UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Case No. 17-cv-02185 (PJS/HB)

ATIF F. BHATTI, TYLER D. WHITNEY, and MICHAEL F. CARMODY,

Plaintiffs,

-vs-

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

Defendants.

PLAINTIFFS' REPLY IN SUPPORT OF THEIR MOTION FOR SUMMARY JUDGMENT

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

ARGUMENT 1

I. The Net Worth Sweep Must Be Vacated Because an Independent Agency May Not Be Headed by a Single Individual. 1

A. Plaintiffs Have Standing to Challenge the Constitutionality of FHFA's Leadership Structure 1

B. FHFA's Leadership Structure Violates the Separation of Powers. 2

C. Mr. DeMarco's Status as Acting Director Does Not Save The Net Worth Sweep. 3

D. FHFA's Imposition of the Net Worth Sweep Is Attributable to the Government. 5

E. The Net Worth Sweep Must Be Vacated Because It Was Imposed by an Unconstitutionally Structured Agency. 8

II. The Net Worth Sweep Must Be Vacated Because Mr. DeMarco Served as a Principal Officer in Violation of the Appointments Clause. 9

III. Treasury Is a Proper Defendant in this Case, and Neither HERA's Succession Clause Nor Claim Preclusion Bars Plaintiffs' Suit. 15

CONCLUSION 19

TABLE OF AUTHORITIES

Cases **Page**

Bennett v. Spear, 520 U.S. 154 (1997) 4

Bond v. United States, 564 U.S. 211 (2011) 18

Buckley v. Valeo, 424 U.S. 1 (1976) 14

Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 14

Department of Transp. v. Association of American R.R., 135 S. Ct. 1225 (2015) 7

Doolin Sec. Sav. Bank, FSB v. OTS, 139 F.3d 203 (D.C. Cir. 1998) 13

Edmond v. United States, 520 U.S. 651 (1997) 10, 13

El Paso Pipeline GP Co. v. Brinckerhoff, 152 A.3d 1248 (Del. 2016) 18

FHFA v. City of Chicago, 962 F. Supp. 2d 1044 (N.D. Ill. 2013) 13

FHFA v. UBS Americas Inc., 712 F.3d 136 (2d Cir. 2013) 13

Fogie v. THORN Americas, Inc., 190 F.3d 889 (8th Cir. 1999) 14

Free Enter. Fund v. PCAOB, 561 U.S. 477 (2010) 2, 3

Free Enter. Fund v. PCAOB, 537 F.3d 667 (D.C. Cir. 2008) 3

Glidden Co. v. Zdanok, 370 U.S. 530 (1962) 14

Harper v. Virginia Dep't of Taxation, 509 U.S. 86 (1993) 14

Humphrey's Executor v. United States, 295 U.S. 602 (1935) 2

IBC v. Copyright Royalty Board, 684 F.3d 1332 (D.C. Cir. 2012) 9

In re Hennen, 38 U.S. (13 Pet.) 230 (1839) 9

In re Medtronic, Inc., 900 N.W. 2d 401 (Minn. 2017) 18

In re United States ex rel. Hall, 825 F. Supp. 1422 (D. Minn. 1993) 16

Jacobs v. FHFA, 2017 WL 5664769 (D. Del. Nov. 27, 2017) 7

Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90 (1991) 17

Libertarian Party v. Judd, 718 F.3d 308 (4th Cir. 2013) 4

McBrearty v. United States Taxpayers Union, 668 F.2d 450 (8th Cir. 1982) 16

Mizokami Brothers v. Mobay Chemical Corp., 660 F.2d 712 (8th Cir. 1981) 19

Morrison v. Olson, 487 U.S. 654 (1988) 10

Myers v. United States, 272 U.S. 52 (1926) 9

National Org. for Women, Inc., St. Paul Chapter v. Minnesota Mining & Mfg. Co., 73 F.R.D. 467 (D. Minn. 1977) 16

Nguyen v. United States, 539 U.S. 69 (2003) 15

NLRB v. Noel Canning, 134 S. Ct. 2550 (2014) 11, 13, 14

NLRB v. SW General, Inc., 137 S. Ct. 929 (2017) 15

Perry Capital, LLC v. Mnuchin, 864 F.3d 591 (D.C. Cir. 2017) 6, 7, 19

Petty v. Lynch, 102 Fed. App'x 24 (6th Cir. 2004) 19

PHH Corp. v. CFPB, 839 F.3d 1 (D.C. Cir. 2016) 3

Potthoff v. Morin, 245 F.3d 710 (8th Cir. 2001) 17

Robinson v. FHFA, -- F.3d --, 2017 WL 5623344 (6th Cir. Nov. 22, 2017) 6, 7

Ryder v. United States, 515 U.S. 177 (1995) 14, 15

Saxton v. FHFA, 245 F. Supp. 3d 1063 (N.D. Iowa 2017) 19

Shelley v. Kraemer, 334 U.S. 1 (1948) 16

Slattery v. United States, 583 F.3d 800 (Fed. Cir. 2009) 7, 8

Starr International Co. v. United States, 856 F.3d 953 (Fed. Cir. 2017) 17

State v. Harris, 667 N.W.2d 911 (Minn. 2003) 14

Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004) 18

United States v. Eaton, 169 U.S. 331 (1898) 10

Webster v. Doe, 486 U.S. 592 (1988) 17

Whitman v. American Trucking Ass'n, 531 U.S. 457 (2001) 8

Wieland v. United States Dep't of Health & Human Servs., 793 F.3d 949 (8th Cir. 2015) 4

Wright v. O'Day, 706 F.3d 769 (6th Cir. 2013) 2

Zivotofsky ex rel. Zivotofsky v. Clinton, 566 U.S. 189 (2012) 14

Statutes

5 U.S.C.

§ 702 16

§ 706(2) 16

§ 3346(b)(1) 5

§ 3348(d) 15

12 U.S.C.

§ 1 3

§ 4 3

§ 4512(f) 5

§ 4617(a)(1) 5

§ 4617(a)(5) 6

§ 4617(b)(2)(A) 6, 7

12 C.F.R. § 1237.12(a), (b) 6

Other

Associated Press, *Bush appoints pair without Senate's OK*, DESERET NEWS (Jan. 12, 2002), https://goo.gl/FhStnY 12

Labor Solicitor Scalia to Resign His Post, LOS ANGELES TIMES (Jan. 7, 2003), https://goo.gl/A21Ecn 12

Designation of Acting Solicitor of Labor, 2002 WL 34461082 (O.L.C. 2002) 11

Officers of the United States Within the Meaning of the Appointments Clause, 2007 WL 1405459 (O.L.C. 2007) 6

Post Employment Restriction of 12 U.S.C. § 1812(e), 2001 WL 35911952 (O.L.C. 2001) 3

Restatement (First) of Judgments (1942) 19

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 a 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.

ARGUMENT

I. The Net Worth Sweep Must Be Vacated Because an Independent Agency May Not Be Headed by a Single Individual.

A. Plaintiffs Have Standing to Challenge the Constitutionality of FHFA's Leadership Structure.

Nothing in Plaintiffs' theory of the case or the Complaint supports FHFA's unsubstantiated speculation that the government would have imposed the Net Worth Sweep even if FHFA had been subject to presidential oversight. To the contrary, the Obama Administration negotiated the Third Amendment in the context of broader disagreements with Mr. DeMarco, First Amended Complaint ¶¶ 47-49 (Aug. 4, 2017), Doc. 27 ("FAC"), and FHFA concedes that Mr. DeMarco's "decision to enter into the Third Amendment was freely made," Mem. of Law in Opp'n to Pls.' Mot. for Summ. J. & in Reply Supp. Mot. to Dismiss at 3 (Nov. 16, 2017), Doc. 49 ("FHFA Reply"). The Court cannot simply assume

that the result would have been the same had Treasury not needed an independent 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 v. PCAOB*, 561 U.S. 477, 512 n.12 (2010); *accord Wright v. O'Day*, 706 F.3d 769, 772 (6th Cir. 2013); Mem. of Law in Resp. to Mot. to Dismiss & in Supp. of Cross-Motion for Summ. J. at 8-9 (Oct. 16, 2017), Doc. 43 ("Pls. Br.") (collecting additional cases).

B. 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 brief, *see* Pls. Br. 9-15, 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 completely 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 diffusion of leadership among multiple individuals." FHFA Reply 5. But even in the absence of a formal bipartisanship requirement or presidential authority to designate a commission's chair, the point remains that multi-member commissions are far more likely to include at least some members who share the incumbent President's policy 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 Enterprise Fund*, 561 U.S. at 495-96.

Second, the "most telling indication of the severe constitutional problem with [FHFA] is the lack of historical precedent for this entity." *Id.* at 505 (quoting *Free Enterprise Fund v. PCAOB*, 537 F.3d 667, 699 (D.C. Cir. 2008) (Kavanaugh, J., dissenting)). 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) (assuming the Comptroller serves at the President's pleasure). 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. *See* FAC ¶¶ 85-86.

C. Mr. DeMarco's Status as Acting Director Does Not Save The Net Worth Sweep.

Irrespective of whether Mr. DeMarco was removable by the President without cause (and the Obama Administration was correct to conclude that he was not), the Court must vacate the Third Amendment and the actions that FHFA has taken pursuant to it so that those actions may be reconsidered by the agency after it is restructured to comply with the

separation of powers. As explained in Plaintiffs' previous brief, the injuries 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. *See* Pls. Br. 17. First, Director Lockhart placed the Companies into conservatorship and made Mr. DeMarco a Deputy Director. Second, acting Director DeMarco signed the Third Amendment. Third, Director Watt required the Companies to honor the Third Amendment's Net Worth Sweep, defended the Net Worth Sweep in court, and maintained a policy compelling the Companies to seek to enrich the federal government without regard to the interests of shareholders.

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 2. FHFA cites no authority for this "separability" theory of Article III causation, and Plaintiffs are aware of none. To the contrary, 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); *Wieland v. United States Dep't of Health & Human Servs.*, 793 F.3d 949, 954-55 (8th Cir. 2015); *see also Libertarian Party v. Judd*, 718 F.3d 308, 316 (4th Cir. 2013) (applying concept of "concurrent causation" and explaining that plaintiff had standing to challenge law so long as it was "at least in part responsible" for his injury). Plaintiffs' injuries are fairly traceable to actions by Directors Lockhart and Watt as well as acting Director DeMarco.

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).[1] This arrangement left the President with no way to effectively assert control over the agency even if he fired Mr. DeMarco, thus unconstitutionally insulating FHFA from presidential oversight. FHFA responds that the Complaint does not fairly present this argument, FHFA Reply 2 n.1, but the Complaint identifies this flaw in HERA and even goes so far as to quote Representative Frank's observation that Mr. DeMarco's handpicked successors "would likely continue the same foreclosure policies" that had angered so many in the President's party. FAC ¶ 49. FHFA also attempts to recharacterize Plaintiffs' claims as exclusively focused on the single-Director aspect of FHFA's structure, but the Complaint is replete with allegations that the various elements of HERA that seek to insulate FHFA from all Executive, Legislative, and Judicial oversight operate together to violate the separation of powers. *See, e.g.*, FAC ¶¶ 84-87.[2]

D. 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, 12 U.S.C. § 4617(a)(1), and every penny Treasury

[1] The Vacancies Reform Act would not have provided an alternative mechanism for filling the vacancy because by the time of the Third Amendment more than 210 days had elapsed since the Senate rejected the President's first nomination to fill the position. *See* FAC ¶ 44; 5 U.S.C. § 3346(b)(1).

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

has received from the Companies has been paid only with FHFA's regulatory blessing, *see* 12 C.F.R. § 1237.12(a), (b); *see also* FAC ¶ 79 (specifically challenging acts of FHFA as regulator that made the Net Worth Sweep possible). Neither Defendant appears to dispute these points, and it thus makes no difference whether FHFA's 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). That describes FHFA's conservatorship powers as they have been interpreted by both the D.C. Circuit and the Sixth Circuit. *Perry Capital, LLC v. Mnuchin*, 864 F.3d 591, 608 (D.C. Cir. 2017); *Robinson v. FHFA*, -- F.3d --, 2017 WL 5623344, at *6 (6th Cir. Nov. 22, 2017). Treasury counters that even before conservatorship the Companies' charters allowed them to consider the public interest, Mem. in Opp'n to Mot. for Summ. J. & in Reply Supp. Mot. to Dismiss at 5 (Nov. 16, 2017), Doc. 48 ("Treas. Reply"), 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. As conservator, FHFA may promote the public interest by exercising *Plaintiffs'* rights as shareholders as well as the rights of

[3] Despite Treasury's argument to the contrary, Treas. Reply 4, 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* FAC ¶ 80.

the Companies, 12 U.S.C. § 4617(b)(2)(A), and the D.C. Circuit held that by contract FHFA was able to effectively alter Treasury's legal obligations under HERA and the APA, *Perry Capital*, 864 F.3d at 615-16. Exercising statutorily conferred power to further the public interest by altering the rights of third parties and the obligations of federal agencies is a fundamentally governmental act. *See Department of Transp. v. Association of American R.R.*, 135 S. Ct. 1225, 1228 (2015).[4]

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. Reply 4-5. As Plaintiffs explained in their previous brief and Treasury does not dispute, the Net Worth Sweep would have been a clear violation of the duty of loyalty had it been undertaken by the Companies' private management. Pls. Br. 21; *cf. Jacobs v. FHFA*, 2017 WL 5664769, at *5 (D. Del. Nov. 27, 2017) (rejecting argument "that HERA incorporated state law limitations on the Companies' authority in such a manner that [FHFA] exceeds its statutory authority under HERA when it violates state law"). It was only by virtue of having received powers "far beyond [those] contemplated in a traditional conservatorship arrangement" that FHFA was able to expropriate Plaintiffs' economic rights. *Robinson*, 2017 WL 5623344, at *6. FHFA's actions in this case are indistinguishable from those of the FDIC in *Slattery v. United States*, 583 F.3d 800, 826-

[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. Br. 24.

29 (Fed. Cir. 2009), a case in which the Federal Circuit held that a receiver could be sued for a Fifth Amendment taking.

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. This is a surprising argument for FHFA to advance because the Constitution's Vesting Clauses only recognize three types of federal governmental power: Legislative, Executive, and Judicial. Only the first two of those powers could plausibly provide a basis for the Net Worth Sweep, and 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) ("Article I, § 1, of the Constitution vests '[a]ll legislative Powers herein granted . . . in a Congress of the United States.' This text permits no delegation of those powers."). If FHFA acted in a governmental capacity when it imposed the Net Worth Sweep but did not exercise Executive power, it follows *a fortiori* that FHFA exercised Legislative power in violation of the nondelegation doctrine.

E. The Net Worth Sweep Must Be Vacated Because It Was Imposed by an Unconstitutionally Structured Agency.

Plaintiffs' previous brief 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. Br. 22. 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 4. But an agency head who is unconstitutionally unaccountable to the President cannot "hold the office and act" any more than one who was unconstitutionally appointed. *Id.* In both situations, the agency official exercises authority in violation of the Constitution's separation of powers.

Nor does precedent support FHFA's argument for withholding a remedy in removal cases that courts routinely grant in cases that concern unconstitutional appointments. In *IBC v. Copyright Royalty Board*, 684 F.3d 1332 (D.C. Cir. 2012), for example, the D.C. Circuit cured an Appointments Clause violation by striking down a for-cause removal provision, thereby making members of the Copyright Royalty Board inferior rather than principal officers. In adopting that remedy, the D.C. Circuit heavily relied on *Free Enterprise Fund*—a case about removal restrictions—explaining that it was vacating the Board decision at issue "[b]ecause the Board's structure was unconstitutional at the time it issued its determination," *id.* at 1342. The *IBC* court's approach comports with Supreme Court precedent, which has long recognized the close relationship between the President's appointment and removal powers. *See 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."); *see also Myers v. United States*, 272 U.S. 52, 119 (1926).

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 in August 2012. Despite FHFA's attempts to recharacterize this claim as asking the Court to recognize a "proposed new cause of action," FHFA Reply 9, 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) (collecting cases). The Supreme Court's most recent decisions in this area identify the factors the Court should consider when drawing the distinction: the degree to which the officer is subject to supervision by another officer; the scope and nature of the officer's duties and jurisdiction; and limitations on the officer's tenure. *Id.* at 662-64; *Morrison v. Olson*, 487 U.S. 654, 671-72 (1988).

Of these factors, the only one that FHFA cites to support its position that Mr. DeMarco was an inferior officer is length of tenure; FHFA does not dispute that its Director is a principal officer or that Mr. DeMarco enjoyed all the powers of the Director during his four years and four months at the agency's helm. To be sure, the length of an acting officer's tenure has seldom been the focal point of Appointments Clause litigation, and Plaintiffs have therefore derived principles to guide the analysis that are based on the Constitution's structure and opinions of the Executive Branch. But the requirement that there must be *some* temporal limitation on an acting agency head's tenure is evident from Supreme Court precedent, which for over a century has treated length of tenure as an important factor for distinguishing between principal and inferior officers. *See United States v. Eaton*, 169 U.S. 331, 343 (1898). The structure and history 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) (canvassing history of constitutional provisions concerning appointments and emphasizing that provisions should not be interpreted to give the President "authority routinely to avoid the need for Senate confirmation" of principal officers).

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's only response is that this argument "ignore[s] the differences between holding an office and acting in it." FHFA Reply 7. 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 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.[5] In any event, Mr. DeMarco never received a recess appointment, and this case does not require the Court to decide whether the President could have used some combination of powers under the Recess Appointments Clause and HERA to extend the maximum constitutionally permissible length of Mr. DeMarco's tenure.

Even setting the Recess Appointments Clause aside, the length of Mr. DeMarco's tenure made him a principal officer by the time he signed the Third Amendment. By August 2012, Mr. DeMarco had headed one of the federal government's most important independent 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 opinions have identified as relevant to this inquiry 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 8. To the contrary, the "reasonable under the circumstances" inquiry requires adjudicating the reasonableness of the length of Mr. DeMarco's tenure as acting Director, not deciding who is to blame for any delay.

"By requiring the joint participation of the President and the Senate, the Appointments Clause was designed to ensure public accountability for both the making of a bad appointment and the rejection of a good one," and this process "is among the

[5] The Bush Administration used this maneuver to extend Eugene Scalia's tenure as Solicitor of Labor by less than seven weeks. Between his recess appointment and subsequent designation under the Vacancies Reform Act, Mr. Scalia served in the post for slightly less than one year. *See* Associated Press, *Bush appoints pair without Senate's OK*, DESERET NEWS (Jan. 12, 2002), https://goo.gl/FhStnY; *Labor Solicitor Scalia to Resign His Post*, LOS ANGELES TIMES (Jan. 7, 2003), https://goo.gl/A21Ecn.

significant structural safeguards of the constitutional scheme." *Edmond*, 520 U.S. at 659, 660. The Framers well understood that this arrangement could result in offices remaining vacant due to disagreements between the President and the Senate, but the Appointments Clause would be a nullity if "political opposition in the Senate" could justify departures from the procedures the Constitution mandates for appointments of principal officers. *Noel Canning*, 134 S. Ct. at 2567; *see Edmond*, 520 U.S. at 659 (rejecting notion that Appointments Clause is a mere "matter of etiquette or protocol" between the political branches (quotation marks omitted)).

In any case, 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). *See* Pls. Br. 33-34. 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).

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. *See* Pls. Br. 35. In its latest brief, FHFA renews its political question doctrine argument but says nothing at all about this most relevant and recent 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 2593-94 (Scalia, J., concurring in the judgment) (invoking political question doctrine and arguing that Court should have adopted a clearer rule that would have construed President's recess appointments power even more narrowly). 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 in this case when not a single Justice thought it a proper basis for dismissal in *Noel Canning*.

3. Plaintiffs explained in their previous brief that 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); *see State v. Harris*, 667 N.W.2d 911, 920 n.5 (Minn. 2003); Pls. Br. 36-37. FHFA contends that the Supreme Court did not follow that rule in *Buckley v. Valeo*, 424 U.S. 1, 142 (1976); FHFA Reply 6. 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); *Fogie v. THORN Americas, Inc.*, 190 F.3d 889, 902 n.7 (8th Cir. 1999). 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.

In arguing for application of the de facto officer doctrine to constitutional claims, FHFA also invokes the "unique concerns presented by retroactive attacks on government officials' authority." FHFA Reply 7. But FHFA never explains why those concerns deserve greater weight here than they did in *Nguyen v. United States*, 539 U.S. 69, 79 (2003)—a case in which the Supreme Court entertained an untimely challenge to the composition of a Ninth Circuit panel in view of the important statutory policy at issue. Whatever hardship FHFA would experience if required to revisit prior 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 certainly 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); *see NLRB v. SW General, Inc.*, 137 S. Ct. 929, 938 n.2 (2017), 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. *See* Mem. in Supp. of Treas. Mot. to Dismiss at 8-11 (Sept. 15, 2017), Doc. 36. 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. Reply 3. But Treasury is plainly an appropriate defendant in this action to invalidate a contract to which it is a party. *See, e.g.*, *In re United States ex rel. Hall*, 825 F. Supp. 1422, 1428 (D. Minn. 1993); *National Org. for Women, Inc., St. Paul Chapter v. Minnesota Mining & Mfg. Co.*, 73 F.R.D. 467, 469 (D. Minn. 1977). And while Treasury still does not appear to argue that its participation in the Net Worth Sweep somehow immunizes FHFA from the consequences of its violation of the separation of powers or otherwise changes the appropriate remedy, any such argument would be meritless. A contract that violates the Constitution is void. *Cf. Shelley v. Kraemer*, 334 U.S. 1 (1948); *McBrearty v. United States Taxpayers Union*, 668 F.2d 450, 450-51 (8th Cir. 1982) ("As a general rule, an agreement which contravenes some recognizable public policy is void.").

In view of these points, Treasury's joinder argument at most raises a technical pleading issue that could easily be corrected with an amendment to the Complaint. The Administrative Procedure Act 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.

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.

Reply 9 n.6. 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 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 brief, the Succession Clause would be unconstitutional if Treasury's position were correct. Pls. Br. 42.

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) (avoiding "serious constitutional question that would arise if a federal statute were construed to deny any judicial forum for a colorable constitutional claim"). Federal courts applying the shareholder standing rule must not follow the state law distinction between direct and derivative claims when doing so would undermine federal policy, *see Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 99 (1991), and no federal policy is clearer or more important than the one of protecting individual liberty by strictly honoring the Constitution's separation of powers. That policy was not implicated in *Starr International Co. v. United States*, 856 F.3d 953 (Fed. Cir. 2017), or *Potthoff v. Morin*, 245 F.3d 710, 716 (8th Cir. 2001), for neither case even concerned the separation of powers—much less separation of powers claims that the government argued could only be vindicated if a federal agency sued itself. Because there is no more directly injured party capable of suing, federal law

gives Plaintiffs "a direct interest in objecting to laws that upset the constitutional balance." *Bond v. United States*, 564 U.S. 211, 222 (2011).

Plaintiffs' claims are also direct under prevailing principles of state law. Plaintiffs "can prevail without showing an injury to the corporation," *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004), for unlawfully transferring the right to receive dividends and liquidation preference payments from one shareholder to another does not inevitably injure the corporation. *El Paso Pipeline GP Co. v. Brinckerhoff*, 152 A.3d 1248, 1263 (Del. 2016), is not to the contrary. That case involved a general partner who was alleged to have wasted partnership assets—not the rearrangement of a corporation's capital structure to shift 100% of the corporation's *ongoing* value to a single, favored investor. *See In re Medtronic, Inc.*, 900 N.W. 2d 401, 411 (Minn. 2017) (claim was direct where shareholder alleged "loss of certain rightful incidents of his ownership interest" "rather than a simple loss of economic value").

To the extent the Court deems Plaintiffs' claims to be derivative, constitutional avoidance also counsels strongly in favor of recognizing an exception to the general rule against derivative suits during conservatorship for cases in which the conservator is a defendant and therefore incapable of asserting the claim. As Plaintiffs' previous brief explained, two courts of appeals have already recognized such an exception, *see* Pls. Br. 41-43, and Plaintiffs are unaware of any case in which the Succession Clause has been held to require dismissal of constitutional claims against a federal conservator or receiver.

3. While Treasury's claim preclusion defense fails for the multiple reasons explained in Plaintiffs' previous brief, *see* Pls. Br. 44-50, 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 on the ground that HERA's Succession Clause "transfers to the FHFA all claims a shareholder may bring derivatively on behalf of a Company." *Perry Capital*, 864 F.3d at 624; *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); *see also* Restatement (First) of Judgments § 49 (1942) cmt. a (listing "lack of jurisdiction of the court" and "the plaintiff's lack of capacity to sue" as among grounds for concluding that decision is not on the merits). The only case Treasury cites in support of its contrary position—*Mizokami Brothers v. Mobay Chemical Corp.*, 660 F.2d 712, 715 (8th Cir. 1981)—concerned issue preclusion, not claim preclusion, and says nothing remotely to the contrary. Furthermore, Treasury does not dispute that one consequence of its position is that a prior shareholder derivative suit dismissed under the Succession Clause would bar FHFA from asserting the same claims on the Companies' behalf even though FHFA would not be subject to the same defense. *See* Pls. Br. 45-46. That is plainly not what Congress intended when it decided to transfer the authority to bring certain claims from shareholders to the conservator.

CONCLUSION

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

Dated: December 1, 2017

BRIGGS AND MORGAN, P.A.

By *s/Scott G. Knudson*
Scott G. Knudson (#141987)
Michael M. Sawers (#392437)
2200 IDS Center
80 South Eighth Street
Minneapolis, Minnesota 55402
(612) 977-8400

ATTORNEYS FOR PLAINTIFFS ATIF F. BHATTI, TYLER D. WHITNEY, AND MICHAEL F. CARMODY

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Case No. 17-cv-02185 (PJS/HB)

ATIF F. BHATTI, TYLER D. WHITNEY, and MICHAEL F. CARMODY,

Plaintiffs,

-vs-

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

Defendants.

WORD COUNT COMPLIANCE CERTIFICATE

I, Scott G. Knudson, certify that Plaintiff's Reply in Support of Their Motion for Summary Judgment consists of 5,547 words total.

Plaintiffs' Memorandum has been prepared in size 13 font using Microsoft Word 2010.

I relied on the word count tool in Microsoft Word 2010, applied specifically to include all text, including headings, footnotes and quotations, to determine the number of words contained in Plaintiffs' Memorandum.

Dated: December 1, 2017.

BRIGGS AND MORGAN, P.A.

By *s/Scott G. Knudson*

Scott G. Knudson (#0141987)
Michael M. Sawers (#0392437)
2200 IDS Center
80 South Eighth Street
Minneapolis, Minnesota 55402
(612) 977-8400

ATTORNEYS FOR PLAINTIFFS