UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

MICHAEL ROP; STEWART KNOEPP; and ALVIN WILSON,

Plaintiffs,

v.

THE FEDERAL HOUSING FINANCE AGENCY; MELVIN L. WATT, in his official capacity as Director of the Federal Housing Finance Agency; and THE DEPARTMENT OF TREASURY,

Defendants.
_____/

Case No. 1:17-cv-00497

Hon. Paul L. Maloney

REPLY BRIEF IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY DISPOSITION

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REPLY ARGUMENT

The Housing and Economic Recovery Act ("HERA") purports to insulate the Federal Housing Finance Agency ("FHFA") from any meaningful direction or oversight by the President, Congress, or even the Judiciary. It was an acting Director—one who had held office for three years without being nominated by the President or confirmed by the Senate—who imposed the Third Amendment. Defendants strive mightily to keep this Court from reaching the merits of the multiple separation of powers problems inherent in FHFA's disturbing leadership structure and extraordinary actions, but Defendants' arguments are unpersuasive. The Court should vacate the Net Worth Sweep and strike down the provisions of HERA that make FHFA one of the most powerful, least accountable agencies in our Nation's history.

I. The Net Worth Sweep must be vacated because an independent agency may not be headed by a single individual.

A. FHFA's leadership structure violates the separation of powers.

The merits of Plaintiffs' challenge to FHFA's leadership structure were thoroughly canvassed in Plaintiffs' previous briefing, but two points deserve further emphasis. First, FHFA cannot deny that its leadership structure has the potential to diminish presidential influence to a degree that would not be possible with a multi-member, bipartisan commission of the sort that the Supreme Court approved in *Humphrey's Executor v. United States*, 295 U.S. 602 (1935). It is impossible for the President's party to be frozen out of a bipartisan multi-member commission, but that is the situation today with respect to leadership at FHFA. FHFA responds that this is a result of "particular add-on features" such as bipartisanship requirements and "not anything inherent in leadership being shared by multiple individuals." FHFA Reply 10. But even in the absence of a formal bipartisanship requirement, the point remains that multi-member

commissions are far more likely to include at least some members who share the incumbent President's views. Both when the Third Amendment was signed and today, the incumbent President had less influence over FHFA than President Roosevelt had over the FTC in 1935. This diminished degree of presidential influence "makes a difference." *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 495-96 (2010).

Second, the "most telling indication of the severe constitutional problem with [FHFA] is the lack of historical precedent for this entity." *Id.* at 505. FHFA's argument that this history does not matter runs headlong into a long line of Supreme Court separation of powers cases. *See PHH Corp. v. CFPB*, 839 F.3d 1, 21-25 (D.C. Cir. 2016). FHFA is also wrong when it argues that the Comptroller of the Currency provides historical support for its structure. The Comptroller does not enjoy for-cause removal protection, *id.* at 20 n.6, and operates "under the general direction of the Secretary of the Treasury," who selects the Comptroller's Deputies, 12 U.S.C. §§ 1, 4; *see* Post Employment Restriction of 12 U.S.C. § 1812(e), 2001 WL 35911952 (O.L.C. 2001). Also unlike FHFA, the Comptroller does not benefit from statutory provisions that attempt to insulate him from congressional and judicial as well as presidential oversight.[1]

B. Mr. DeMarco's status as Acting Director does not save the Net Worth Sweep.

Regardless of whether Mr. DeMarco was removable by the President without cause (and he was not), the Court must vacate the Third Amendment. As previously explained, the injuries

[1] The fact that Treasury signed the Third Amendment does not defeat Plaintiffs' standing to assert this claim. Nothing in Plaintiffs' theory of the case or the Complaint supports FHFA's speculation that the government would have imposed the Net Worth Sweep even if FHFA had been subject to presidential oversight. The Obama Administration negotiated the Third Amendment in the context of broader disagreements with Mr. DeMarco. Am. Compl. ¶¶ 60-63. The Court cannot assume that the result would have been the same had Treasury not needed FHFA's approval to amend the PSPAs, and it is not Plaintiffs' burden to prove what might have happened "in that counterfactual world." *Free Enter. Fund*, 561 U.S. at 512 n.12; *see Wright v. O'Day*, 706 F.3d 769, 772 (6th Cir. 2013).

that are the subject of this suit were caused by a series of actions by FHFA, not all of which were taken during acting Director DeMarco's tenure. FHFA responds that Plaintiffs lack standing to challenge the actions of Directors Lockhart and Watt in the absence of "concrete harm separable from the Third Amendment executed by Mr. DeMarco." FHFA Reply 3. But when a plaintiff's injury arises from a series of events, some but not all of which involved unlawful government action, the plaintiff generally has standing to sue the government unless his injury is "th[e] result [of] the *independent* action of some third party not before the court." *Bennett v. Spear*, 520 U.S. 154, 169 (1997); *see Libertarian Party v. Judd*, 718 F.3d 308, 316 (4th Cir. 2013).

Furthermore, FHFA does not dispute that, had Mr. DeMarco been removed from office, he could have only been replaced by one of the agency's other Deputy Directors—officials selected by Mr. DeMarco himself or his Republican predecessor. 12 U.S.C. § 4512(f). This arrangement left the President with no way to assert control over the agency even if he fired Mr. DeMarco. FHFA responds that the Complaint does not fairly present this argument, FHFA Reply 5 n.2, but the Complaint specifically identifies this flaw in HERA, Am. Compl. ¶ 64.[2] This aspect of HERA operates with others to unconstitutionally insulate FHFA from all Executive, Legislative, and Judicial oversight.

C. FHFA's imposition of the Net Worth Sweep is attributable to the government.

FHFA acted as regulator when it forced the Companies into conservatorship, thus making the Net Worth Sweep possible, and every penny Treasury has received from the Companies has been paid only with FHFA's regulatory blessing. It thus makes no difference whether FHFA's

[2] To the extent the Court agrees with FHFA that Plaintiffs cannot make this argument under the current Complaint, Plaintiffs seek leave to amend.

actions as conservator are attributable to the federal government.[3]

In any event, the Office of Legal Counsel ("OLC") has said that a governmental actor is one who exercises "power lawfully conferred by the Government to bind third parties, or the Government itself, for the public benefit." Officers of the United States Within the Meaning of the Appointments Clause, 2007 WL 1405459, at *11 (O.L.C. 2007). Treasury argues that even before conservatorship the Companies' charters allowed them to consider the public interest, Treas. SJ Br. 6, but those charters did *not* empower the Companies to make decisions that are binding on third parties or the government. HERA gives FHFA such power.

Simply labeling the Net Worth Sweep as "an action that private fiscal managers typically undertake for the benefit of the financial institutions they oversee" does not make it so. *See* Treas. SJ Br. 5. The Net Worth Sweep would have violated the duty of loyalty had it been undertaken by the Companies' private management, and FHFA's actions are indistinguishable from those of the FDIC in *Slattery v. United States*, 583 F.3d 800, 826-29 (Fed. Cir. 2009), *vacated and reinstated as modified*, 635 F.3d 1298 (Fed. Cir. 2011)—a case that held that a receiver could be sued for a Fifth Amendment taking.[4]

FHFA contends that even if it acted as the government when it imposed the Net Worth Sweep, it was not exercising "the type of executive powers that demand Presidential supervision." FHFA Reply 4. But the Constitution's Vesting Clauses only recognize three types

[3] Despite Treasury's argument to the contrary, Treas. SJ Br. 5, the 30-day statute of limitations contained in 12 U.S.C. § 4617(a)(5) only applies to suits: (1) brought by "the regulated entit[ies]," i.e., the Companies themselves; *and* that (2) challenge an initial decision to impose conservatorship or receivership. Plaintiffs plainly were not required to sue FHFA four years before they were injured in August 2012. *See* Am. Compl. ¶ 143.

[4] To the extent the Court concludes that FHFA is a private entity when it acts as conservator despite exercising governmental power, it should grant Plaintiffs' motion for summary judgment on the private nondelegation doctrine claim. *See* Pls. SJ Br. 10-11.

of federal governmental power: Legislative, Executive, and Judicial. The nondelegation doctrine prohibits *any* delegation of Legislative power to an administrative agency. *Whitman v. American Trucking Ass'n*, 531 U.S. 457, 472 (2001). If FHFA acted in a governmental capacity when it imposed the Net Worth Sweep but did not exercise Executive power, it follows that FHFA unconstitutionally exercised Legislative power.[5]

II. The Net Worth Sweep must be vacated because Mr. DeMarco served as a principal officer in violation of the appointments clause.

1. Plaintiffs' Appointments Clause claim requires only that the Court decide whether Mr. DeMarco was serving as a principal officer when he signed the Third Amendment. Despite FHFA's attempts to recharacterize this claim as asking the Court to recognize a "proposed new cause of action," FHFA Reply 19, federal courts have distinguished between principal and inferior officers throughout our Nation's history, *see Edmond v. United States*, 520 U.S. 651, 661 (1997). For over a century, Supreme Court precedent has made length of tenure an important factor for distinguishing between principal and inferior officers, thus making clear that there is a temporal limit to how long an inferior officer may execute the duties of a principal officer in an acting capacity. *See United States v. Eaton*, 169 U.S. 331, 343 (1898). The structure and history

[5] Plaintiffs' previous briefing cited a host of cases in which courts have vacated decisions by agency officials who held their positions in violation of the Appointments Clause or the separation of powers. Pls. FHFA MTD Opp. 10-11. FHFA does not appear to dispute that those cases provide the correct rule of decision in Appointments Clause cases, but it contends that a lesser remedy is appropriate in removal cases because "protection from removal" that "exceeds constitutional limits" "does not oust an official of the power to hold the office and act." FHFA Reply 5-6. But an agency head who is unaccountable to the President cannot "hold the office and act" any more than one who was unconstitutionally appointed. In both situations, the agency official exercises authority in violation of the Constitution's separation of powers. *See IBC v. Copyright Royalty Bd.*, 684 F.3d 1332 (D.C. Cir. 2012) (looking to Supreme Court precedent in removal cases to determine appropriate remedy for violation of Appointments Clause); *see also In re Hennen*, 38 U.S. (13 Pet.) 230, 259 (1839) ("[I]t would seem to be a sound and necessary rule, to consider the power of removal as incident to the power of appointment.").

of the Appointments Clause point definitively to the same conclusion, for the President would have little reason to subject an agency head to the demands of Senate confirmation if he could unilaterally appoint someone to hold the office indefinitely in an "acting" capacity. *See NLRB v. Noel Canning*, 134 S. Ct. 2550, 2559 (2014).

Plaintiffs' previous brief explained why the two-year maximum possible tenure of appointees under the Recess Appointments Clause provides an appropriate benchmark for determining at what point an acting agency head has served for so long that he becomes a principal officer. There is no more reasonable basis for the President to fill an important vacancy without consulting the Senate than the Senate's unavailability, but even in that scenario the appointment may last for at most two years. FHFA responds that this argument "ignore[s] the differences between holding an office and acting in it." FHFA Reply 16. But FHFA does not explain what those differences are or how they support its position. To the extent the distinction matters, one who "hold[s]" an office pursuant to the Recess Appointments Clause should be permitted to serve for a *longer* period than one who merely "act[s]" in the office without having gone through either of the procedures the Constitution specifies for appointments of principal officers. FHFA also cites an OLC opinion that concluded that the Vacancies Reform Act permits the President to designate a recess appointee whose term has expired to succeed himself in an "acting" capacity. *See* Designation of Acting Solicitor of Labor, 2002 WL 34461082, at *3 (O.L.C. 2002). But that opinion does not address when such a former recess appointee would become a principal officer.

Even setting the Recess Appointments Clause aside, the length of Mr. DeMarco's tenure made him a principal officer. By August 2012, Mr. DeMarco had headed one of the most important independent federal agencies for *three years*—a multiple of any period ever upheld by

any court or approved by OLC. Tellingly, FHFA makes no attempt to show that Mr. DeMarco's tenure was reasonable under the factors that OLC has identified as relevant but instead resorts to mischaracterizing Plaintiffs' position as asking the Court to rule on "the reasonableness of the President's and Senate's nomination and confirmation efforts." FHFA Reply 18. But the "reasonable under the circumstances" inquiry requires adjudicating the reasonableness of the length of Mr. DeMarco's tenure, not deciding who is to blame for any unconstitutional delay.[6]

2. Rejecting objections based on the political question doctrine, the Supreme Court in *Noel Canning* adopted a standard for deciding whether the President may make a recess appointment that is very much like OLC's "reasonable under the circumstances" standard for determining the maximum permissible tenure of an acting agency head. In its latest brief, FHFA renews its political question doctrine argument but says almost nothing about this most relevant of precedents. If anything, concerns about the administrability of judicial inquiry into the reasonableness of an acting officer's tenure would justify applying a fixed two-year ceiling—not dismissing Plaintiffs' claim as nonjusticiable. *Cf. Noel Canning*, 134 S. Ct. at 2593 (Scalia, J., concurring in the judgment). The political question doctrine is a "narrow exception" to the judiciary's "responsibility to decide cases properly before it, even those it would gladly avoid." *Zivotofsky ex rel. Zivotofsky v. Clinton*, 566 U.S. 189, 194-95 (2012) (quotation marks omitted). There is no basis for dismissing Plaintiffs' claim when not a single Justice thought it a proper basis for dismissal in *Noel Canning*.

[6] The Court can avoid this constitutional issue by ruling that Mr. Lockhart's resignation did not trigger the President's authority to appoint an acting Director under 12 U.S.C. § 4512(f). FHFA cites *FHFA v. UBS Americas Inc.*, 712 F.3d 136, 144 (2d Cir. 2013), and *FHFA v. City of Chicago*, 962 F. Supp. 2d 1044, 1053-55 (N.D. Ill. 2013). But the more persuasive decision is *Doolin Sec. Sav. Bank, FSB v. OTS*, 139 F.3d 203, 207-08 (D.C. Cir. 1998).

3. The de facto officer doctrine does not apply "when the challenge is based upon nonfrivolous constitutional grounds." *Glidden Co. v. Zdanok*, 370 U.S. 530, 536 (1962) (plurality). FHFA contends that the Supreme Court did not follow that rule in *Buckley v. Valeo*, 424 U.S. 1, 142 (1976); FHFA Reply 13. But the constitutional challenge raised by the *Buckley* plaintiffs was decided in their favor, and the declaratory and injunctive relief they sought was awarded to them. *See Ryder v. United States*, 515 U.S. 177, 183 (1995). *Buckley*'s remedial ruling is thus best understood as having been based on *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1971)—a case that announced a doctrine limiting the retroactive application of new rules of constitutional law that the Supreme Court has largely abandoned and that FHFA does not argue applies here. *See Harper v. Virginia Dep't of Taxation*, 509 U.S. 86 (1993); *Hatchett v. United States*, 330 F.3d 875, 882 (6th Cir. 2003). In any event, the Supreme Court has refused to extend *Buckley*'s remedial ruling beyond the unique circumstances of that case: "[t]o the extent [*Buckley*] may be thought to have implicitly applied a form of the de facto officer doctrine, we are not inclined to extend [it] beyond [its] facts." *Ryder*, 515 U.S. at 184.

FHFA also invokes the "unique concerns raised by claims retroactively attacking government officials' authority." FHFA Reply 14. But FHFA never explains why those concerns deserve greater weight here than in *Nguyen v. United States*, 539 U.S. 69, 79 (2003). Whatever hardship FHFA would face if required to revisit actions from during Mr. DeMarco's unconstitutional tenure, preserving the constitutional roles of the President and the Senate in the selection of principal officers is more important than administrative convenience. Indeed, the de facto officer doctrine does not normally apply when an agency acts in violation of *statutory* limits on the tenure of an acting officer, 5 U.S.C. § 3348(d), and no lesser remedy is merited when an acting officer's tenure violates the Constitution.

III. Treasury is a proper defendant in this case, and neither HERA's succession clause nor claim preclusion bars Plaintiffs' suit.

1. Treasury's motion to dismiss did not say that it was improperly joined as a party or that vacating the Net Worth Sweep would be an inappropriate remedy if the Court concludes that FHFA violated the Constitution by agreeing to it. In its latest round of briefing, Treasury argues for the first time that it is an improper party and makes the puzzling assertion that Plaintiffs conceded the point by failing to anticipate it. Treas. MTD Reply 1-2. But Treasury is plainly an appropriate defendant in this action to invalidate a contract to which it is a party. *See Onyx Waste Servs., Inc. v. Mogan*, 203 F. Supp. 2d 777, 787 (E.D. Mich. 2002). And while Treasury still does not appear to argue that its participation in the Net Worth Sweep somehow changes the appropriate remedy, any such argument would be meritless. A contract signed by a federal agency in violation of the Constitution is contrary to public policy and therefore void. *Cf. Shelley v. Kraemer*, 334 U.S. 1 (1948); *Cochran v. Michigan Reg. Council of Carpenters*, 192 F. Supp. 3d 861, 864 (W.D. Mich. 2016) ("Contracts founded on acts prohibited by a statute, or contracts in violation of public policy, are void." (internal quotation omitted)).[7]

2. Treasury argues that dismissing this suit under HERA's Succession Clause would raise no constitutional concerns because doing so would "merely require [Plaintiffs'] claims to be brought by a party capable of demonstrating direct, personal injury." Treas. MTD Reply 6 n.5. But Treasury's position is that the Companies are the only parties that have such an injury and that during conservatorship the Companies must accept FHFA as their sole representative in all

[7] Treasury's joinder argument at most raises a pleading issue that could easily be corrected with an amendment to the Complaint. The APA authorizes this Court to "hold unlawful and set aside agency action . . . found to be . . . contrary to constitutional right, power, privilege, or immunity," 5 U.S.C. § 706(2), and it is sufficient in such cases to name "the United States" as the defendant, *id.* § 702. To the extent that the Court concludes that Treasury's argument has merit, it should grant Plaintiffs leave to amend the Complaint to name the United States as a defendant.

litigation, even when FHFA itself is the defendant. Since no court could hear a suit in which FHFA attempted to advance the claims at issue here—a point that Treasury does not dispute—the upshot of Treasury's position is that the courts are powerless to enjoin the Net Worth Sweep even if FHFA violated the Constitution by imposing it. As explained in Plaintiffs' previous briefing, the Succession Clause would be unconstitutional if Treasury's position were correct. Fortunately, there are multiple ways the Court can avoid this constitutional issue, just as the Supreme Court did in *Webster v. Doe*, 486 U.S. 592, 603 (1988). Plaintiffs' claims are direct as a matter of both federal and state law, and in any event the Succession Clause does not bar derivative suits when the conservator is a defendant and alleged to have violated the Constitution. *See* Plfs. Treas. MTD Opp. 11-17.

3. While Treasury's claim preclusion defense fails for all the reasons Plaintiffs previously explained, *see* Pls. Treas. MTD Opp. 18-23, perhaps the most straightforward basis for rejecting the defense is that the dismissals in *Perry Capital* and *Saxton* were not decisions on the merits. Rather, both courts dismissed the derivative claims before them because HERA's Succession Clause "transfers to the FHFA all claims a shareholder may bring derivatively on behalf of a Company." *Perry Capital v. Mnuchin*, 864 F.3d 591, 624 (D.C. Cir. 2017); *see Saxton v. FHFA*, 245 F. Supp. 3d 1063, 1078-79 (N.D. Iowa 2017). That is not a determination of the merits of the underlying claim but a ruling on the threshold issue of who may assert it, and a dismissal based on a plaintiff's "lack of capacity to sue" is "not a judgment on the merits" for claim preclusion purposes. *Petty v. Lynch*, 102 Fed. App'x 24, 25 (6th Cir. 2004) (applying Kentucky law).

CONCLUSION

For the foregoing reasons, the Court should grant Plaintiffs' motion for summary judgment.

Dated: December 4, 2017

/s/ Matthew T. Nelson

Matthew T. Nelson
Ashley G. Chrysler
WARNER NORCROSS & JUDD LLP
900 Fifth Third Center
111 Lyon Street, N.W.
Grand Rapids, Michigan 49503-2487
616.752.2000
mnelson@wnj.com
achrysler@wnj.com

Attorneys for Plaintiffs

16543541