compl. ¶ 44.

F. The Coordinated Shareholder Litigation Campaign Attacking the Third Amendment

Beginning in 2013, shareholders of the Enterprises waged a coordinated litigation campaign attacking the Third Amendment in courts across the country. For the first three years of litigation, the shareholders claimed that the Conservator acted outside its statutory authority and violated the Administrative Procedure Act by executing the Third Amendment. Every court that considered those arguments rejected them.[2] In late 2016, shareholder plaintiffs filed a new action in Texas federal court alleging, in addition to APA counts that were routine in the prior challenges, that HERA violates the Constitution by establishing FHFA as an independent agency headed by a single Director removable by the President only for cause. The court dismissed that action as well. *See Collins v. FHFA*, 2017 WL 2255564 (S.D. Tex. May 22, 2017), *appeal docketed*, No. 17-20364 (5th Cir.).

Within a few weeks of the dismissal of *Collins*, shareholder plaintiffs filed this action, as well as an action raising exactly the same claims in the Western District of Michigan. *Rop v. FHFA*, No. 1:17-cv-00497 (W.D. Mich. filed June 1, 2017). In this action (and *Rop*), plaintiffs rehash the same removal-restriction claim rejected in *Collins*,

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[2] *See, e.g.*, *Perry Capital*, 864 F.3d 591; *Roberts v. FHFA*, 2017 WL 1049841 (N.D. Ill. Mar. 20, 2017), *appeal docketed*, No. 17-1880 (7th Cir.); *Saxton v. FHFA*, 2017 WL 1148279 (N.D. Iowa Mar. 27, 2017), *appeal docketed*, No. 17-1727 (8th Cir.); *Robinson v. FHFA*, 223 F. Supp. 3d 659 (E.D. Ky. 2016), *appeal docketed*, No. 16-6680 (6th Cir.); *Cont'l W. Ins. Co. v. FHFA*, 83 F. Supp. 3d 828, 840 (S.D. Iowa 2015).

and add claims under the separation of powers, the Appointments Clause, and the non-delegation doctrine.

ARGUMENT

I. THE COURT SHOULD DISMISS PLAINTIFFS' CONSTITUTIONAL CHALLENGES TO FHFA'S STRUCTURE

Plaintiffs allege in Count I that the Third Amendment should be vacated because HERA "violates the President's constitutional removal authority" by "making FHFA's head a single Director rather than a multi-member board and eliminating the President's power to remove the Director at will." Compl. ¶ 76. Plaintiffs allege in Count II that "this feature of FHFA's structure" violates the separation of powers "when combined with" HERA's funding mechanism for FHFA and its limitations on judicial review of certain FHFA actions. *Id.* ¶¶ 84-86.

The Court should dismiss both counts for failure to state a claim because Plaintiffs lack standing to assert the claims; Plaintiffs' legal theories are contrary to longstanding Supreme Court precedent upholding the constitutionality of independent agencies; and the funding mechanism and limitations on judicial review Congress chose to adopt for FHFA are irrelevant to the constitutionality of FHFA's structure.

A. Plaintiffs Lack Standing

To have standing to challenge the constitutionality of a statute, Plaintiffs must show an injury-in-fact, "a causal connection between the injury" and the alleged constitutional violation (*i.e.*, traceability), and a likelihood that the injury "will be redressed by a favorable decision" (*i.e.*, redressability). *Constitution Party of S.D. v. Nelson*, 639 F.3d 417, 420 (8th Cir. 2011); *accord Comm. for Monetary Reform v. Bd. of*

Governors of Fed. Reserve Sys., 766 F.2d 538, 542-43 (D.C. Cir. 1985) (dismissing separation-of-powers claim for lack of standing). Plaintiffs claim to have been injured by the Third Amendment. But that injury is not traceable to the requirement of cause for removal of a Senate-confirmed FHFA Director, and would not be redressed by a judicial holding that such a cause requirement is unconstitutional.

1. For two independent reasons, Plaintiffs cannot show the necessary "causal connection" between the alleged constitutional violation and their alleged injury. *First*, the Conservator's decision to enter into the Third Amendment was made by an official who did not have the allegedly unconstitutional tenure protection. Plaintiffs attack 12 U.S.C. § 4512(b)(2), which provides that an FHFA Director appointed by the President and confirmed by the Senate shall serve "for a term of 5 years, unless removed before the end of such term for cause by the President." But Plaintiffs concede that an *acting* Director, *not* a permanent Director confirmed by the Senate for a term of five years, made the decision on behalf of FHFA to enter into the Third Amendment. Compl. ¶¶ 43-46.

As Plaintiffs further concede, the circumstances under which someone at FHFA may serve as acting Director are governed by a *separate* provision of the statute, § 4512(f). *Id*. ¶ 43. Section 4512(f) does not give an acting Director any fixed term nor does it contain any "cause" limitations on the President's authorities; rather, it simply provides that the designated Deputy Director may act as Director until a permanent Director is appointed and confirmed or the acting designation is withdrawn. Plaintiffs therefore cannot show any causal link between the for-cause removal provision in § 4512(b)(2) and the Third Amendment.

Second, the crux of Plaintiffs' claim is that "the President has less influence over [FHFA's] decisions" than the Constitution requires. *Id.* ¶ 16. Thus, traceability requires Plaintiffs to demonstrate that *more* Presidential influence over FHFA might have spurred FHFA to reject the Third Amendment. But Plaintiffs' own allegations indicate exactly the opposite. Plaintiffs allege that the Third Amendment is a contract between FHFA as Conservator and the Secretary of the Treasury, *see*, *e.g.*, *id.* ¶ 55, and there is no dispute that the Secretary is removable by the President at will and subject to plenary Presidential control. Had the President not supported the Third Amendment, he of course could have directed Treasury not to enter into it. He did not, and the Amended Complaint does not allege that more presidential influence over Treasury's contractual counterparty would have led to any different outcome.

2. Nor would a holding that § 4512(b)(2) is unconstitutional redress Plaintiffs' alleged injury. When a limitation on the President's removal authority crosses constitutional lines (which is not the case here), the remedy is to declare that limitation prospectively inoperative, not to void past actions by the official who was protected from removal. Where, as here, Plaintiffs' alleged injury stems from past action that would not be undone by a victory in court, Plaintiffs cannot show redressability.

In its most recent removal-restrictions case, the Supreme Court held unconstitutional certain unique restrictions on the President's ability to remove members of the Public Company Accounting Oversight Board ("PCAOB"). *Free Enter. Fund v. PCAOB*, 561 U.S. 477 (2010). However, the Court "reject[ed]" the plaintiff's argument that the removal restrictions rendered "all power and authority exercised by [the PCAOB] in violation of the Constitution." *Id.* at 508 (internal quotation marks omitted). It was

not "the existence of the Board" that "violate[d] the separation of powers," but the particular removal restrictions in the statute. *Id*. at 508-09. "When confronting a constitutional flaw in a statute, [courts] try to limit the solution to the problem;" thus, the appropriate remedy for such a claim is simply to excise the problematic provisions so that they do not constrain the President's powers going forward. *Id.* at 508 (internal quotation marks omitted); *accord John Doe Co. v. CFPB*, 849 F.3d 1129, 1133 (D.C. Cir. 2017).

Thus, if Plaintiffs here were to succeed on their constitutional claim, the result would be an order striking the "cause" limitation from § 4512(b)(2) and altering the conditions under which an FHFA Director might be removed by the President in the future. That would not help Plaintiffs, who complain not of any current or anticipated future action by FHFA but rather about entry into the Third Amendment five years ago. Plaintiffs protest that they are suffering "ongoing injuries," Compl. ¶ 81, but any such injuries stem from the historical adoption of the Third Amendment.

Moreover, to the extent vacatur could ever be an appropriate remedy for a removal-restriction claim, the agency action of which vacatur was sought would at least have to be executive in nature. After all, the theoretical underpinning for Count I is that the "'executive Power [is] vested in [the] President'" and limiting his control of other officials who perform executive functions could interfere with his duty to "'take Care that the Laws be faithfully executed.'" *Id*. ¶ 75 (quoting U.S. Const. art. II, §§ 1, 3). Thus, vacatur of agency action could only be appropriate, if at all, for actions of a type "exclusively confined to the Executive Branch." *John Doe Co.*, 849 F.3d at 1132 (holding that claims challenging limitations on the President's ability to remove the CFPB Director would not justify invalidating ongoing CFPB investigative request

because the act of "requesting information from private entities" is not exclusively confined to the Executive).

As the *Collins* court held, "the challenged Third Amendment was adopted by the FHFA in its capacity as conservator of Fannie Mae and Freddie Mac, not as an executive enforcing the laws of the United States." 2017 WL 2255564, at *5. When government agencies like FHFA serve as conservators or receivers for financial institutions, they "step into [the] shoes" of those institutions. *Herron v. Fannie Mae*, 861 F.3d 160, 169 (D.C. Cir. 2017). Thus, when acting on behalf of those institutions, they are not acting as the Government at all, let alone carrying out functions that are "Executive" in character. *Id.*; *Meridian Invs., Inc. v. Freddie Mac*, 855 F.3d 573, 579 (4th Cir. 2017). Here in particular, when the Conservator approved the Third Amendment, the Conservator was engaging in a business transaction on behalf of private entities, not carrying out law enforcement or other executive governmental functions that are exclusively confined to the Executive Branch. Redressability is therefore lacking.

B. HERA's For-Cause Standard For Removal of a Senate-Confirmed FHFA Director Is Constitutional

Even if Plaintiffs had standing, their constitutional challenge to FHFA's structure is nevertheless contrary to well-established Supreme Court precedent. The Court should dismiss it for failure to state a claim.

1. Longstanding Supreme Court Precedent Endorses Independent Agencies

In *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), the Supreme Court held that Congress may "create independent agencies run by principal officers appointed by the President, whom the President may not remove at will but only for good cause."

Free Enter. Fund, 561 U.S. at 483. The Court "found it 'plain' that the Constitution did not give the President 'illimitable power of removal' over the officers of independent agencies." *Morrison v. Olson*, 487 U.S. 654, 687 (1988) (quoting *Humphrey's Ex'r*, 295 U.S. at 629). The Court has repeatedly reaffirmed this central principle. *See Wiener v. United States*, 357 U.S. 349, 352 (1958); *Morrison*, 487 U.S. at 686-87; *Free Enter. Fund*, 561 U.S. at 483, 509. In the modern era, Congress has created dozens of independent agencies, performing a vast array of important functions, based on this judicially approved model. *See CFPB v. ITT Educ. Servs., Inc.*, 219 F. Supp. 3d 878, 899 (S.D. Ind. 2015).

As the court in *Collins* held, rejecting an identical claim by other Enterprise shareholders, "[v]iewed in light of this Supreme Court rubric, the structure of the FHFA does not violate the Constitution." 2017 WL 2255564, at *5. Congress created FHFA to regulate and supervise, among select other entities, Fannie Mae and Freddie Mac, financial institutions that play a vital role in housing finance. It has long been recognized that "[i]ndependence from presidential control is arguably important if agencies charged with regulating financial institutions ... are to successfully fulfill their responsibilities; people will likely have greater confidence in financial institutions if they believe that the regulation of these institutions is immune from political influence." *Swan v. Clinton*, 100 F.3d 973, 983-84 (D.C. Cir. 1996). Congress's decision that FHFA should be led by a Director removable by the President for cause serves those important interests and was well within the constitutional latitude provided to Congress by *Humphrey's Executor* and its progeny.

2. Plaintiffs' Efforts to Manufacture an Exception Are Unavailing

Plaintiffs ask this Court to create a new exception to *Humphrey's Executor* by holding that it does not apply to agencies, like FHFA, headed by a single individual. *See* Compl. ¶ 75. Numerous courts have rejected that argument. The *Collins* court rejected it in the context of an Enterprise shareholder claim identical to Count I. *See* 2017 WL 2255564, at *5. And four courts have rejected similar challenges to the constitutional structure of the Consumer Financial Protection Bureau ("CFPB"). *See CFPB v. Navient Corp.*, 2017 WL 3380530, at *9-19 (M.D. Pa. Aug. 4, 2017); *CFPB v. Future Income Payments, LLC*, 2017 WL 2190069, at *5-9 (C.D. Cal. May 17, 2017); *ITT*, 219 F. Supp. 3d at 890-99; *CFPB v. Morgan Drexen, Inc.*, 60 F. Supp. 3d 1082, 1086-92 (C.D. Cal. 2014).[3]

While *Humphrey's Executor* happened to involve an agency structured as a multi-member commission (the FTC), the number of commissioners played no part in the Court's constitutional analysis. *See* 295 U.S. at 626-32. As the *Collins* court emphasized, "the Supreme Court did not limit its decision in *Humphrey's Executor* to a multimember board rather than a single director." 2017 WL 2255564, at *6. Rather, the relevant issue is simply "'whether the removal restrictions are of such a nature that they impede the President's ability to perform his constitutional duty.'" *Id.* at *5 (quoting

[3] In October 2016, a split panel of the D.C. Circuit held that the CFPB's structural aspects combined with its "unilateral authority to bring law enforcement actions against private citizens" violated the separation of powers. *See PHH Corp. v. CFPB*, 839 F.3d 1 (D.C. Cir. 2016), *reh'g en banc granted, order vacated* (Feb. 16, 2017). However, the D.C. Circuit vacated the panel order and granted rehearing en banc in February 2017, and heard oral argument en banc in May 2017. In the meantime, the D.C. Circuit is not treating the *PHH* panel opinion as operative and rejected a request by another litigant for relief based on the *PHH* decision. *John Doe Co.*, 849 F.3d at 1131-32.

Morrison, 487 U.S. at 691). Here, because Plaintiffs claim not that the removal restriction is problematic by itself, but only when combined with FHFA's single-director structure, Plaintiffs must show that tenure protection for a single agency head impedes the President's performance of his constitutional duties to a greater degree than if the same tenure protection were provided to multiple members of a commission.

Plaintiffs cannot make that showing. The notion that a President would find it more difficult to supervise a *single* individual removable for cause than a body composed of *numerous* individuals who are each removable for cause defies logic. As one court reasoned, "[i]t is no more difficult for the President to assure that the Director of the CFPB is competently performing his or her statutory responsibilities than it was for the President to oversee the leadership of the FTC at the time of *Humphrey's Executor*." *Morgan Drexen*, 60 F. Supp. 3d at 1088. After all, "if the President had needed to fully revamp the leadership of the FTC at that time, he would have been required to [effect] five separate for cause removals, while only one is required in order to change the leadership of the CFPB." *Id.* Furthermore, "[w]ith a multi-member body, it is more difficult to assess or allocate responsibility among the members of the body for policy decisions or actions taken because decision making is made within the group and may be the product of compromise. In contrast, with a single director, it is very clear who made the decision." *Navient*, 2017 WL 3380530, at *17.

The Complaint surmises that "[i]ndependent agencies headed by multi-member boards are forced to account for multiple viewpoints, adopt compromises that result in less extreme decisions, and better resist capture by interest groups." Compl. ¶ 15. However, such speculative pronouncements about the merits of collective decision-

making are policy issues for Congress—not courts—to weigh. Congress could reasonably conclude, particularly when enacting a statute in a time of economic emergency, that a single head would be more conducive to the type of firm, immediate decisions and actions that would be committed to FHFA.

Plaintiffs contend that multi-member commissions are constitutionally preferable because "the President can influence agency actions by appointing one or more commission members and selecting the chairperson." *Id.* ¶ 16. But whether a President has such influence or not depends on the number of commission members, the lengths of the commission members' terms, and how those terms are staggered. While it is theoretically possible for an FHFA Director to "remain in office during the entire four-year term of a President," *id.*, that is no different than the situation that would apply to a board composed of multiple members selected once every five years. For the vast majority of Presidents who will have an occasion to appoint an FHFA Director within a four-year term, that appointment will have a much more "immediate impact" than a mere chance to appoint one or two commissioners, because "the appointee, and the appointee alone, now heads the agency." *Navient*, 2017 WL 3380530, at *17.

"At bottom, whether to structure an independent agency as a multimember or director-led body depends on the proper weighing of the advantages and drawbacks of each structure." *Future Income Payments*, 2017 WL 2190069, at *9. "But neither the text of the Constitution nor any Supreme Court precedent supports drawing a constitutional distinction between multimember and director-led independent agencies, so the question is properly reserved for the political branches and the democratic process." *Id*.

C. FHFA's Funding Mechanism and Limitations From Judicial Review Raise No Constitutional Issues

In Count II, Plaintiffs argue that if the FHFA Director's protection from removal without cause is constitutional in its own right (as it plainly is), that protection is nevertheless unconstitutional "when combined with other aspects of HERA," namely the funding mechanism Congress adopted for FHFA and the statutory exemptions of certain FHFA actions from judicial review. Compl. ¶ 84. However, the "other aspects" add nothing. Multiple courts have considered this "mosaic" theory of unconstitutionality in the context of the CFPB and have uniformly rejected it. *See Navient*, 2017 WL 3380530, at *9, *16; *ITT*, 219 F. Supp. 3d at 894-99; *Morgan Drexen*, 60 F. Supp. 3d at 1086-91.

Plaintiffs complain that HERA "exempts FHFA from the appropriations process by permitting FHFA to self-fund through fees it assesses on the entities it regulates without any oversight from Congress." Compl. ¶ 85 (citing 12 U.S.C. § 4516(f)(2)). But Congress frequently organizes agencies, particularly in the financial regulatory sector, to be funded through fees assessed on regulated entities. *See Navient*, 2017 WL 3380530, at *16 (collecting examples, including the Federal Reserve dating back over a century). This common mechanism presents no constitutional issue. "[T]he Constitution does not prohibit Congress from enacting funding structures for agencies that differ from the procedures prescribed by the ordinary appropriations process." *ITT*, 219 F. Supp. 3d at 896; *accord Morgan Drexen*, 60 F. Supp. 3d at 1089. Congress may choose "to loosen its own reins on public expenditure" and "not to finance a federal entity with appropriations." *Am. Fed'n of Gov't Emps., AFL-CIO, Local 1647 v. FLRA*, 388 F.3d 405, 409 (3d Cir. 2004).

Nor does Congress's decision to exempt certain FHFA actions from judicial review raise any constitutional concerns, either by itself or combined with other issues raised by Plaintiffs. It is well-established that Congress has "the power to preclude judicial review of non-constitutional challenges to agency actions." *Campbell v. OPM*, 694 F.2d 305, 307 (3d Cir. 1982); *accord Morgan Drexen*, 60 F. Supp. 3d at 1091-92 n.5. Thus, the Court should dismiss Count II for failure to state a claim.

II. THE COURT SHOULD DISMISS PLAINTIFFS' APPOINTMENTS CLAUSE CLAIM

Plaintiffs contend in Count III that the Third Amendment is invalid because at the time of its adoption, FHFA had an acting director who was not confirmed by the Senate. However, longstanding precedent permits subordinate agency officers to act temporarily as head of an agency without Senate confirmation. Plaintiffs' various allegations of defects in Mr. DeMarco's designation and tenure are barred by the *de facto* officer doctrine, non-justiciable, and in any event meritless.

A. Mr. DeMarco Was Properly and Constitutionally Designated to Act as FHFA Director While That Office Was Vacant

The Appointments Clause provides that the President must nominate and the Senate must confirm all "principal officers" of the United States. U.S. Const. art. II, § 2, cl. 2. It has long been understood, however, that to prevent the responsibilities of such an office from "go[ing] unperformed if a vacancy arises and the President and Senate cannot promptly agree on a replacement," the President may "direct certain officials to temporarily carry out the duties of a vacant [principal] office in an acting capacity, without Senate confirmation." *SW Gen., Inc. v. NLRB*, 137 S. Ct. 929, 934 (2017).

The Supreme Court settled the constitutionality of this approach long ago, holding that even though the Appointments Clause requires a full consul to be confirmed by the Senate, such confirmation was not required to enable the vice consul to perform those duties in an acting capacity: "Because the subordinate officer is charged with the performance of the duty of the superior for a limited time, and under special and temporary conditions, he is not thereby transformed into the superior and permanent official." *United States v. Eaton*, 169 U.S. 331, 343 (1898). Plaintiffs acknowledge that under this precedent, "[w]hen there is a vacancy in a position that must be filled by a principal officer, the Constitution permits an inferior officer to temporarily assume the responsibilities of the position in an acting capacity." Compl. ¶ 92.

Congress has conferred such authority through two distinct and complementary routes. First, the Federal Vacancies Reform Act ("Vacancies Act"), 5 U.S.C. § 3345 *et seq.*, generally authorizes the President to designate acting officers across government. Second, Congress sometimes includes specific acting-officer provisions within agencies' enabling statutes. FHFA's enabling statute contains such a provision in § 4512(f), which enables the President to designate one of FHFA's Deputy Directors to act temporarily as Director while that office is vacant. In some instances, Congress has imposed a time limit on how long an official can serve in an acting capacity. *See, e.g.*, Vacancies Act, 5 U.S.C. § 3346 (210 days, tolled while nomination pending, and subject to renewal for a total potential period of almost two years). In others, such as § 4512(f), Congress opted *not* to impose any time limit.

Here, the President designated Mr. DeMarco to act as Director under § 4512(f), upon Mr. Lockhart's resignation. *See* Compl. ¶ 43. Plaintiffs do not dispute that Mr.

DeMarco qualified as someone the President could designate to act as Director under HERA or that the conditions for making such a designation were satisfied. The designation of Mr. DeMarco to serve as Acting Director was plainly consistent with both HERA and the Constitution.

B. Plaintiffs' Contrary Arguments Are Without Merit

While Plaintiffs appear to concede that the Appointments Clause did not prohibit Mr. DeMarco from "temporarily assum[ing] the responsibilities of the [Director] in an acting capacity," *id.* ¶ 92, they nevertheless argue that Mr. DeMarco's service in that capacity was deficient on three grounds. Those attacks all fail for multiple reasons.

1. As a threshold matter, Count III is barred by the *de facto* officer doctrine, which "confers validity upon acts performed by a person acting under the color of official title even though it is later discovered that the legality of that person's appointment or election to office is deficient." *Ryder v. United States*, 515 U.S. 177, 180 (1995). Such protection helps avoid the risk of "chaos" and "multiple and repetitious suits challenging every action taken by every official whose claim to office could be open to question." *Id.* (internal quotation marks omitted). The *de facto* officer doctrine is a common "cure[]" for "potential infirmities in the authority" of acting officers. *Acting Officers*, 6 Op. O.L.C. 119, 122 (1982).

A plaintiff who seeks to invalidate agency action due to alleged invalidity of an officer's appointment or service must (1) bring its action "at or around the time that the challenged government action is taken," and (2) "show that the agency or department involved has had reasonable notice under all the circumstances of the claimed defect in the official's title to office." *SW Gen., Inc. v. NLRB*, 796 F.3d 67, 81 (D.C. Cir. 2015)

(internal quotation marks omitted), *aff'd on other grounds*, 137 S. Ct. 929 (2017). Here, Plaintiffs waited nearly five years after the action at issue, and over three years after Mr. DeMarco left the agency, to bring their claim. Indeed, the *Rop* case, filed the same month as this one, was the first time in nearly twenty lawsuits over four years that shareholder plaintiffs challenging the Third Amendment ever challenged Mr. DeMarco's authority as Acting Director. Thus, the *de facto* officer doctrine precludes Plaintiffs' claim.

2. Even if it were not procedurally barred, Plaintiffs' first attack on Mr. DeMarco's service—that the three years for which he had served as acting Director at the time he approved the Third Amendment "exceeded the period that was reasonable under the circumstances" (Compl. ¶ 93)—has no merit. The text of the Constitution imposes no "reasonable under the circumstances" limitation. Despite the common presence of acting officials throughout the U.S. government's history, *see SW General*, 137 S. Ct. at 935-36, no court has ever recognized such a claim, let alone invalidated agency action on that basis.[4]

The Complaint provides no hint as to how Plaintiffs would have the Court decide what time period was "reasonable under the circumstances." Because an acting official is needed for however long a vacancy persists, to assert that an acting official has stayed longer than reasonable is the equivalent of asserting that the President has taken longer

[4] While the Vacancies Act provides that acts taken after expiration of its time limits "have no force or effect," 5 U.S.C. § 3348(d), Plaintiffs do not rely on those provisions, and they do not apply here because Mr. DeMarco was designated to act under independent authority in 12 U.S.C. § 4512(f). *See* 5 U.S.C. § 3347 (providing that Vacancies Act restrictions do not apply to designations under independent statutory provisions such as § 4512(f)).

than reasonable to nominate and secure confirmation of a permanent appointee. Such an inquiry into the reasonableness of the President's efforts, however, would present non-justiciable political questions for which there are no "judicially discoverable and manageable standards." *Zivotofsky ex rel. Zivotofksy v. Clinton*, 566 U.S. 189, 197 (2012) (internal quotation marks omitted). Indeed, judicial exploration of the Administration's deliberations and strategies regarding nominations would raise grave separation-of-powers concerns. *See, e.g., Cheney v. U.S. Dist. Ct.*, 542 U.S. 367 (2004).

If the Court nevertheless entertains this novel claim, the history surrounding the President's efforts to nominate an FHFA Director easily establishes the reasonableness of those efforts, and *a fortiori* Mr. DeMarco's service as acting director in August 2012. When the vacancy arose in 2009, with the country still reeling from recession, the Enterprises' future and FHFA's future role were uncertain. Despite those hurdles, President Obama nominated an FHFA Director in the year after the vacancy arose, only to see that nomination rejected by the Senate in a highly polarized political environment. When the President later submitted the nomination of the current FHFA Director, then a sitting Member of Congress, it took seven months and the historic abolition of the filibuster for that nomination to be approved by the narrowest of party-line margins. *See supra* at 3-4, 5.

Given this fractious climate, and Plaintiffs' own allegations that the President sparred with Mr. DeMarco over policy and thus had an incentive to replace him, *see* Compl. ¶¶ 47-48, there is no basis to suspect the amount of time it took to fill the office was attributable to anything other than factors outside the President's control. The three

years Mr. DeMarco had served as Acting Director as of August 2012 are not outside the range of times for which other subordinate officials have acted in senior posts.[5]

3. Plaintiffs next argue that it was "*per se* unreasonable and unconstitutional" for Mr. DeMarco "to serve as an acting principal officer" for more than two years because "it is impossible for someone to serve as a principal officer without Senate confirmation as a *recess appointee* for more than two years." *id.* ¶ 94 (emphasis added); *see* Recess Appointments Clause, U.S. Const. art. II, § 2, cl. 3 (empowering President to fill vacancies during a Senate recess with appointments that "expire at the [e]nd" of the next Senate session). The conclusion does not follow from the premise, because Mr. DeMarco was not a recess appointee. *See Designation of Acting Solicitor of Labor*, 2002 WL 34461082, at *3 (O.L.C. Nov. 15, 2002) (contrasting acting officials with recess appointees and explaining that provisions applicable to recess appointees do not apply to acting officials).

4. Finally, Plaintiffs contend that the designation of Mr. DeMarco to serve as Acting Director was unconstitutional because the President "chose Mr. DeMarco from among three possible candidates to serve as FHFA's acting Director," as opposed to Congress specifying that he would become acting Director automatically upon a vacancy.

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[5] *See, e.g.*, *Doolin Sec. Sav. Bank v. OTS*, 139 F.3d 203, 205 (D.C. Cir. 1998) (Office of Thrift Supervision had an acting director for nearly four years); Social Security Commissioners, https://www.ssa.gov/history/commissioners.html (last visited Sept. 15, 2017) (Social Security Administration has had an acting administrator for the last four-and-a-half years); Morton Rosenberg, *The New Vacancies Act: Congress Acts to Protect the Senate's Confirmation Prerogative*, CRS Report 98-892, at CRS-4 (Cong. Res. Serv., Nov. 2, 1998) (DOJ had acting head of Criminal Division for over 30 months and acting solicitor general for over 14 months).

Compl. ¶ 95. It is the norm, however, for the President to designate acting officials, and nothing in the Constitution prohibits Congress from allowing the President to choose from among several qualified candidates. *See SW General*, 137 S. Ct. at 935 (observing that "[s]ince President Washington's first term, Congress has given the President limited authority to appoint acting officials," including via statutes allowing the President to choose "any person or persons"); Vacancies Act, 5 U.S.C. § 3345(a)(2), (3) (authorizing the President to direct a person, from among a wide field of options, to act in vacant position). Plaintiffs' novel theory that acting officials must be pre-selected by Congress would upend that long-settled understanding and is entirely without merit.

III. THE COURT SHOULD DISMISS THE NONDELEGATION CLAIMS

Plaintiffs' Count IV alleges that Congress violated the nondelegation doctrine by improperly delegating "Legislative power" to FHFA as a government agency. Compl. ¶¶ 97-103. In Count V, Plaintiffs alternatively allege that when FHFA acts as Conservator, it acts as a private entity—not the federal government—and that Congress improperly delegated to this private entity "Legislative or Executive power." *Id.* ¶¶ 104-110. Both claims fail as a matter of law because the powers FHFA as Conservator exercised by entering into the Third Amendment were neither legislative, executive, nor governmental at all in nature. To the extent FHFA might be deemed to have acted in a governmental capacity, moreover, HERA provides more than sufficient "intelligible principles" to avoid any nondelegation issue.

Under the conventional nondelegation doctrine, Congress generally cannot delegate legislative power to another branch of government. *See Mistretta v. United States*, 488 U.S. 361, 371 (1989). Cases holding that Congress violated the

nondelegation principle are rare: "with the exception of two cases in 1935, … the Supreme Court has uniformly rejected every nondelegation challenge it has considered." *United States v. Fernandez*, 710 F.3d 847, 849 (8th Cir. 2013). The modern test for nondelegation challenges merely requires that Congress provide an "intelligible principle" to guide the agency's exercise of discretion. *Id.*

Under the private nondelegation doctrine, Congress generally cannot delegate sovereign legislative or executive power to a private entity. *See Pittston Co. v. United States*, 368 F.3d 385, 394-95 (4th Cir. 2004). Courts have found impermissible private nondelegations in rare instances when statutes authorized private companies to enact regulations that carried the force of law and were binding on the entire industry, including competitors. *See Carter v. Carter Coal Co.*, 298 U.S. 238 (1936); *Ass'n of Am. R.Rs. v. U.S. Dep't of Transp.*, 721 F.3d 666, 673-77 (D.C. Cir. 2013), *rev'd on other grounds*, 135 S. Ct. 1225 (2015).

An essential prerequisite for either form of nondelegation claim is that the powers at issue are sovereign and governmental in nature. For example, in *Pittston*, the Fourth Circuit analyzed a claim that a statute empowering a coal industry pension fund "to invest the premiums it receives from the coal operators" constituted an unconstitutional delegation to a private entity. 368 F.3d at 397. The court held that "the central inquiry" was "whether the *function* of the Combined Fund in preserving and investing money assessed by statute is governmental in nature." *Id.* at 398. Because that function was "not essentially governmental," there simply was no nondelegation problem. *Id.* at 397. Although *Pittston* involved a private nondelegation claim, the same analysis is dispositive of a claim that Congress improperly delegated its legislative powers to another branch: if

the functions at issue are not governmental in nature, *a fortiori* they cannot be legislative in nature.

Here, as in *Pittston*, it is clear that the function of entering into the Third Amendment, a contract relating to the terms of preferred stock, was "not essentially governmental." *Id.* at 397. Rather, the "Third Amendment was adopted by the FHFA in its capacity as conservator of Fannie Mae and Freddie Mac, not as an executive enforcing the laws of the United States." *Collins*, 2017 WL 2255564, at *5. The Conservator's execution of the Third Amendment was an exercise of "FHFA's business judgment," not the type of legislative or executive function the Constitution commits to Congress or the President. *Perry Capital*, 864 F.3d at 615. The action in this case has nothing in common with the handful of cases in which courts have found it impermissible to give private companies the power to make binding rules that govern their competitors.

To the extent that the Conservator might be deemed to have functioned in a governmental capacity when it entered into the Third Amendment, Plaintiffs' nondelegation claim would fail because Congress provided intelligible principles to guide FHFA's discretion. It is well-established that Congress can "obtain[] the assistance of its coordinate Branches" in carrying out the law. *Mistretta v. United States*, 488 U.S. 361, 372 (1989). The requisite intelligible principle may be a "broad policy statement," *Fernandez*, 710 F.3d at 849, including to act in the "public interest," *Nat'l Broad. Co. v. United States*, 319 U.S. 190, 216 (1943).[6]

[6] *See also Yakus v. United States*, 321 U.S. 414, 448-49 (1944) ("generally fair and equitable"); *Milk Indus. Found. v. Glickman*, 132 F.3d 1467, 1475 (D.C. Cir. 1998) ("compelling public interest").

In HERA, Congress empowered FHFA as Conservator "take such action as may be ... appropriate to carry on the business of the [Enterprises] and preserve and conserve the[ir] assets and property." 12 U.S.C. § 4617(b)(2)(D). Additionally, HERA states the "purpose" of FHFA's appointment as conservator is to "reorganiz[e], rehabilitat[e], or wind[] up the affairs" of the Enterprises. *Id.* § 4617(a)(2). Congress thus "empower[ed] FHFA to 'take such action' as may be necessary or appropriate to fulfill several goals." *Perry Capital,* 864 F.3d at 608. Congress also provided explicit guidance in the Enterprises' statutory charters, where it directed them, *inter alia,* to "provide stability in" and "ongoing assistance to the secondary market for residential mortgages" by increasing liquidity and improving investment capital, to "promote access to mortgage credit," and to "manage and liquidate federally owned mortgage portfolios." 12 U.S.C. § 1716 (Fannie Mae); *see also id.* § 1451 note (Freddie Mac). These statutory purposes and goals easily provide a sufficient "intelligible principle" to avoid any unconstitutional delegation of legislative power.

CONCLUSION

For the foregoing reasons, the Court should dismiss this case.

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Respectfully submitted,

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UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

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LOCAL RULE 7.1 WORD COUNT COMPLIANCE CERTIFICATE

I, Mark A. Jacobson, certify that the foregoing Memorandum of Law in Support of FHFA Defendants' Motion to Dismiss complies with Local Rules 7.1(f) and (h).

I further certify that, in preparation of this memorandum, I used Microsoft Office Word Version 2010, with a 13-point font type size, and that this word processing program has been applied specifically to include all text, including headings, footnotes, and quotations, in the following word count.

I further certify that the above-referenced memorandum contains 6,657 words.

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