No. 18-2506

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

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

Plaintiffs-Appellants

v.

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

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA (No. 17-2185)

REPLY BRIEF OF PLAINTIFFS-APPELLANTS

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ARGUMENT

I. FHFA's Nationalization of Fannie and Freddie Is Attributable to the Government.

A. Plaintiffs sued FHFA as both conservator *and regulator* for violating the separation of powers and the Appointments Clause. We did so because our injuries are the product of a series of actions by FHFA, many of which involved the exercise of the agency's regulatory powers. FHFA was only able to agree to the Net Worth Sweep as conservator because it first used its regulatory authority to place the Companies into conservatorship. 12 U.S.C. § 4617(a)(1). The Net Worth Sweep itself radically transformed the Companies' capital structure and permanently deprived them of their capacity to raise funds by issuing additional stock—steps that the Companies' management could never have taken without the regulator's blessing. *See* 12 U.S.C. §§ 4511(b), 4513(a)(1)(B). And by regulation, every Net Worth Sweep dividend payment the Companies have made to Treasury required the express approval of FHFA as regulator. 12 C.F.R. § 1237.12(a), (b) (providing that "a regulated entity shall make no capital distribution while in conservatorship" except with authorization from "[t]he Director," i.e., FHFA as regulator). This issue was extensively briefed to the district court, which dismissed Plaintiffs' separation of powers and Appointments Clause claims without embracing Defendants' argument that FHFA acted in an exclusively private capacity. (In contrast to the separation of powers and Appointments Clause claims, a different analysis is

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required for the nondelegation claims because those claims only challenge actions FHFA took as conservator.) Defendants ignore the fact that FHFA as regulator is a defendant in this case, and that fact is a complete answer to their arguments for dismissing the separation of powers and Appointments Clause claims on the theory that FHFA is a private entity when it acts as conservator.

Further support for the same conclusion can be found in the fact that, unlike the FDIC, FHFA does not exercise its conservatorship powers in a manner that is independent from FHFA as regulator. *See Plaintiffs in All Winstar-Related Cases at Court v. United States*, 44 Fed. Cl. 3, 7 & n.5 (1999). Rather than attempting to silo FHFA's pursuit of its conservatorship and regulatory functions, the same policymakers and lawyers simultaneously represent the agency in both capacities. The Net Worth Sweep was the product of this blending of conservatorship and regulatory roles, as FHFA signed an agreement on behalf of the Companies that pursued the "governmental" objectives of winding down the Companies and wiping out their private shareholders. *Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 608 (D.C. Cir. 2017); *see* JA31. When FHFA acts as *both* conservator *and* regulator, its actions are attributable to the Government. And the same is true when FHFA acts to pursue governmental objectives, regardless of whether it acts as conservator or regulator or both. *Cf. Freytag v. Commissioner*, 501 U.S. 868, 882 (1991) (declining

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to treat special trial judges as inferior officers for purposes of some of their duties but mere employees with respect to others).

B. Even with respect to Plaintiffs' nondelegation claims, Defendants' arguments that FHFA did not act as the Government when it agreed to the Net Worth Sweep fail. In approving the Net Worth Sweep as conservator, FHFA exercised power conferred upon it by a federal statute and acted "for the benefit of the federal government." *B&G Enters., Ltd. v. United States*, 220 F.3d 1318, 1324 (Fed. Cir. 2000). Such actions are inherently governmental, especially when they involve the expropriation of private property for the Government's benefit. *Slattery v. United States*, 583 F.3d 800, 826-29 (Fed. Cir. 2009). Defendants attempt to create the impression that courts treat federal conservators and receivers as private parties in every situation, but they are wrong. *See, e.g.*, *FDIC v. Meyer*, 510 U.S. 471, 475-83 (1994) (sovereign immunity); *Auction Co. of America v. FDIC*, 132 F.3d 746, 749 (D.C. Cir. 1997) (statute of limitations); *FDIC v. Hartford Ins. Co.*, 877 F.2d 590, 591-94 (7th Cir. 1989) (Federal Tort Claims Act and venue statute). As the Court of Federal Claims recently observed, "[a] government [agency] performing a government function for the government's benefit must be the government." *Citizens Cent. Bancorp, Inc. v. United States*, 2017 WL 10544024, at *7 (Fed. Cl. Sept. 7, 2017).

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II. The Net Worth Sweep Must Be Vacated Because FHFA Is Unconstitutionally Structured.

A. Plaintiffs Have Standing Irrespective of Whether a Differently Structured FHFA Would Have Imposed the Net Worth Sweep.

To the list of authorities supporting Plaintiffs' standing to challenge FHFA's structure can now be added the Treasury Department's brief to this Court. As Treasury explains, Plaintiffs are "not required to show that FHFA would have made a different decision had it been differently structured in order to demonstrate standing to raise their claim that FHFA is unconstitutionally structured." Treasury Br. 26 n.3 (citing *Landry v. FDIC*, 204 F.3d 1125, 1131 (D.C. Cir. 2000)); *accord Free Enter. Fund v. PCAOB*, 561 U.S. 477, 512 n.12 (2010); *Clinton v. City of New York*, 524 U.S. 417, 431-33 (1998) (standing to challenge line item veto did not depend on showing what statute Congress would have passed absent unconstitutional provision); *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 572 n.7 (1992); *Collins v. Mnuchin*, 896 F.3d 640, 654-57 (5th Cir. 2018), *vacated and en banc reh'g granted*, 2018 WL 5928985 (5th Cir. Nov. 12, 2018).[1]

FHFA attempts to distinguish *Free Enterprise Fund* and the other cases discussed in Plaintiffs' opening brief, but it never responds to Plaintiffs' argument

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[1] In *Collins*, the Fifth Circuit granted en banc petitions filed by both the plaintiffs and FHFA. The Fifth Circuit directed the parties to file supplemental en banc briefs that address the appropriate remedy if FHFA's structure is held unconstitutional and "in practical terms, what would setting aside the Net Worth

that the prophylactic, procedural nature of the separation of powers makes FHFA's approach to Article III causation inappropriate. *See* Opening Br. 11-13. And while FHFA acknowledges that "regulated entities" have standing "without specifically showing that an agency with constitutionally appointed officers would have acted differently," it is mistaken when it argues that this rule does not apply to Plaintiffs. FHFA Br. 14 n.1. Conservatorship *directly* affects shareholders; FHFA "may, by regulation or order, provide for the exercise of any function by any stockholder . . . of any regulated entity for which the Agency has been named conservator." 12 U.S.C. § 4617(b)(2)(C); *see also id.* § 4617(b)(2)(A). The only Article III causation question in a case like this one is whether Plaintiffs' injuries were caused by actions FHFA took while operating in violation of the separation of powers. This approach does not "dispense[ ] with Article III causation," FHFA Br. 16, but properly focuses the inquiry on the causal relationship between the unconstitutional agency's actions and Plaintiffs' injuries.

FHFA insists that the Complaint's allegations establish that the Obama Administration would have adopted the Net Worth Sweep unilaterally if FHFA had been subject to presidential control. FHFA Br. 16-17. This argument is not only irrelevant to Plaintiffs' standing but also factually incorrect. The Complaint alleges

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Sweep entail." Clerk's Letter, *Collins v. FHFA*, No. 17-20364 (5th Cir. Nov. 15, 2018).

that Mr. DeMarco clashed with the Administration on some of its most significant housing finance policies and resisted pressure from the White House to step down. JA26. As a political matter, the Administration might not have been willing to run the risks inherent in draining all of the capital out of Fannie and Freddie without the blessing of an independent financial regulator. As a policy matter, the Administration might not have wanted to adopt the Net Worth Sweep if it could have forced FHFA to use a portion of the Companies' substantial profits to support principal reduction on underwater mortgages. *See* JA26. The Court cannot assume that the President would have preferred the Net Worth Sweep to those or innumerable other policies had he been able to influence the agency by threatening to fire its Director or veto its appropriations. Plaintiffs told the district court that it could not "simply assume that the result would have been the same had Treasury not needed an independent FHFA's approval to amend the PSPAs." Pls.' Reply in Supp. of Summ. J. at 1-2 (Dec. 1, 2017), Doc. 51. FHFA's suggestion that this argument was somehow "waived" is meritless.

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

Respecting the merits of Plaintiffs' challenge to FHFA's structure, little can be added to what has already been said by the Fifth Circuit panel in *Collins*, 896 F.3d at 659-75, the *PHH* dissents, *PHH Corp. v. CFPB*, 881 F.3d 75, 164-67 (D.C.

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Cir. 2018) (en banc) (Kavanaugh, J., dissenting); *id.* at 137-39 (Henderson, J., dissenting), and the Department of Justice's brief to this Court, Treasury Br. 32-35.

No agency has ever been as wholly unaccountable to all three branches of government as FHFA. The Comptroller of the Currency "is removable at will by the President." *PHH*, 881 F.3d at 177 n.4 (Kavanaugh, J., dissenting). The FTC upheld in *Humphrey's Executor* was a bipartisan multi-member commission subject to the usual appropriations process. *See Collins*, 896 F.3d at 671-72. The Independent Counsel was an *inferior* officer with "limited jurisdiction" who was required to follow Department of Justice policy—not an "agency head," as FHFA wrongly suggests. *Morrison v. Olson*, 487 U.S. 654, 691, 696 (1988). The CFPB's regulatory actions may be vetoed by a board of Executive Branch officials and are not immunized from judicial review. *Collins*, 896 F.3d at 669-70. And perhaps most tellingly, the unique constellation of independence-enhancing features that apply to FHFA go much further than the double for-cause removal provision the Supreme Court struck down in *Free Enterprise Fund*, which "did not afford PCAOB members all that much additional insulation from the President." *PHH*, 881 F.3d at 191 (Kavanaugh, J., dissenting). FHFA's structure is unconstitutional.

C. Vacatur Is the Remedy for An Agency Action Taken in Violation of the Separation of Powers.

In *Bowsher*, a three-judge panel that included then-Judge Scalia vacated an exercise of Executive Power that had been taken without the minimum degree of

presidential oversight that the Constitution requires. *Synar v. United States*, 626 F. Supp. 1374, 1378, 1394-1404 (D.D.C. 1986). The Supreme Court affirmed. *Bowsher v. Synar*, 478 U.S. 714, 736 (1986). The same remedy should apply here.

FHFA attempts to distinguish *Bowsher* by observing that it concerned a "specific unconstitutional process," FHFA Br. 23-24, but the same is true of this case. The crux of Plaintiffs' challenge to FHFA's structure is that the process FHFA used to impose and implement the Net Worth Sweep—exercising governmental power without meaningful oversight from the President, Congress, or the judiciary—violated the separation of powers.

Treasury argues that *Bowsher* is distinguishable because the statute in that case "spoke directly to what should occur" if the constitutionally problematic provisions of the Gramm-Rudman-Hollings Act were invalidated. Treasury Br. 36. True, the Act included a "fallback" provision that specified alternative procedures to be followed if the Comptroller General's role in the budgeting process was held unconstitutional. *Bowsher*, 478 U.S. at 735. But nothing in the statute empowered courts to award relief for *past* presidential sequestration orders that would not have otherwise been available. *See* Pub. L. No. 99-177 § 274. *Bowsher* shows that, just as

in appointments cases, vacatur is the remedy for past unconstitutional agency actions in removal cases. *See NLRB v. Noel Canning*, 134 S. Ct. 2550 (2014).

FHFA's discussion of the remedial issue focuses primarily on *Free Enterprise Fund*, but it never responds to the points Plaintiffs made about that case in their opening brief. *See* Opening Br. 29-30. There was no final agency action to vacate in *Free Enterprise Fund* because the case concerned an *ongoing* agency investigation. Moreover, FHFA's discussion of *Free Enterprise Fund* conflates two issues: (1) whether an unconstitutional agency's past actions are subject to vacatur, *see Bowsher*, 478 U.S. at 736; and (2) whether the courts should sever the Director's for-cause removal protection or otherwise "blue-pencil" HERA to fix FHFA's constitutional problems going forward, *see Free Enterprise Fund*, 561 U.S. at 509. There are compelling arguments against severance. *See* Opening Br. 30-31; *Murphy v. NCAA*, 138 S. Ct. 1461, 1485-87 (2018) (Thomas, J., concurring). But no matter how the Court resolves the severability issue, it must set aside the past agency actions Plaintiffs challenge. *See* 5 U.S.C. § 706 ("To the extent necessary to decision and when presented, . . . [t]he reviewing court *shall* . . . hold unlawful and set aside agency action . . . contrary to constitutional right, power, privilege, or immunity." (emphasis added)).

Plaintiffs' preferred remedy is for the Court to vacate the Net Worth Sweep while allowing the original PSPAs to remain in place. *See* Opening Br. 31-33. The

liquidation preference on Treasury's senior preferred stock would be treated as having been paid down to zero by excess Net Worth Sweep dividends. No money would change hands, and Treasury's funding commitment under the original agreements would remain. Treasury objects that this remedy would allow Plaintiffs to benefit from the original agreement even though it was entered into by an unconstitutional FHFA. Treasury Br. 36-37. But Plaintiffs did not benefit from the original PSPAs, and the Companies only drew on Treasury's funding commitment due to accounting gimmicks the Companies used (and later reversed) while under FHFA's control. *See* JA27-29. Regardless, if the Court deems it more appropriate, Plaintiffs have no objection to vacatur of the PSPAs in their entirety. We doubt that is what Treasury prefers; vacating the PSPAs *in toto* would force Treasury to return the over $94 billion profit it has netted since investing in the Companies in 2008 and to forfeit common stock warrants that potentially are worth tens if not hundreds of billions of dollars. Irrespective of whether the Court adopts Plaintiffs' preferred remedy or vacates the PSPAs in their entirety, the Companies would today have access to more than adequate capital.

Finally, even if the Court declines to vacate the Net Worth Sweep, that would not justify withholding prospective relief. As in *Collins*, Plaintiffs here "allege an *ongoing* injury—being subjected to enforcement or regulation by an unconstitutionally constituted body." *Collins*, 896 F.3d at 657; *see* JA35-37. Every

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quarter FHFA as conservator orders, and FHFA as regulator approves, the Companies' payment of dividends to Treasury (and not Plaintiffs)—payments that the Court should prospectively enjoin so long as FHFA is unconstitutionally structured. Moreover, FHFA makes policy for the Companies and the Government while insulated from presidential control and without considering what is best for private shareholders. And FHFA is an essential participant in administrative efforts to reform the housing finance system—efforts that directly affect the Companies' shareholders. An order subjecting FHFA to oversight by the President would partially redress those injuries, and Plaintiffs are at a minimum entitled to prospective relief. *See Free Enterprise Fund*, 561 U.S. at 513.[2]

D. Mr. DeMarco's Status as an Acting Director Does Not Affect Plaintiffs' Claims.

Defendants argue that Plaintiffs' challenge to FHFA's independence fails because the Net Worth Sweep was signed by FHFA's acting Director, who they contend did not enjoy for-cause removal protection. But HERA says that FHFA is an "independent" agency without any suggestion that its status changes during the tenure of an acting Director. 12 U.S.C. § 4511(a); 44 U.S.C. § 3502(5). "There is no indication that Congress sought to revoke the FHFA's status as an independent

[2] FHFA frames this issue in terms of standing, but whether the Net Worth Sweep should be vacated is a merits issue. The Court must assume that Plaintiffs are right about the merits when deciding whether there is Article III standing. *See American Farm Bureau Fed'n v. EPA*, 836 F.3d 963, 968 (8th Cir. 2016).

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agency when it is led by an acting, rather than appointed, Director." *Collins*, 896 F.3d at 656.

Furthermore, "[t]he most reliable factor for drawing an inference regarding the President's power of removal . . . is the nature of the function that Congress vested in" the officer in question. *Wiener v. United States*, 357 U.S. 349, 353 (1958). Given that Congress vested in the acting Director the same responsibility for running an independent agency that is otherwise assigned to the Director, it follows that the acting Director enjoys the Director's removal protections. That Congress did not think it necessary to repeat in 12 U.S.C. § 4512(f) what it had already said in 12 U.S.C. § 4512(b)(2)—that the Director enjoys "for cause" removal protection—does not support a different conclusion. Acting officers are presumed to "succeed[ ] to all the powers of the office" except as otherwise specified. *United States v. Guzek*, 527 F.2d 552, 560 (8th Cir. 1975).[3]

The Obama Administration understood that HERA insulated Mr. DeMarco from removal by the President. When a senior Administration official was asked

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[3] Treasury cites *Swan v. Clinton*, 100 F.3d 973 (D.C. Cir. 1996), a case that concerned the President's authority to use the Recess Appointments Clause to replace a holdover member of the National Credit Union Administration. Treasury Br. 31. But that agency is headed by a multi-member board, and even the President's recess appointee could not be fired without cause once she took office. *Swan* thus did not have the bizarre effect Treasury urges with respect to FHFA: that an otherwise independent agency should lose its independence when headed by an acting Director.

about the possibility of firing Mr. DeMarco over a policy disagreement, he told reporters "[t]hat is not authority that the President has." JA26. The Administration's legal analysis was correct.

In any case, the series of FHFA actions that ultimately resulted in the nullification of Plaintiffs' economic rights were not undertaken exclusively during Mr. DeMarco's tenure. As of this writing, FHFA is headed by a Senate-confirmed Director who has required the Companies to declare dividends under the Net Worth Sweep and steadfastly refused to consider the interests of private shareholders when making policy decisions that affect the Companies. *See* JA27, 38-39. Thus, whether FHFA was an independent agency during Mr. DeMarco's tenure is ultimately of no moment; Plaintiffs' have sustained injuries caused by an independent, Senate-confirmed FHFA Director.

Moreover, even with respect to actions taken by Mr. DeMarco, giving the President power to remove the acting Director without cause would not have cured the constitutional defect. If fired, Mr. DeMarco could have only been replaced by one of the agency's other Deputy Directors—individuals selected by Mr. DeMarco or his Republican-appointed predecessor. *See* 12 U.S.C. § 4512(c)-(f); *Collins*, 896 F.3d at 667 n.199. That prevented the President from using any removal power he had to effect a policy change at the agency, thus unconstitutionally insulating the agency from presidential control. *See* JA27 (statement by Representative Barney

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Frank that President could not force change in policies at FHFA by firing Mr. DeMarco because FHFA's Deputy Directors "support DeMarco's strategies" and "would likely continue the same" policies).[4]

III. The Net Worth Sweep Must Be Vacated Because FHFA Was Constituted in Violation of the Appointments Clause.

A. Mr. DeMarco's Lengthy Tenure as FHFA's Acting Director Violated the Appointments Clause.

There was nothing "special and temporary" about Mr. DeMarco's four-and-a-half-year service as the acting head of an agency whose Director normally serves a five-year term. *United States v. Eaton*, 169 U.S. 331, 343 (1898). This was not a post that unexpectedly opened half-way around the world in the days before air travel and that implicated the President's unique role in foreign affairs, but a key domestic policymaking position that remained unfilled through parts of four separate Senate sessions. Mr. DeMarco was never confirmed by the Senate to *any* position, and this

[4] FHFA suggests that the President could replace a removed acting FHFA Director under the Federal Vacancies Reform Act ("FVRA"). The only judicial opinion that has addressed this issue suggests otherwise. *English v. Trump*, 279 F.Supp.3d 307, 322 (D.D.C. 2018). Regardless, by the time of the Net Worth Sweep, whatever authority the President has under the FVRA had lapsed because more than 210 days had passed since the Senate rejected the President's first nominee. *See* JA25; 5 U.S.C. § 3346(b)(1).

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Court would create a roadmap for evading the Appointments Clause if it upholds his lengthy tenure.

Defendants dismiss the Recess Appointments Clause as irrelevant because Mr. DeMarco was not appointed under that provision of the Constitution. But the Recess Appointments Clause reflects a constitutional judgment that under the *most* exigent of circumstances—when the Senate is unavailable to confirm a principal officer—two years is the longest period that it is reasonable for the President to fill a vacancy unilaterally. The judicial line-drawing problem this case presents is thus significantly less difficult than the one the Supreme Court resolved in *Noel Canning* by adopting a presumptive requirement that the Senate remain in recess for at least 10 days to trigger the President's power under the Recess Appointments Clause. 134 S. Ct. at 2574. *Noel Canning* was not dismissed on political question grounds, and this case should not be either.

FHFA emphasizes that it is possible for an acting agency head to serve more than two years under the FVRA and some other federal statutes. FHFA Br. 45. But these statutes cannot change the meaning of the Appointments Clause. Moreover, the FVRA was only enacted in 1998 and contains time limits that "go well beyond what Congress has historically allowed." E. Garrett West, *Congressional Power over Office Creation*, 128 YALE L.J. 166, 218 (2018). FHFA's recent examples of other acting principal officers serving more than two years likewise deserve no

weight in the face of the textual, structural, and longstanding doctrinal support for the proposition that acting principal officers may serve only for a limited time.

B. Mr. DeMarco's Service in Violation of the Appointments Clause Requires Vacatur of the Net Worth Sweep.

Courts routinely vacate the decisions of officials who serve in violation of the Appointments Clause. *See* Opening Br. 27 (collecting cases). Defendants' arguments against that remedy fail.

1. The de facto officer doctrine does not apply to "nonfrivolous constitutional" claims. *Glidden Co. v. Zdanok*, 370 U.S. 530, 536 (1962) (plurality). Apart from statute of limitations and res judicata defenses that Defendants have not raised, there is no requirement that challenges to the constitutional authority of an officer be "timely." *Nguyen v. United States*, 539 U.S. 69, 78 (2003). Furthermore, FHFA is wrong when it argues that these principles are limited to cases that concern the federal courts' authority to hear cases under Article III. In *Lamar v. United States*, 241 U.S. 103, 117-18 (1916), the Supreme Court heard a claim that an intercircuit assignment violated the criminal venue restrictions of the Sixth Amendment even though the claim was not preserved in the lower courts.

The *only* case either Defendant cites that even arguably applied the de facto officer doctrine to bar a constitutional claim is *Buckley v. Valeo*, 424 U.S. 1, 142 (1976). *See* FHFA Br. 42. But *Buckley* is consistent with the relief Plaintiffs seek, for the Court in that case accorded validity only to past agency actions *that the*

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plaintiffs did not challenge. The Supreme Court has since said that it is "not inclined to extend [*Buckley*'s remedial discussion] beyond [its] facts." *Ryder v. United States*, 515 U.S. 177, 184 (1995). FHFA argues that *Ryder* merely limited the de facto officer doctrine to civil cases, FHFA Br. 42, but that is not a plausible reading of the Court's opinion, *see Ryder*, 515 U.S. at 181 (acknowledging prior cases in which Court applied de facto officer doctrine to "challenges by criminal defendants").

2. Treasury argues for the first time on appeal that Plaintiffs should be denied all relief based on laches. Treasury Br. 46-47. Even if Treasury had not waited too long to raise this defense, laches would not provide a proper basis for affirming the district court. Plaintiffs sued within the applicable six-year statute of limitations, *see* 28 U.S.C. § 2401, and the Supreme Court has "never applied laches to bar in their entirety claims for discrete wrongs occurring within a federally prescribed limitations period." *Petrella v. MGM, Inc.*, 572 U.S. 663, 680 (2014); *see also SCA Hygiene Prods. Aktiebolag v. First Quality Baby Prods., LLC*, 137 S. Ct. 954, 961 (2017). It was "inherently reasonable" for Plaintiffs to sue within the period that Congress specified, *Grant v. Swarthout*, 862 F.3d 914, 919 (9th Cir. 2017), and that is so "regardless of the remedy sought," *Lyons P'ship, L.P. v. Morris Costumes, Inc.*, 243 F.3d 789, 798 (4th Cir. 2001). To the extent that this Court suggested otherwise

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in *Goodman v. McDonnell Douglas Corp.*, 606 F.2d 800, 805 (8th Cir. 1979), that decision is no longer good law.

Furthermore, even when a laches defense is available, it only applies if (1) the plaintiff "engaged in unreasonable and inexcusable delay"; (2) "which result[ed] in undue prejudice" to someone else. *Citizens & Landowners Against the Miles City/New Underwood Powerline v. Dep't of Energy*, 683 F.2d 1171, 1175 (8th Cir. 1982). Plaintiffs did not act unreasonably in suing within the statute of limitations. Treasury's suggestion that third-party reliance interests have built up around an action that benefited no one but the federal government and has been the subject of active litigation since 2013 cannot withstand serious scrutiny. Nor can Treasury plausibly claim to have suffered prejudice from delay; under Plaintiffs' preferred remedy, Treasury would keep the over $94 billion in profits it has collected since investing in the Companies and still retain warrants to purchase nearly 80% of the Companies' common stock.

IV. The Net Worth Sweep Must Be Vacated Because FHFA's Unbounded Conservatorship Powers Violate the Nondelegation Doctrine.

FHFA responds to the merits of Plaintiffs' nondelegation claims by pointing to everything HERA "empower[s]" it to do, but it fails to identify an intelligible principle that guides the agency's exercise of discretion when it uses its conservatorship powers. FHFA Br. 55. Treasury likewise says that the nondelegation doctrine is satisfied so long as Congress articulates a broad policy, but it is unable to

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locate in HERA any policy the conservator must follow. Treasury Br. 50-51. Under this Court's precedent, Congress gave a "blank check to the FHFA" to do whatever it wants with the Companies. *Saxton v. FHFA*, 901 F.3d 954, 960 (8th Cir. 2018) (Stras, J., concurring). That violates the nondelegation doctrine.

Neither do HERA's amendments to the Companies' charters help FHFA. *See* 12 U.S.C. §§ 1455(*l*)(1)(B), 1719(g)(1)(B). These provisions are directed to Treasury's exercise of discretion when investing in the Companies—not FHFA's exercise of discretion when it acts as conservator. Moreover, Defendants have successfully argued elsewhere that the Net Worth Sweep was not a "purchase" that triggered Treasury's obligations under the charter provisions. *Roberts v. FHFA*, 889 F.3d 397, 407-08 (7th Cir. 2018). Defendants should not be heard to argue the opposite here.

V. HERA's Succession Clause Does Not Suspend the Constitutional Rights of the Companies and Their Shareholders.

A. The Succession Clause Is Unconstitutional if it Mandates Dismissal of this Case.

Treasury argues that this suit is barred by HERA's Succession Clause, 12 U.S.C. § 4617(b)(2)(A), but it never acknowledges what this argument would mean for the Companies' constitutional rights. Treasury's position is that HERA authorizes FHFA to seize the Companies by appointing itself conservator, violate their constitutional rights, and then invoke its power under the Succession Clause to

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stop them or anyone acting on their behalf from suing to enjoin the violation. If that is what the Succession Clause means, it is unconstitutional. The Due Process Clause would not permit Congress to pass a law requiring a litigant to accept the decisions of a conflicted class representative, *Richards v. Jefferson Cty.*, 517 U.S. 793, 801 (1996), criminal defense lawyer, *Wood v. Georgia*, 450 U.S. 261, 271-72 (1981), or judge, *Ward v. Village of Monroeville*, 409 U.S. 57, 61-62 (1972). Neither may a federal statute require the Companies to accept FHFA as their exclusive representative in a lawsuit alleging that FHFA itself is unconstitutional.

Indeed, even if FHFA were inclined to file suit on behalf of the Companies arguing that its own organic statute gives it too much power, it would lack standing to do so. The Supreme Court has long recognized the "general principle that no person may sue himself." *United States v. ICC*, 337 U.S. 426, 430 (1949); *SEC v. Federal Labor Relations Auth.*, 568 F.3d 990, 997 (D.C. Cir. 2009) (Kavanaugh, J., concurring). Under Treasury's interpretation, the Succession Clause is unconstitutional because it makes it impossible for *anyone* to sue to vindicate the Companies' constitutional rights when FHFA violates them. *See Bartlett v. Bowen*, 816 F.2d 695, 705 (D.C. Cir. 1987); *Battaglia v. General Motors Corp.*, 169 F.2d 254, 257 (2d Cir. 1948); *see also Reich v. Collins*, 513 U.S. 106, 111 (1994).

Anticipating these points, Treasury says that *someone else* injured by *some other* FHFA action might be able to obtain redress for *their* injuries by offering the

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same legal theories that Plaintiffs advance here. Treasury Br. 22-23. That is true but does nothing to lessen the glaring due process problem with leaving it up to FHFA to decide whether the Companies will sue FHFA for violating the Constitution.

Courts strive "to avoid the 'serious constitutional question' that would arise if a federal statute were construed to deny any judicial forum for a colorable constitutional claim." *Webster v. Doe*, 486 U.S. 592, 603 (1988). The Court can easily avoid the constitutional problems inherent in Treasury's argument for the reasons explained in the following sections. But if the Court agrees with Treasury, it should rule that the Succession Clause is one more provision of HERA that unconstitutionally hands power to an unaccountable FHFA.

B. Plaintiffs' Claims Are Direct Under Principles of Both Federal and State Law.

1. Treasury argues only that the Succession Clause applies to derivative claims, and the direct or derivative nature of Plaintiffs' claims is ultimately a question of federal law. *Starr Int'l Co. v. United States*, 856 F.3d 953, 965-66 (Fed. Cir. 2017); Treasury Br. 16. While federal courts often look to state law principles when distinguishing between direct and derivative claims, they will not do so when the application of state law "would be inconsistent with the federal policy underlying the cause of action." *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 99 (1991); *see Guenther v. Griffin Constr. Co.*, 846 F.3d 979, 983 (8th Cir. 2017). The federal policy underlying Plaintiffs' causes of action is clear: "The declared purpose of

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separating and dividing the powers of government . . . was to 'diffus[e] power the better to secure liberty.' " *Bowsher*, 478 U.S. at 721 (quoting *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 635 (1952) (Jackson, J., concurring)). Because treating Plaintiffs' claims as derivative would frustrate this policy by leaving it up to FHFA to decide whether this separation of powers challenge to FHFA's operations may go forward, Plaintiffs' claims are direct as a matter of federal law.

This analysis finds support in the Supreme Court's relaxation of prudential third-party standing rules in cases in which there is a "close relationship" between the plaintiff and a third party facing "a 'hindrance' to [his] ability to protect his own interests." *Kowalski v. Tesmer*, 543 U.S. 125, 130 (2004). With FHFA hopelessly conflicted and unable to sue itself, Plaintiffs' status as shareholders gives them a close relationship with the Companies that makes them the appropriate parties to assert the claims at issue here. At least where there is no more directly injured party with the capacity to sue, an individual who has suffered "injury that is concrete, particular, and redressable" "has a *direct* interest in objecting to laws that upset the constitutional balance." *Bond v. United States*, 564 U.S. 211, 222 (2011) (emphasis added).

Treasury responds by citing cases in which courts applied the usual state law standard to decide whether federal constitutional claims were direct or derivative. Treasury Br. 21-22. But none of Treasury's cases involved a scenario in which

treating separation of powers claims as derivative meant that the claims could only go forward with the assent of the very federal agency alleged to be operating unconstitutionally.[5] *See Pagan v. Calderon*, 448 F.3d 16, 28 (1st Cir. 2006) (shareholder may sue in own name for injury to corporation when "it is absolutely inconceivable that the corporation itself would pursue a claim for the misconduct").

2. Plaintiffs' claims are also direct under state law. As the *Collins* panel explained, Plaintiffs have a "direct, personal interest in their cause of action—their security interests are subject to the FHFA's continuing jurisdiction, regulation and control." 896 F.3d at 658.

"Causes of action for the misallocation of shares among competing stockholders or for discrimination against specific stockholders have often been found to be direct and not derivative in nature." *Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.*, 2005 WL 1713067, at *8 n.41 (Del. Ch. July 13, 2005); *see also Pareto v. FDIC*, 139 F.3d 696, 699-700 (9th Cir. 1998) (minority shareholders may sue directly to challenge "a majority stockholders' breach of a fiduciary duty to

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[5] *Gregory v. Mitchell*, 634 F.2d 199, 202 (5th Cir. 1981), did not concern separation of powers claims. Moreover, the due process and equal protection claims at issue in that case could have been raised by the bank itself as part of a challenge to Alabama regulators' decision to take the bank over. *See* ALA. CODE § 5-8-27 (1980); *Gregory v. Mitchell*, 459 F.Supp. 1162, 1168 (M.D. Ala. 1978) (observing that plaintiffs "were given the opportunity to present their case" in state administrative proceedings). The same is not true here, for Plaintiffs' injuries from the Net Worth Sweep arose years after the Companies were forced into conservatorship.

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minority stockholders, which resulted in the majority stockholders retaining a disproportionate share of the corporation's ongoing value"); FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5908. Rearranging a corporation's capital structure to shift part of its ongoing value from one shareholder to another does not affect all shareholders in the same way or necessarily injure the corporation. In such cases, the disadvantaged shareholder directly suffers the "alleged harm" and receives "the benefit of any recovery." *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). This is a basic principle governing the distinction between direct and derivative claims. Despite Treasury's assertions to the contrary, it does not depend on shareholder voting rights or the Delaware Supreme Court's decision in *Gentile v. Rossette*, 906 A.2d 91, 100 (Del. 2006); *see* Treasury Br. 19-21.

The Net Worth Sweep rearranged the Companies' capital structure so that dividends that would have been shared with Plaintiffs are instead paid exclusively to Treasury. Treasury's argument that this change to the Companies' capital structure harms Plaintiffs only derivatively is not correct; the fact that Treasury now receives dividends that would have otherwise been paid to Plaintiffs harms Plaintiffs, not the Companies. Accordingly, Plaintiffs "can prevail without showing an injury to the corporation." *Tooley*, 845 A.2d at 1039. Indeed, even if the Net Worth Sweep had benefitted the Companies, Plaintiffs would be no less injured by having their economic rights transferred to Treasury.

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Treasury argues that vacatur of the Net Worth Sweep would only benefit Plaintiffs indirectly, Treasury Br. 17, but when a plaintiff seeks injunctive or declaratory relief rather than damages the only way to determine to whom the relief flows is to consider whose injury it remedies. Accordingly, "courts have been more prepared to permit the plaintiff to characterize the action as direct when the plaintiff is seeking only injunctive or prospective relief," as is the case here. *Grimes v. Donald*, 673 A.2d 1207, 1213 (Del. 1996), *overruled on other grounds*, *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000). For example, *Gatz v. Ponsoldt* held that a shareholder's claim was direct where the plaintiff asked the court to unwind a transaction entered into by the corporation to the advantage of certain shareholders at the expense of others. 2004 WL 3029868, at *7-8 (Del. Ch. Nov. 5, 2004). That Plaintiffs' claims are direct is also underscored by the fact that awarding damages to the Companies would do nothing to redress Plaintiffs' injuries, for any such damages would simply be swept back to Treasury if the Net Worth Sweep is not vacated.

Plaintiffs' claims are also direct because the Net Worth Sweep targeted the Companies' private shareholders. Even when a claim would otherwise be derivative, investors need not sue derivatively to challenge an action that "targeted shareholders directly." *Starr*, 856 F.3d at 973; *Maiz v. Virani*, 253 F.3d 641, 655-56 (11th Cir. 2001). The Net Worth Sweep is just such an action. *See* JA26, JA30-31.

C. HERA's Succession Clause Does Not Prevent Shareholders from Asserting Derivative Constitutional Claims Against FHFA.

Even if the Court concludes that Plaintiffs' claims are derivative, it still can avoid the due process problem Treasury's argument presents because the Succession Clause does not bar derivative claims alleging that FHFA violated the Constitution. To be sure, the D.C. and Seventh Circuits have held that the Succession Clause forecloses derivative *statutory* and *common law* claims during conservatorship. *Perry Capital*, 864 F.3d at 623; *Roberts*, 889 F.3d at 409. But neither court relied upon the Succession Clause as a basis for dismissing derivative *constitutional* claims, and the constitutional avoidance canon provides a powerful reason to read the statute to allow such claims to go forward. *See Webster*, 486 U.S. at 603.

Even apart from the constitutional concerns that make this case different from *Perry Capital* and *Roberts*, those decisions are wrong. Before Congress enacted HERA, the Federal and Ninth Circuits had interpreted 12 U.S.C. § 1821(d)(2)(A)(i), the provision of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") on which HERA's Succession Clause was modeled, as allowing shareholders to maintain derivative suits when the conservator or receiver has a manifest conflict of interest. *See First Hartford Corp. Pension Plan & Tr. v. United States*, 194 F.3d 1279, 1283 (Fed. Cir. 1999); *Delta Sav. Bank v. United States*, 265 F.3d 1017, 1024 (9th Cir. 2001). When Congress reenacted substantially

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the same language in HERA, it must be presumed to have adopted these consistent judicial constructions. *See Bragdon v. Abbott*, 524 U.S. 624, 645 (1998).

First Hartford and *Delta Savings Bank* also reflect the best reading of the statute's text. Another provision of HERA contemplates that during conservatorship a "regulated entity" may sue "for an order requiring the Agency to remove itself as conservator." 12 U.S.C. § 4617(a)(5). Since FHFA "immediately succeed[s]" to the Companies' rights when it places them into conservatorship and cannot sue itself, *id.* § 4617(b)(2)(A), this provision would be meaningless if shareholders could not sue the conservator derivatively. HERA's Succession Clause, moreover, does not purport to *eliminate* any shareholder rights but only provides that FHFA temporarily "succeed[s]" to them. For this reason as well, HERA should not be read as making FHFA the "successor" to rights it cannot exercise. *See Delta Sav. Bank*, 265 F.3d at 1024.

CONCLUSION

The district court's decision should be reversed.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure because this brief contains 6,499 words, excluding the parts of the brief exempted by Rule 32(f) of the Federal Rules of Appellate Procedure.

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

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CERTIFICATE OF SERVICE

I hereby certify that on November 28, 2018, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Eighth Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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