UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

WAZEE STREET OPPORTUNITIES FUND IV, LP, et al., Plaintiffs, -vs.- THE FEDERAL HOUSING FINANCE AGENCY, et al., Defendants.	No. 2:18-cv-03478-NIQA

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS

TABLE OF CONTENTS

Page

INTRODUCTION 1

BACKGROUND 4

A. Congress Establishes FHFA as an Independent Agency Headed by a Single Director 4

B. FHFA Forces the Companies into Conservatorship and Signs the PSPAs on Their Behalf 5

C. Mr. DeMarco Serves as FHFA's Acting Director for Over Four Years 6

D. Unwarranted Accounting Decisions Artificially Increase the Companies' Draws from Treasury, and FHFA Expropriates Plaintiffs' Investments by Imposing the Net Worth Sweep 7

ARGUMENT 8

I. FHFA Is Unconstitutionally Structured 8

A. The Constitution's Separation of Powers Does Not Permit an Independent Agency with One Director 8

B. FHFA Is Unconstitutionally Insulated from the President's Control 11

C. The FHFA's Unconstitutional Structure Requires Invalidating the Third Amendment 13

1. FHFA Cannot Escape Separation of Powers Restraints by Labeling Its Actions Nongovernmental or Pretending It Is Not an Independent Agency 13

2. Remedying FHFA's Unconstitutional Structure Requires Invalidating the Third Amendment 17

II. FHFA Approved the Net Worth Sweep When Its Director Was Acting in Violation of the Appointments Clause 19

A. Mr. DeMarco Served as the Acting Director of FHFA in Violation of the Appointments Clause 19

1. Mr. DeMarco Was No Longer a "Temporary" Official When the Third Amendment Was Implemented 20

2. The President Cannot Appoint Acting Principal Officers 24

B. Plaintiffs' Claims Are Timely 24

III. FHFA Violated the Nondelegation Doctrine When It Imposed the Net Worth Sweep 25

IV. Plaintiffs Have Article III Standing to Challenge the Actions that Caused Plaintiffs' Injuries 26

A. Plaintiffs' Injury Is Sufficiently Connected to the Constitutional Violation 27

B. Plaintiffs Have Redressable Injuries 31

V. Plaintiffs' Claims Are Not Barred by HERA 32

A. Plaintiffs' Claims Are Direct Under Applicable Federal Law 32

B. Plaintiffs' Claims Are Direct Under Applicable State Law 34

C. Plaintiffs Have Standing to Challenge the Constitutionality of FHFA Under Article III 37

VI. Treasury Is an Appropriate Defendant 37

CONCLUSION 40

TABLE OF AUTHORITIES

Page(s)

Cases

In re Activision Blizzard, Inc. Stockholder Litig.,
124 A.3d 1025 (Del. Ch. 2015)....................30

Bhatti v. FHFA,
332 F. Supp. 3d 1206 (D. Minn. 2018), *appeal docketed,* No. 18-2506 (8th Cir. July 16, 2018) 2

Bhatti v. FHFA,
No. 18-2506 (8th Cir. Nov. 14, 2018)....................29

Bond v. United States,
564 U.S. 211 (2011)....................33, 34

Bowsher v. Synar,
478 U.S. 714 (1986)....................17, 18, 33

Buckley v. Valeo,
424 U.S. 1 (1976)....................28

Carter v. Carter Coal Co.,
298 U.S. 238 (1936)....................3, 25

CASA de Md., Inc. v. Trump,
No. GJH-18-845, 2018 WL6192367 (D. Md. Nov. 28, 2018) 39

Citizens to Preserve Overton Park, Inc. v. Volpe,
401 U.S. 402 (1971)....................18

Clinton v. New York,
524 U.S. 417 (1998)....................17, 29

Collins v. Mnuchin,
896 F.3d 640 (5th Cir. 2018), *rehearing en banc granted*.................... *passim*

Collins v. Mnuchin,
No. 17-20364 (5th Cir. Sept. 13, 2018) 29

Constitution Party of Pa. v. Aichele,
757 F.3d 347 (3d Cir. 2014)....................37

Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.,
No. Civ. A. 379, 2005 WL 1713067 (Del. Ch. July 13, 2005)....................34

Dresser-Rand Co. v. NLRB,
576 F. App'x 332 (5th Cir. 2014) 17

FEC v. NRA Political Victory Fund,
6 F.3d 821 (D.C. Cir. 1993) 17

Feldman v. Cutaia,
956 A.2d 644 (Del. Ch. 2007) 35

Free Enterprise Fund v. Public Co. Accounting Oversight Bd.,
561 U.S. 477 (2010) .... *passim*

Freytag v. Commissioner,
501 U.S. 868 (1991) 14

In re G-I Holdings, Inc.,
755 F.3d 195 (3rd Cir. 2014) 34

Gatz v. Ponsoldt,
No. Civ. A. 174, 2004 WL 3029868 (Del. Ch. Nov. 5, 2004) 36

Glidden Co. v. Zdanok,
370 U.S. 530 (1962) 24, 29

Grimes v. Donald,
673 A.2d 1207 (Del. 1996), *overruled on other grounds*, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) 36

Grocery Mfrs. Ass'n v. EPA,
693 F.3d 169 (D.C. Cir. 2012) 31

Guenther v. Griffin Constr. Co.,
846 F.3d 979 (8th Cir. 2017) 33

Hendler v. United States,
952 F.2d 1364 (Fed. Cir. 1991) 15

Humphrey's Ex'r v. United States,
295 U.S. 602 (1935) 9, 11

INS v. Chadha,
462 U.S. 919 (1983) 17, 23

Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.,
684 F.3d 1332 (D.C. Cir. 2012) 17

Jacobs v. FHFA,
908 F.3d 884 (3d Cir. 2018) 3, 14, 15, 26

John Wyeth & Bro. Ltd. v. CIGNA Int'l Corp.,
119 F.3d 1070 (3d Cir.1997)....23

Juliana v. United States,
No. 15-cv-1517, 2018 WL 4997032 (D. Or. Oct. 15, 2018) 39

Kamen v. Kemper Fin. Servs.,
500 U.S. 90 (1991)....22, 33, 34

Kowalski v. Tesmer,
543 U.S. 125 (2004)....33

Loral Space & Commc'ns, Inc. v. Highland Crusader Offshore Partners, L.P.,
977 A.2d 867 (Del. 2009) 37

Lucia v. SEC,
138 S. Ct. 2044 (2018)....17

Lujan v. Defenders of Wildlife,
504 U.S. 555 (1992)....29

In re McNeil Consumer Healthcare,
877 F. Supp. 2d 254 (E.D. Pa. 2012) 31

Mistretta v. United States,
488 U.S. 361 (1989)....26

Morrison v. Olson,
487 U.S. 654 (1988)....9, 10, 20

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

Nguyen v. United States,
539 U.S. 69 (2003)....24, 25

NLRB v. Noel Canning,
134 S. Ct. 2550 (2014).... *passim*

NLRB v. SW Gen., Inc.,
137 S. Ct. 929 (2017)....21, 23, 24

Ohio Pub. Emps. Retirement Sys. v. FHFA,
No. 11-1543 (D.D.C. Aug. 26, 2011) 25

Pareto v. FDIC,
139 F.3d 696 (9th Cir. 1998) 34

Pennsylvania v. New Jersey,
426 U.S. 660 (1976)..........31

Perry Capital LLC v. Mnuchin,
864 F.3d 591 (D.C. Cir. 2017)..........26, 32

PHH Corp. v. CFPB,
839 F.3d 1 (D.C. Cir. 2016), *rev'd*, 881 F.3d 75 (2018)..........18

PHH Corp. v. CFPB,
881 F.3d 75 (2018)..........10, 11, 12, 13

Plaut v. Spendthrift Farm, Inc.,
514 U.S. 211 (1995)..........14

Preseault v. United States,
100 F.3d 1525 (Fed. Cir. 1996)..........15

Richards v. Jefferson Cty.,
517 U.S. 793 (1996)..........32

Ryder v. United States,
515 U.S. 177 (1995)..........24

San Antonio Fire & Police Pension Fund v. Bradbury,
No. C.A. 4446-VCH, 2010 WL 4273171 (Del. Ch. Oct. 28, 2010)..........37

SEC v. Federal Labor Relations Auth.,
568 F.3d 990 (D.C. Cir. 2009)..........33

Slattery v. United States,
583 F.3d 800 (Fed. Cir. 2009)..........15

Starr Int'l Co. v. United States,
856 F.3d 953 (Fed. Cir. 2017)..........32, 34, 36

SW Gen., Inc. v. NLRB,
796 F. 3d 67 (D.C. Cir. 2015)..........25

Synar v. United States,
626 F. Supp. 1374 (D.D.C. 1986)..........17, 18

Tooley v. Donaldson, Lufkin & Jenrette, Inc.,
845 A. 2d 1031 (Del. 2004)..........34, 35, 36

United States v. Beszborn,
21 F.3d 62 (5th Cir. 1994)..........14

United States v. Eaton,
169 U.S. 331 (1898)....3, 20, 21, 23

United States v. Guzek,
527 F.2d 552 (8th Cir. 1975) 16

United States v. ICC,
337 U.S. 426 (1949)....33

Ward v. Village of Monroeville,
409 U.S. 57 (1972)....32

Whitman v. American Trucking Ass'ns,
531 U.S. 457 (2001)....25

Wood v. Georgia,
450 U.S. 261 (1981)....32

Youngstown Sheet & Tube Co. v. Sawyer,
343 U.S. 579 (1952)....17

Zivotofsky v. Kerry,
135 S. Ct. 2076 (2015)....11

Constitutional Provisions

U.S. Const. art. II §§ 1, 3 8

U.S. Const. art. II, § 2 20

U.S. Const. art. II, § 2, cl. 2 19

U.S. Const. art. II, § 2, cl. 3 19

Rules & Statutes

5 U.S.C. § 706....18

12 U.S.C. § 2....10

12 U.S.C. § 1455(l)(1)(A)....5

12 U.S.C. § 1455(l)(4) 5

12 U.S.C. § 1719(g)(1)(A)....5

12 U.S.C. § 1719(g)(4) 5

12 U.S.C. § 4511(a) 16

12 U.S.C. §§ 4511(b) 16, 26

12 U.S.C. § 4512 16

12 U.S.C. § 4512(a) 12

12 U.S.C. § 4512(a)-(b) 9

12 U.S.C. § 4512(b)(2) 4, 12, 21

12 U.S.C. § 4512(b)(5) 6

12 U.S.C. § 4512(c)-(e) 6

12 U.S.C. § 4512(f) 6, 16, 19, 23

12 U.S.C. § 4513a(1) 13

12 U.S.C. § 4513a(d)(2) 13

12 U.S.C. § 4516(f)(2) 4

12 U.S.C. § 4526 10

12 U.S.C. § 4617 19

12 U.S.C. § 4617(a) 4

12 U.S.C. § 4617(a)(7) 4, 12

12 U.S.C. § 4617(b) 26

12 U.S.C. § 4617(b)(2)(A)(i) 32

12 U.S.C. § 5321 13

12 C.F.R. § 1237.12(a), (b) 16, 26

28 U.S.C. § 2401 24

DEL. CODE ANN. tit. 6, § 8-302(a) 30

Fed. Rule Civ. P. 12(b)(6) 37

Gramm-Rudman-Hollings Act 17

Housing and Community Development Act of 1992 §§ 1311, 1312, 106 Stat. 3672 (Oct. 28, 1992) 4

Housing and Economic Recovery Act .... *passim*

Congressional Record

156 CONG. REC. S7911 (Nov. 15, 2010) 7

Other Authorities

1 Op. O.L.C. 287 (1977) 22

Designation of Acting Director of OMB, 2003 WL 24151770 (O.L.C. June 12, 2003) 22

Designation of Acting Solicitor of Labor, 2002 WL 34461082 (O.L.C. Nov. 15, 2002) 22

INTRODUCTION

In 2008, in the midst of the financial crisis, Congress created the Federal housing Finance Authority ("FHFA"). Declaration of Eric L. Zagar in Support of Plaintiffs' Motion for Summary Judgment ("Zagar Decl.") ¶ 5. FHFA soon after placed two government sponsored entities, Fannie Mae and Freddie Mac (the "Companies"), into conservatorship. Zagar Decl. ¶ 8. The conservatorship was supposed to be temporary—in FHFA's words, it had "the objective of returning the entities to normal business operations." Zagar Decl. ¶ 9; Compl. ¶ 19.[1] Similarly, Treasury justified its investing in the Companies in part on the basis that "Fannie Mae and Freddie Mac may emerge from conservatorship to resume independent operations." Compl. ¶ 24.

Yet, years after the financial crisis abated, FHFA and the Department of the Treasury ("Treasury") decided that the Companies would not be allowed to emerge from conservatorship. Instead, every quarter, they would divert the Companies' entire net worth to Treasury as a dividend. This "Net Worth Sweep" was implemented through the Third Amendment to the Senior Preferred Stock Purchase Agreement (the "Third Amendment") to preferred stock purchase agreements the Companies entered into with Treasury during the financial crisis. Treasury explained that this amendment would sweep "every dollar of profit that [the] firm earns going forward" and further its effort that the Companies "be wound down," rather than being "allowed to retain profits, rebuild capital, and return to the market in their prior form." Zagar Decl. ¶ 26; Compl. ¶ 41.

FHFA and Treasury's effort to that effect has been extraordinarily profitable for the Government. Through the Net Worth Sweep, the Government has received approximately $90 billion more as dividends under the PSPAs than it invested in the Companies. These dividends

---

[1] All citations to "Compl. ¶__" refer to paragraphs in Plaintiffs' Class Action Complaint (the "Complaint"), filed in this action on August 16, 2018.

have left the Companies with effectively no capital reserves, prevented them from redeeming Treasury's Senior Preferred Stock, or paying dividends to other shareholders. The Net Worth Sweep thus effectively nationalized the Companies, diverting their profits from private shareholders to the Companies' largest shareholder, Treasury.

Other cases have been filed challenging several aspects of this nationalization. Only two other cases thus far have raised the question raised here: is the Net Worth Sweep the product of an agency with a structure that violates the Constitution's separation of powers and, at the time, headed by an acting director serving in violation of the Appointments Clause? A panel of the Fifth Circuit concluded that FHFA was unconstitutionally structured. *Collins v. Mnuchin*, 896 F.3d 640, 668 (5th Cir. 2018), *rehearing en banc granted*.[2] One district court has ruled to the contrary. *Bhatti v. FHFA*, 332 F. Supp. 3d 1206 (D. Minn. 2018), *appeal docketed,* No. 18-2506 (8th Cir. July 16, 2018).

The Fifth Circuit panel is correct. FHFA was unconstitutionally structured when it implemented the Net Worth Sweep and remains so today. Unlike the multi-member commissions and boards of experts the Supreme Court has sanctioned and are typical of independent agencies, FHFA is led by a single administrator removable only for cause. This alone violates of the Constitution's separation of powers, and even if that were not the case, the combination of (i) having a single administrator removable only for cause, (ii) the power to finance its budget separate and apart from the President's budgetary process, and (iii) the lack of any power by the President to overrule, directly or indirectly, a decision by FHFA, certainly renders FHFA's structure

[2] The Fifth Circuit granted both parties' petitions for an *en banc* rehearing, and argument is scheduled for January 23, 2019. As part of the *en banc* argument, the Fifth Circuit has asked for supplemental briefing on topics that include remedies and what setting aside the Net Worth Sweep would entail.

unconstitutional.

Additionally, and as an independent basis for finding a constitutional violation, the acting FHFA director who implemented the Net Worth Sweep was serving in violation of the Appointments Clause. While the Supreme Court allows inferior officers to assume the duties, responsibilities, and powers of principal officers "*for a limited time* and under special and *temporary* conditions, he is not thereby transformed into the superior and permanent official," *United States v. Eaton*, 169 U.S. 331, 343 (1898) (emphasis added), Edward DeMarco, the acting director of FHFA at the time the Net Worth Sweep was implemented, served as acting director for over four years—just eight months short of the full term set for FHFA directors. He thus was in no way a "special and temporary" official permitted to act as a principal officer of the United States.

FHFA and Treasury try to escape these infirmities by arguing that FHFA was not exercising governmental powers, and was not acting as the government, when it implemented the Net Worth Sweep. This position is wrong and contrary to the reasoning they used to defend FHFA's statutory authority to undertake the Net Worth Sweep, including before the Third Circuit. *Jacobs v. FHFA*, 908 F.3d 884 (3d Cir. 2018). Regardless, even if FHFA were correct, FHFA would only create another constitutional problem: the delegation of governmental power—the power to expropriate the rights of private persons to further the public good—to a private actor. The Constitution does not permit such delegation. *Carter v. Carter Coal Co.*, 298 U.S. 238, 311 (1936).

For these reasons, and those below, this Court should conclude that the Net Worth Sweep is invalid because it was unlawfully implemented by an agency or director structured or acting in violation of the Constitution.

BACKGROUND

A. Congress Establishes FHFA as an Independent Agency Headed by a Single Director

Fannie Mae and Freddie Mac are private, for-profit corporations that insure and securitize mortgages. Zagar Decl. ¶¶ 2-3; Compl. ¶ 11. From 1992 until 2008, the Companies were regulated by the Office of Federal Housing Enterprise Oversight ("OFHEO"). Zagar Decl. ¶ 4; Compl. ¶ 14. OFHEO was not an independent agency; its Director could be removed from office by the President for any reason. *See* Housing and Community Development Act of 1992 §§ 1311, 1312, 106 Stat. 3672 (Oct. 28, 1992).

During the summer of 2008, Congress enacted the Housing and Economic Recovery Act ("HERA"), which established FHFA as the successor to OFHEO. Zagar Decl. ¶ 5; Compl. ¶ 14. Unlike its predecessor, FHFA is an "independent" agency, and it is headed by a Director who is only removable "for cause by the President," 12 U.S.C. § 4512(b)(2); Zagar Decl. ¶ 6; Compl. ¶ 15. To further insulate FHFA from presidential influence, HERA also provides that when FHFA acts as conservator it "shall not be subject to the direction or supervision of any other agency of the United States." 12 U.S.C. § 4617(a)(7); Zagar Decl. ¶ 7; Compl. ¶ 15. FHFA is funded through assessments that are "not . . . construed to be Government or public funds or appropriated money." 12 U.S.C. § 4516(f)(2); Zagar Decl. ¶ 7; Compl. ¶ 15. As a result, FHFA is neither subject to presidential control nor constrained by the congressional appropriations process. Compl. ¶ 15.

In addition to giving FHFA supervisory regulatory powers over the Companies, HERA also empowered FHFA to appoint itself as the Companies' conservator under specified circumstances. *See* 12 U.S.C. § 4617(a).

B. FHFA Forces the Companies into Conservatorship and Signs the PSPAs on Their Behalf

On September 6, 2008, FHFA exercised its power to place the Companies into conservatorship. Zagar Decl. ¶ 8; Compl. ¶ 16. In addition to establishing FHFA, HERA also gave Treasury temporary authority to invest in the Companies' securities. Zagar Decl. ¶¶ 15; Compl. ¶ 21, 23-24. This authority expired at the end of 2009 and could only be exercised with the Companies' consent. *See* 12 U.S.C. §§ 1455(l)(1)(A), 1455(l)(4), 1719(g)(1)(A), 1719(g)(4); Zagar Decl. ¶ 17; Compl. ¶ 27. Concurrent with FHFA's imposition of conservatorship, Treasury exercised this authority by entering into agreements with FHFA to purchase equity in the Companies ("Preferred Stock Purchase Agreements" or "PSPAs"). Zagar Decl. ¶ 12; Compl. ¶ 21. The PSPAs allowed the Companies to draw up to $100 billion each from Treasury as needed to avoid a negative net worth—an amount that was subsequently increased to allow the Companies to draw unlimited sums from Treasury until the end of 2012, and thereafter capped at the amount drawn from 2010 through 2012, plus $200 billion per Company. Zagar Decl. ¶ 18; Compl. ¶ 28.

In return for Treasury's funding commitment, FHFA agreed that the Companies would provide several forms of consideration. First, the PSPAs created a new class of securities with very favorable terms to Treasury, known as Senior Preferred Stock. Zagar Decl. ¶¶ 13-14; Compl. ¶ 21. For each Company, the Senior Preferred Stock had an initial liquidation preference of $1 billion, an amount that would increase by one dollar for every dollar drawn on Treasury's funding commitment. Zagar Decl. ¶ 14; Compl. ¶ 21. The original PSPAs required the Companies to pay quarterly dividends on the Senior Preferred Stock's liquidation preference. Zagar Decl. ¶ 14; Compl. ¶ 21. These dividends could be paid in cash, at an annual rate of 10%, or in kind, by increasing the liquidation preference by an annual amount of 12%. Zagar Decl. ¶ 14; Compl. ¶

21. Paying the dividends in kind would not have reduced the amount available under Treasury's funding commitment. Compl. ¶ 21.

Second, FHFA agreed that the Companies would issue warrants entitling Treasury to buy 79.9% of their common stock at a nominal price. Zagar Decl. ¶¶ 13-14; Compl. ¶ 21. The PSPAs also provided for the Companies to pay Treasury a quarterly market-based periodic commitment fee, but the fee was never charged and could only be set at a market rate with agreement from the Companies. Zagar Decl. ¶ 14; Compl. ¶ 21. The original PSPAs thus did not eliminate the economic interests of the Companies' private shareholders. Compl. ¶ 22.

C. Mr. DeMarco Serves as FHFA's Acting Director for Over Four Years

As the Director of OFHEO when HERA became law, James Lockhart automatically became vested with the authority to "act" as FHFA's independent Director until a permanent Director could be appointed. *See* 12 U.S.C. § 4512(b)(5); Zagar Decl. ¶ 28; Compl. ¶ 63. Mr. Lockhart forced the Companies into conservatorship and signed the original PSPAs on their behalf in September 2008. Zagar Decl. ¶ 28; Compl. ¶ 63. On August 5, 2009, Mr. Lockhart announced that he would resign. Zagar Decl. ¶ 29; Compl. ¶ 63.

HERA provides that "[i]n the event of the . . . resignation . . . of the Director, the President shall designate" one of FHFA's three Deputy Directors "to serve as acting Director until . . . the appointment of a successor" who is nominated by the President and confirmed by the Senate. 12 U.S.C. § 4512(f); Zagar Decl. ¶ 31; Compl. ¶ 64. Each of FHFA's Deputy Directors is appointed by FHFA's Director. 12 U.S.C. § 4512(c)-(e); Zagar Decl. ¶ 31; Compl. ¶ 64. In accordance with HERA, on August 25, 2009, President Obama designated Edward DeMarco to serve as FHFA's acting Director. Zagar Decl. ¶ 32; Compl. ¶ 64.

Acting agency heads normally serve only temporarily, during the time necessary for the President to nominate and the Senate to confirm someone to permanently fill the position. Compl.

¶ 65. But it was not until fifteen months after Director Lockhart's resignation, on November 12, 2010, that President Obama nominated Joseph A. Smith, Jr. to be FHFA's Director. Zagar Decl. ¶ 34; Compl. ¶ 65; 156 CONG. REC. S7911 (Nov. 15, 2010). The Senate did not confirm Mr. Smith, whose nomination expired on December 22, 2010. Zagar Decl. ¶ 35; Compl. ¶ 65. President Obama did not again nominate someone to fill the vacancy created by Mr. Lockhart's resignation until May 2013, when he nominated Congressman Melvin L. Watt. Compl. ¶ 65. Mr. Watt was sworn into office on January 6, 2014. Zagar Decl. ¶ 36; Compl. ¶ 65.

Thus, between August 2009 and January 2014, Mr. DeMarco was FHFA's acting director. Zagar Decl. ¶ 33; Compl. ¶ 66. Mr. DeMarco undertook a policy aimed at winding down the Companies and doing so in a manner that guaranteed their private shareholders would lose all the value of their investments. Compl. ¶ 67. Despite Mr. DeMarco's commitment to operate the Companies for the exclusive financial benefit of the federal government, he resisted some of the Obama Administration's most significant housing finance policies. Compl. ¶¶ 68-69. Most notably, Mr. DeMarco refused to approve the Administration's proposal that the Companies reduce the principal on certain mortgages in an effort to jumpstart the recovery in housing prices. Compl. ¶ 68.

D. Unwarranted Accounting Decisions Artificially Increase the Companies' Draws from Treasury, and FHFA Expropriates Plaintiffs' Investments by Imposing the Net Worth Sweep

Under FHFA's supervision, the Companies were forced to dramatically write down the value of their assets and to incur substantial and unjustified non-cash accounting losses in the form of loan loss reserves and write-offs of deferred tax assets. Zagar Decl. ¶ 16; Compl. ¶ 25. As a result of these accounting decisions, the Companies made draws on Treasury's funding commitment that caused the liquidation preference on Treasury's Senior Preferred Stock to swell

to $189 billion. Compl. ¶¶ 26, 40. But based on the Companies' performance in the second quarter of 2012, it was apparent that the Companies' private shares still had value. Compl. ¶¶ 30-34.

On August 17, 2012, FHFA and Treasury amended the PSPAs to impose the Net Worth Sweep. Zagar Decl. ¶ 21; Compl. ¶ 36. The Net Worth Sweep replaces the PSPAs' prior dividend structure with one that requires the Companies to pay Treasury their entire net worth on a quarterly basis, minus a small capital buffer of $3 billion. Zagar Decl. ¶ 22; Compl. ¶ 36. FHFA thus agreed to expropriate not just their future earnings but also their retained capital, thereby depriving the Companies' private shareholders of all of their economic rights. Zagar Decl. ¶ 23; Compl. ¶¶ 36-38.

As FHFA expected, the Net Worth Sweep has resulted in massive and unprecedented payments to the government. Since the Companies first began paying dividends under the Net Worth Sweep during the first quarter of 2013, they have transferred to Treasury approximately $280 billion in purported dividends—roughly $125 billion more than Treasury could have received under the original PSPAs. Zagar Decl. ¶ 27; Compl. ¶ 45. Altogether, Treasury has recouped approximately $90 billion more than it disbursed to the Companies. Compl. ¶ 45. Yet the principal value of Treasury's Senior Preferred Stock has not been reduced at all, and it continues to receive quarterly dividends equal to the net worth of the two Companies. Compl. ¶ 45.

ARGUMENT

I. FHFA Is Unconstitutionally Structured

A. The Constitution's Separation of Powers Does Not Permit an Independent Agency with One Director

The Constitution vests the Executive power of the United States federal government in the President, who must "take Care that the Laws be faithfully executed." U.S. Const. art. II §§ 1, 3. In executing these duties, the Constitution provides for executive officers "to 'assist the supreme

Magistrate in discharging the duties of his trust.'" *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 483 (2010) (quoting 30 Writings of George Washington 334 (J. Fitzpatrick ed. 1939)). "Since 1789, the Constitution has been understood to empower the President to keep these officers accountable—by removing them from office, if necessary." *Id.* (citing *Myers v. United States*, 272 U.S. 52 (1926)). There are only two exceptions to the general rule that the President must be able to remove inferior executive officers at will: Congress may require cause for the removal of (1) a multimember "body of experts," *see Humphrey's Ex'r v. United States*, 295 U.S. 602, 624 (1935), and (2) inferior officers with a narrow scope of powers, *see Morrison v. Olson*, 487 U.S. 654, 671-73, 695-97 (1988).[3]

FHFA fails to fit into either of these exceptions. It is led by a single executive officer who is removable only for cause, 12 U.S.C. § 4512(a)-(b), not a "body of experts appointed by law and informed by experience" whose "duties are neither political nor executive." *Humphrey's Ex'r*, 272 U.S. at 624. The President thus "may be stuck for years with a [FHFA] Director who was appointed by the prior President and who vehemently opposes the current President's agenda." *Collins*, 896 F.3d at 668 (quoting *PHH Corp. v. CFPB*, 881 F.3d 75, 167 (2018) (en banc) (Kavanaugh, dissenting)). "This 'dramatic and meaningful difference vividly illustrates that the single-Director structure diminishes Presidential power more than traditional multi-member independent agencies do.'" *Id.* (quoting *PHH Corp.*, 881 F.3d at 167 (Kavanaugh, dissenting)). *See also* Memorandum in Support of Motion to Dismiss by the U.S. Department of the Treasury ("Treasury Br."), filed in this action on November 16, 2018, at 18-19 (explaining why independent agencies with a single leader impair the President's oversight).

[3] Plaintiffs reserve the right to argue that *Humphrey's Executor* and *Morrison* should be overturned by the Supreme Court.

Moreover, FHFA's director is a principal officer who has broad jurisdiction, directing an agency that regulates the multi-trillion dollar housing finance system. *See* 12 U.S.C. § 4526. The director is thus not an inferior officer with only "limited jurisdiction" for defined investigations or who "lacks policymaking or significant administrative authority." *Morrison*, 487 U.S. at 691. On the contrary, the FHFA director "can *write and enforce* laws—as opposed to just enforcing existing laws," as the independent counsel in *Morrison* did. *Collins*, 896 F.3d at 672. Further unlike the independent counsel in *Morrison*, "[n]o principal executive branch official can exert" influence "over the FHFA" that is "comparable" to the Attorney General's influence over the independent counsel. *Id*.

FHFA's structure is thus unlike any independent agency the Supreme Court has previously held exempt from the general rule that the President must be able to excuse executive officers at will. It is also a relatively recent and novel creation. To Plaintiffs' knowledge, there are only three other independent agencies headed by a single person: the Social Security Administration, the Office of Special Counsel, and the Consumer Financial Protection Bureau ("CFPB"). *PHH Corp.*, 881 F.3d at 174 (Kavanaugh, dissenting) (listing these three agencies as the three provided by CFPB in a pre-argument request from the court "for all historical or current examples it could find of independent agencies headed by a single person"). *See also* Treasury Br. 18 ("single-headed independent agencies like FHFA are a relatively novel innovation").[4] But these are of fairly recent

[4] In related cases, it has been suggested that the Comptroller of Currency is an independent agency with a single individual as its director. This is not correct. 12 U.S.C. § 2 ("The Comptroller of the Currency shall be appointed by the President, by and with the advice and consent of the Senate, and shall hold his officer for a term of five years unless sooner removed by the President, upon reasons to be communicated by him to the Senate."). *See also Free Enterprise Fund*, 561 U.S. at 500 n.6 (explaining that the Comptroller's predecessor was removable at will be the President).

vintage and all have been challenged or questioned on the basis of being unconstitutionally structured. *PHH Corp*., 881 F.3d at 174-76 (collecting sources).

The traditional structure of an independent agency is to be composed of multiple commissioners or board members. *See Humphrey's Ex'r*, 295 U.S. at 624. *See also PHH Corp.*, 881 F.3d at 178-79 (collecting sources explaining tradition of multi-member independent agencies). The Supreme Court has made clear that "[i]n separation-of-powers cases this Court has often put significant weight upon historical practice." *Zivotofsky v. Kerry*, 135 S. Ct. 2076, 2091 (2015). The historical preference for multi-member commissions or boards thus indicates that independent agencies must be composed in that way rather than with a single director. *Free Enterprise Fund*, 561 U.S. at 505 ("Perhaps the most telling indication of the severe constitutional problem with the PCAOB is the lack of historical precedent for this entity.").

FHFA's anomalous structure as an independent agency headed by a single director, combined with the inability of the FHFA's director to fit within any exception to the general rule of at-will removal, compel only one conclusion that the FHFA is unconstitutionally structured. Treasury Br. 17-19 (agreeing that FHFA is unconstitutionally structured).

B. FHFA Is Unconstitutionally Insulated from the President's Control

Should the Court conclude that FHFA's structure as a single-head independent agency is insufficient by itself to conclude that FHFA is unconstitutionally insulated from the President's control (which it should not), the Court should also consider this feature in connection with the other aspects of FHFA's structure that insulate it from the President's control. These insulating provisions, "working together, produce a constitutional violation" if they make it such that "the Executive Branch cannot control the FHFA or hold it accountable." *Collins*, 896 F.3d at 666 (quoting *Free Enterprise Fund*, 561 U.S. at 509). The following provisions, taken together, make FHFA unconstitutionally insulated from the President's control:

For Cause Removal. The FHFA director is removable only for cause. 12 U.S.C. § 4512(b)(2). "Limiting the President to only 'for cause' removal dulls an important tool for supervising the FHFA because the agency is protected from Executive influence and oversight." *Collins*, 896 F.3d at 666-67.

Single-Head Leadership Structure. FHFA is not a multi-member commission or board. 12 U.S.C. § 4512(a). This deprives the President of the power to influence the agency through the designation of a chair or other leader. *Collins*, 896 F.3d at 667. Moreover, as discussed above, this feature may result in a President being stuck with a director appointed by the President's predecessor and who "vehemently opposes the current President's agenda," and thus impairs fulfillment of that agenda. *Id*. at 668.

Lack of Bipartisan Leadership Composition Requirement. FHFA also lacks any partisan membership requirement. These requirements provide vital presidential influence with independent agencies by providing political allies that can help further the President's priorities, more opportunities to make appointments to the agency, and warnings from agency leaders that share the President's priorities through the issuance of dissents. *See Collins*, 896 F.3d at 668 & nn.208-13 (collecting academic research discussing the import of political representation on independent agencies).

Irregular Funding Mechanism. FHFA is financed separately from the regular appropriations process. *See* 12 U.S.C. § 4617(a)(7). This is unlike "nearly all other administrative agencies." *PHH Corp.*, 881 F.3d at 146 (Henderson, dissenting). And it reduces the leverage to exert his influence the President can exercise through the budgeting process. *Collins*, 896 F.3d at 669; *Free Enterprise Fund*, 561 U.S. at 524 (Breyer, dissenting) (explaining "who controls the

agency's budget requests and funding" directly impacts "the President's power to get something done"); *PHH Corp.*, 881 F.3d at 147 (Henderson, dissenting).

No Direct Executive Supervision. The Executive Branch has no formal direct control over FHFA's activities. HERA creates a Federal Housing Finance Oversight Board, 12 U.S.C. § 4513a(1), but it serves a purely advisory function and contains only two cabinet officials directly accountable to the President, 12 U.S.C. § 4513a(d)(2). This is unlike the CFPB, whose regulations can be set aside by an oversight board. 12 U.S.C. § 5321; *Collins*, 896 F.3d at 669-70. And it means, particularly when combined with for-cause removal and the consequences of being a single-head agency, the President has no direct way to control the FHFA director's actions.

"[W]orking together," these provisions "produce a constitutional violation" by collectively insulating the FHFA director from the President's control. *Collins*, 896 F.3d at 666. FHFA argues that independently unproblematic features cannot be assessed together "unless they 'affect the same constitutional concern and amplify each other in a constitutionally relevant way.'" Memorandum of Law in Support of FHFA Defendants' Motion to Dismiss ("FHFA Br."), filed in this action on November 16, 2018, at 20-21 (quoting *PHH Corp.*, 881 F.3d at 96). The above factors comply with this rule because each is a mechanism by which FHFA is insulated from the control of the Executive Branch. Combined, they unconstitutionally remove FHFA from the control and accountability of the President. *Collins*, 896 F.3d at 666-67.

C. The FHFA's Unconstitutional Structure Requires Invalidating the Third Amendment

1. FHFA Cannot Escape Separation of Powers Restraints by Labeling Its Actions Nongovernmental or Pretending It Is Not an Independent Agency

Treasury argues that FHFA's unconstitutional structure is irrelevant to this case because FHFA was not exercising governmental power when it agreed to the Third Amendment. Treasury

Br. 14-15. The separation of powers in the Constitution, however, is a "prophylactic device" that is "a structural safeguard rather than a remedy to be applied only when specific harm, or risk of specific harm, can be identified." *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 239 (1995). Thus, "[w]hether the FHFA's specific conduct or actions were governmental in nature is not relevant—the structure of the agency is." *Collins*, 896 F.3d at 657. *See also Freytag v. Commissioner*, 501 U.S. 868, 882 (1991) (declining to treat special trial judges as inferior officers for purposes of some of their duties but mere employees with respect to others); *Collins*, 896 F.3d at 657 (distinguishing Treasury's primary case, *United States v. Beszborn*, 21 F.3d 62, 68 (5th Cir. 1994), on the basis that separation of powers "rests on an entirely different foundation" than the constitutional issue in *Beszborn*).

Moreover, Treasury's argument is undermined by the Third Circuit's decision in *Jacobs v. FHFA*, 908 F.3d 884 (3d Cir. 2018), where the Court held that FHFA had authority to enter into the Net Worth Sweep under HERA precisely *because* it had powers beyond those of the Companies. *Id*. at 892-94.[5] The plaintiffs in that case argued that the Net Worth Sweep was unlawful because FHFA acted "in Treasury's interest, and not Fannie's and Freddie's interest, and acting in a manner in which Fannie and Freddie themselves had no power to act, when implementing the Third Amendment." *Id*. at 893. The Court did not hold that the Companies could "themselves" have implemented the Third Amendment. Instead, it affirmed FHFA's implementation as proper because HERA "gave the Agency not only power inherited from those enterprises, but also a host of other powers. And the Agency acted within *those* statutory powers."

[5] *Jacobs* addressed whether FHFA had statutory authority to enter into the Net Worth Sweep and did not rule on any of the constitutional issues raised in this case.

Id. at 894 (emphasis added). In short, the Net Worth Sweep was not an exercise of the Companies' powers but rather separate powers given to FHFA through HERA.

Those powers are governmental powers. Where a federal agency exercises authority derived from a federal statute to expropriate property in furtherance of federal interests, its actions are attributable to the federal government and must therefore be subject to constitutional limitations. *Slattery v. United States*, 583 F.3d 800, 826-29 (Fed. Cir. 2009); *Preseault v. United States*, 100 F.3d 1525, 1550 (Fed. Cir. 1996); *Hendler v. United States*, 952 F.2d 1364, 1379 (Fed. Cir. 1991). Here, FHFA exercised governmental power when it exercised its authority under HERA to alter the legal rights and obligations of third parties—the Companies and their shareholders—and promote what it deemed to be in the public interest. Again, the Third Circuit has ruled as much, upholding FHFA's entering into the Net Worth Sweep because—unlike at "common law," where "a conservator could not 'act for the benefit of himself or a third party'"—HERA requires FHFA to "consider the public interest" and authorizes it to "act in its own best *governmental* interests, which may include the taxpaying public's interest." *Id*. at 893 (emphasis added) (quoting *Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 608 (D.C. Cir. 2017)). It is this prioritization of governmental interests over the interests the Companies and the Companies' shareholders—which is an authority FHFA could not have acquired from the Companies because they lack this authority—that makes the Net Worth Sweep more than a mere "renegotiation of an existing lending agreement" the Government wants this Court to believe it is. Treasury Br. 14-15 (quoting *Jacobs*, 908 F.3d at 890); FHFA Br. 34 (same).

This conclusion is reinforced by the fact that the Net Worth Sweep was made possible and has been implemented by FHFA's exercise of its regulatory powers. The Net Worth Sweep 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).

Treasury also argues that the unconstitutionality of FHFA is irrelevant with respect to the Net Worth Sweep because, at the time, FHFA was headed by an acting Director. Treasury Br. 15-16. It argues this is meaningful because the for-cause removal provision is in the subsection of 12 U.S.C. § 4512 defining the term of the director but is not mentioned in the subsection allowing the President to select a deputy director to serve as acting director. *Id*.

Nothing supports Treasury's tortured notion that FHFA is a hybrid agency, an executive agency when led by an acting director but an independent agency when led by a validly appointed director. *Collins*, 896 F.3d at 656 ("But if the acting Director could be removed at will, the FHFA would be an executive agency—not an independent agency. There is no indication that Congress sought to revoke the FHFA's status as an independent agency when it is led by an acting, rather than appointed, Director."). To the contrary, Congress explicitly provided that FHFA is an independent agency. 12 U.S.C. § 4511(a) ("There is established the Federal Housing Finance Agency, which shall be an independent agency of the Federal Government."). Section 4512(f) does not comprehensively enumerate the rights and powers of the acting Director because such 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). Regardless, the Net Worth Sweep has been sustained, implemented, and defended by FHFA under the leadership of Director Watt—a Senate-confirmed FHFA Director who indisputably enjoys for-cause removal protection under 12 U.S.C. § 4512.

2. Remedying FHFA's Unconstitutional Structure Requires Invalidating the Third Amendment

Treasury finally argues, briefly, that the appropriate remedy for the separation of powers violation does not include setting aside the Third Amendment and should be limited to severing the for-cause removal provisions. Treasury Br. 19. This is contrary to common practice in separation of powers cases. Vacating past decisions by officials who acted while serving in an office unconstitutionally is routine in Appointments Clause cases. *See, e.g., Lucia v. SEC*, 138 S. Ct. 2044, 2055 (2018); *NLRB v. Noel Canning*, 134 S. Ct. 2550 (2014); *Dresser-Rand Co. v. NLRB*, 576 F. App'x 332, 333 (5th Cir. 2014); *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 684 F.3d 1332, 1334 (D.C. Cir. 2012); *FEC v. NRA Political Victory Fund*, 6 F.3d 821, 828 (D.C. Cir. 1993). The Supreme Court has also frequently awarded backward-looking relief in other separation of powers cases. *See, e.g., Clinton v. New York*, 524 U.S. 417, 425 & n.9 (1998) (past cancellation of particular funds under line item veto was invalid); *INS v. Chadha*, 462 U.S. 919, 936 (1983) (plaintiff had standing because "[i]f the [legislative] veto provision violates the Constitution, and is severable, the deportation order against Chadha will be cancelled"); *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 589 (1952) (President required to return steel mills he had already seized).

In the context of separation of powers involving the President's power to remove officers, *Bowsher v. Synar*, 478 U.S. 714 (1986), is controlling. *Bowsher* concerned provisions of the Gramm-Rudman-Hollings Act under which the Comptroller General released an annual budget report, which the President was in turn required to implement automatically by ordering the sequestration of specified funds in the federal budget. *Synar v. United States*, 626 F. Supp. 1374, 1377 (D.D.C. 1986), *aff'd sub nom Bowsher,* 478 U.S. 714. After the Comptroller General released his first report, which caused President Reagan to issue a sequestration order, a union

whose members would suffer harm as a result of that order brought suit. *Id*. at 1378. The union argued that the Comptroller General violated the separation of powers of the Constitution because he exercised executive powers but was not removable by the President. *Id*. at 1391. The three-judge panel ruled in the union's favor and provided not only prospective relief but an order "that the presidential sequestration order issued on February 1, 1986 pursuant to the unconstitutional automatic deficit reduction process be, and hereby is, declared without legal force and effect." *Id*. at 1404. The Supreme Court, in affirming, approved both "the judgment and order of the District Court," *Bowsher,* 478 U.S. at 736, thus approving the backward-looking relief provided to remedy the separation of powers violation.

This practice is consistent with the Administrative Procedure Act, which states "The review court *shall . . . hold unlawful and set aside* agency action . . . found to be . . . contrary to constitutional right, power, privilege, or immunity." 5 U.S.C. § 706 (emphasis added). Thus, "[i]n *all* cases agency action *must* be set aside . . . if the action failed to meet . . . constitutional requirements." *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 413-14 (1971) (emphases added).

Treasury cites three cases to support its argument: *Collins*, 896 F.3d at 675-76; *Free Enterprise Fund*, 561, 508-09; and *PHH Corp. v. CFPB*, 839 F.3d 1, 37-38 (D.C. Cir. 2016), *rev'd*, 881 F.3d 75 (2018). The primary focus of each of these decisions is not whether backward-looking relief is appropriate but whether the Court should sever the unconstitutional provision or strike an entire enactment. Only *Collins* briefly addresses relief with respect to a final action. *Collins*, 896 F.3d at 675 & n.280. It depends, however, on a case for which there was no prior final action to invalidate. *See id*. (citing *John Doe Co. v. CFPB*, 849 F.3d 1129, 1133 (D.C. Cir. 2017) (involving an ongoing investigation)). It thus does not address the situation found in the cases

cited above where a final agency action is challenged as being in violation of a separation of powers doctrine and, upon the plaintiffs' victory on the constitutional claim, the court invalidates the final agency action.

II. FHFA Approved the Net Worth Sweep When Its Director Was Acting in Violation of the Appointments Clause

A. Mr. DeMarco Served as the Acting Director of FHFA in Violation of the Appointments Clause

The Appointments Clause provides that the President "shall nominate, and by and with the Advice and Consent of the Senate, shall appoint" all officers of the United States. U.S. Const. art. II, § 2, cl. 2. The Constitution permits only two exceptions to this rule: First, Congress may "vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." *Id.* (emphasis added). Second, the President "shall have Power to fill up all vacancies that may happen during the recess of the Senate, by granting commissions which shall expire at the end of their next session." U.S. Const. art. II, § 2, cl. 3.

When the Net Worth Sweep was implemented, Mr. DeMarco was serving as FHFA's director in an acting capacity. Mr. DeMarco was selected by President Obama to serve in this acting capacity in August 2009, pursuant to 12 U.S.C. § 4512(f). The President did not nominate a replacement for Mr. DeMarco until fifteen months later. That nominee was rejected by the Senate on December 22, 2010, after which the President did not nominate another candidate for twenty-nine months. Thus, when the Net Worth Sweep was implemented, FHFA lacked an appointed director and was led by an acting director who had served as such for three years.[6]

[6] Treasury argues that Count III fails because Congress could have chosen a non-principal officer to act a conservator. Treasury Br. 20-21. This is not correct because, as explained in Parts I.C & III, the Net Worth Sweep required governmental powers to implement. Regardless, Congress specifically selected an agency led by a principal officer to act as conservator. 12 U.S.C. § 4617. Accordingly, if the person purporting to act for that agency is unlawfully appointed, then the officer Congress chose is unavailable to carry out the powers given to him by law.

1. Mr. DeMarco Was No Longer a "Temporary" Official When the Third Amendment Was Implemented

The Supreme Court has held that inferior officers may perform the duties of a principal officer—those that must be nominated and confirmed by the Senate—for a "limited time." *Eaton*, 169 U.S. at 343 ("Because the subordinate officer is charged with the performance of the duty of the superior *for a limited time* and under special and *temporary* conditions, he is not thereby transformed into the superior and permanent official.") (emphasis added). *See also Morrison*, 487 U.S. at 672 (explaining and reaffirming the holding of *Easton*). FHFA concedes that the FHFA's Director is a principal officer. It also does not dispute that the Supreme Court has stated that acting officials can serve only for a "limited time." FHFA Br. 23 (quoting *Eaton*, 169 U.S. at 343).

The question before this Court thus is what constitutes a "limited time" in the context of an inferior officer carrying out the duties of a principal officer. Neither FHFA nor Treasury offers an answer to this question. They argue only that the Recess Appointments Clause is irrelevant for assessing when a temporary officer becomes a permanent one. FHFA Br. 29-32; Treasury Br. 21-22.

In the context of the Constitution, a temporary position becomes permanent after two years. This follows from the constitutional limitation on how long a principal officer is permitted to serve without confirmation by the Senate. U.S. Const. art. II, § 2 (allowing the President to make appointments during the recess of the Senate until the Senate's session ends, which is typically two years). *See also Noel Canning*, 134 S. Ct. at 2574-79 (allowing intra-session appointments and thus appointments made early in the typical two-year session of the Senate last two year). This limitation represents the Constitution's balancing of "the President's continuous need for the assistance of subordinates" and "the Senate's practice . . . of meeting for a single brief session each year" so that it can provide the "excellent check upon a spirit of favoritism in the President"

provided by the Constitution. *Id*. at 2559 (quotations and citations omitted). Thus, because the Constitution permits a maximum of two years for the clause "intended to authorise the President *singly* to make *temporary appointments*," *id*. (quoting Federalist No. 67 (Hamilton) (second emphasis added)), two years is the most any person can temporarily serve as a principal officer.

The Government argues that this constitutional limit should be ignored because "recess appointees are not analogous to acting officers." FHFA Br. 30 (quoting *Bhatti*, 332 F. Supp. at 1221). This is wrong. They are analogous in the way most important to the question here: both are ways a person may serve as a principal officer of the United States without Senate confirmation for a "limited time" or "temporary" time. *Compare Eaton*, 169 U.S. at 343, *with Noel Canning*, 134 S. Ct. at 2559.

The Government's remaining arguments forget the central inquiry of how long an acting official's tenure can be before his service is no longer "for a limited time and under special and temporary conditions," and thus the "acting" official becomes "transformed into the superior and permanent official." *Eaton*, 169 U.S. at 343. The candidates among which the President could choose to select the acting official has no relevance to this question. What is relevant is that the "limited time" for which Mr. DeMarco served is longer than the length of time the President could have directly appointed an FHFA director without Senate confirmation. Additionally, with respect to Mr. DeMarco, it is impossible to conceive of his service as acting Director as "temporary" given that he served only eight months shy of the full five-year term provided for Directors in 12 U.S.C. § 4512(b)(2). *See NLRB v. SW Gen., Inc.*, 137 S. Ct. 929, 946 n.1 (2017) (Thomas, concurring) (explaining "[t]here was thus nothing 'special and temporary'" about an acting principal officer's

tenure because he served three years in an office limited to a four-year term and exercised all the powers of the office) (quoting *Eaton*, 169 U.S. at 343).[7]

If the Recess Appointments clause is irrelevant, the only alternative proposed for assessing whether a temporary acting official has transformed into a permanent official is from a 2003 Office of Legal Counsel memorandum. Designation of Acting Director of OMB, 2003 WL 24151770, at *1 n.2 (O.L.C. June 12, 2003). *See also* Status of the Acting Director, Office of Management and Budget, 1 Op. O.L.C. 287 (1977). It suggests that the Court assess whether the tenure challenged is "reasonable under the circumstances" and identified the following factors for the Court to consider:

> [1] the specific functions being performed by the [acting officer]; [2] the manner in which the vacancy was created (death, long-planned resignation, etc.); [3] the time when the vacancy was created (*e.g.,* whether near the beginning or the end of a session of the Senate); [4] whether the President has sent a nomination to the Senate; and [5] particular factors affecting the President's choice (*e.g.,* a desire to appraise the work of an Acting Director) or the President's ability to devote attention to the matter.

1 Op. O.L.C. at 290.[8] Each of these factors indicates that Mr. DeMarco's tenure as acting Director was unconstitutionally long:

---

[7] FHFA's reliance on a 2002 Office of Legal Counsel letter is irrelevant because it also does not deal with the question at issue here. The memo focuses on whether a person who served as a recess appointee for a principal office can be then designated to the same role in an acting capacity. Designation of Acting Solicitor of Labor, 2002 WL 34461082, at *3 (O.L.C. Nov. 15, 2002). The question of what duration of time an acting principal officer may carry out the duties of a principal officer was not presented.

[8] FHFA states in a footnote that Plaintiffs have not made a claim based on this legal opinion. While Plaintiffs view the two-year cap as the correct legal standard, they do not waive the argument that Mr. DeMarco's was unreasonably long and believe that argument is included in Count III. *Kamen v. Kemper Fin. Servs.*, 500 U.S. 90, 99 (1991) ("[W]hen an issue or claim is properly before the court, the court is not limited to the particular legal theories advanced by the parties, but rather retains the independent power to identify and apply the proper construction of governing law"). Should the Court disagree, Plaintiffs respectfully request that they be afforded the opportunity to amend their complaint.

- Mr. DeMarco exercised the full powers of the FHFA Director, 12 U.S.C. § 4512(f), as the head of an independent agency for over four years, just eight months short of the statutory limit on FHFA directors' tenure, *id.* § 4512(b)92); *SW Gen., Inc.*, 137 S. Ct. at 946 n.1 (Thomas, concurring);

- The vacancy was created by Mr. DeMarco's predecessor voluntarily resigning rather a sudden departure;

- The vacancy arose in August 2009, during the first quarter of the Senate's 2009 to 2010 session;

- The President did not send a nomination to the Senate until November 2010, which the Senate refused to act on, and his subsequent nomination was not made for twenty-nine months, well after the Net Worth Sweep;

- Plaintiffs are unware of any particular reason the President was unable to nominate a FHFA director in the years between Mr. DeMarco's appointment and approval of the Net Worth Sweep.

Thus, even under OLC's more malleable standard, by the time the Net Worth Sweep was implemented, Mr. DeMarco was no longer a "temporary" officer but had transformed into a permanent officer.

The FHFA further relies on four relatively recent examples of acting officials remaining in office for more than two years. These cannot overturn the Supreme Court's admonition that acting officials can serve for only a "limited time." *Eaton*, 169 U.S. at 343 Nor are they old enough or frequent enough to warrant deference by the courts. *See Chadha*, 462 U.S. at 944 ("[O]ur inquiry is sharpened rather than blunted by the fact that [the challenged practice was] appearing with increasing frequency . . . ."); *see, e.g., Noel Canning*, 134 S. Ct. at 2567 (considering and rejecting anomalous historical examples of recess appointments made during recesses of fewer than ten days).[9]

---

[9] Treasury claims—in a footnote—that resolving when an officer is longer acting temporarily is a non-justiciable political question. Treasury Br. 22 n.5. "[A]rguments raised in passing (such as, in a footnote), but not squarely argued, are considered waived." *John Wyeth & Bro. Ltd. v. CIGNA Int'l Corp.*, 119 F.3d 1070, 1076 n. 6 (3d Cir.1997). Regardless, the questions of how long is too long is essentially the same type of question the Court resolved with respect to how long an intra-

2. The President Cannot Appoint Acting Principal Officers

Mr. DeMarco's tenure also violates the Constitution because the President *appointed* him to have and exercise the duties of the FHFA Director. But there are only two mechanisms in the Constitution for appointing principal officers: the Appointments Clause and the Recess Appointments Clause. Neither was used to appoint Mr. DeMarco, which makes his tenure as the acting Director unconstitutional. *SW General, Inc.*, 137 S. Ct. at 945-49 (Thomas, concurring).

B. Plaintiffs' Claims Are Timely

The Government argues that Plaintiffs' claims under the Appointments Clause are barred by either the *de facto* officer doctrine or laches. FHFA Br. 26-28; Treasury Br. 23-24. Both arguments are undermined by the fact that these claims were brought prior to expiration of the six-year statute of limitations. 28 U.S.C. § 2401. No more should be required for Plaintiffs' constitutional claim to be deemed timely.

Nevertheless, the *de facto officer* doctrine applies only where the defect in the officer's authority is "merely technical." *Nguyen v. United States*, 539 U.S. 69, 77 (2003). The doctrine's purpose is to avoid multiple challenges to an officer's authority, as FHFA states, *and* "to protect the public by insuring the orderly functioning of the government despite *technical defects* in title to office." *Ryder v. United States*, 515 U.S. 177, 180 (1995) (emphasis added). In *Glidden Co. v. Zdanok*, 370 U.S. 530 (1962), the Court explained that the doctrine does not apply "when the statute claimed to restrict authority is not merely technical but embodies a strong policy concerning the proper administration of judicial business," and held that "[a] fortiori is this so when the challenge is based upon nonfrivolous constitutional grounds." *Id*. at 535-36. Moreover, such

---

session recess must be to allow the President to make recess appointments. *Noel Canning*, 134 S. Ct. at 2567. Courts are thus able to identify justiciable standards to apply for these types of question.

constitutional claims are not barred by the doctrine "even though the defect was not raised in a timely manner." *Nguyen*, 539 U.S. at 78.

Even under FHFA's proferred test, Plaintiffs' claims are timely. The D.C. Circuit assesses timeliness by determining that the claims (a) satisfy administrative jurisdictional requirements, (b) are brought within the statute of limitations, and (c) were not forfeited. *SW Gen., Inc. v. NLRB*, 796 F. 3d 67, 82 (D.C. Cir. 2015). All three are true here: these claims (a) do not arise out of an administrative proceeding and thus there is no need to satisfy administrative jurisdictional requirements, (b) were brought within the statute of limitations, and (c) are asserted in the complaint. Moreover, with respect to notice, the D.C. Circuit explains that "the notice requirement is satisfied if the agency learns of the defect from any source, not only the petitioner." *Id*. This is satisfied by a suit filed in 2011 alleging that Mr. DeMarco's lengthy tenure violated the Appointments Clause. *See Ohio Pub. Emps. Retirement Sys. v. FHFA*, No. 11-1543 (D.D.C. Aug. 26, 2011).[10]

III. FHFA Violated the Nondelegation Doctrine When It Imposed the Net Worth Sweep

Neither legislative nor executive power can be delegated to a private entity. *Carter*, 298 U.S. at 311. Moreover, Congress cannot delegate its legislative power to the executive branch. *Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 472 (2001).

Neither FHFA nor Treasury disputes these propositions. Thus, to the extent the Court concludes FHFA was acting as a private entity when it implemented the Net Worth Sweep, it violated the prohibition on delegating legislative or executive power to a private entity. Defendants try to argue that this doctrine is inapplicable because no governmental power was

---

[10] This notice also mitigates any prejudice the Government may have purportedly suffered as a result of relying on Mr. DeMarco's appointment. Otherwise, with respect to the argument that there is no way to remedy the wrong, this is addressed in Part I.C.

exercised. FHFA Br. 34-35; Treasury Br. 24-25. This argument, as explained above in Part I.C, cannot be made consistent with the Third Circuit's ruling that when it entered into the Third Amendment, FHFA relied on powers it received from HERA to further the public interest. *See Jacobs*, 908 F.3d at 892-94; 12 U.S.C. §§ 4511(b), 4513(a)(1)(B); 12 C.F.R. § 1237.12(a), (b). Thus, to the extent this Court rules that FHFA was acting as a private entity rather than the government when it implemented the Net Worth Sweep, those actions were an unconstitutional delegation of governmental powers to a private entity and must be invalidated.

Alternatively, FHFA and Treasury argue that if FHFA was exercising governmental power, it complies with the nondelegation doctrine because HERA provides an intelligible principle to guide the agency. FHFA Br. 35-36; Treasury Br. 25-26. The provisions cited, however (at least as interpreted by the DC Circuit), do not *require* certain factors be taken into account. They instead state what FHFA "may" do or "may" consider, giving the agency "permissive, discretionary authority," *Perry Capital*, 864 F.3d at 607; 12 U.S.C. § 4617(b), that lacks "any outer limit to FHFA's statutory powers," *id*. at 642 (Brown, dissenting), and further lacks a standard to which FHFA "is directed to conform" the exercise of the powers given to it, *Mistretta v. United States*, 488 U.S. 361, 372 (1989). Without such a standard, there is no intelligible principle and the delegation is unconstitutional. *Id*.

IV. Plaintiffs Have Article III Standing to Challenge the Actions that Caused Plaintiffs' Injuries

FHFA—but not Treasury—argues that plaintiffs who have had their rights and property taken by an unconstitutionally structured federal agency lack constitutional standing to challenge the constitutionality of that agency and its actions. FHFA further argues that Plaintiffs lack injury in fact because their injury fails the "traceability" and "redressability" tests. These arguments fail for several reasons.

A. Plaintiffs' Injury Is Sufficiently Connected to the Constitutional Violation

FHFA argues that Plaintiffs lack constitutional standing because they cannot establish a causal connection between their injury and the constitutional violation. FHFA makes three arguments in support of its position, none of which has merit.

First, FHFA argues that "traceability requires Plaintiffs to demonstrate that *more* Presidential influence over the FHFA might have spurred FHFA to reject the Third Amendment." FHFA Br. 10 (emphasis in original). To begin with, a constitutional structure clearly placing FHFA under the control of and answerable to the President certainly "might have" prevented the naked grab of Plaintiffs' shareholder rights by Treasury and the FHFA by tying the action more closely with the administration and taking away the fig leaf of independence. The administration might not have been willing to take the political risks involved with this move. Similarly, had the White House had the degree of guaranteed control over the FHFA it should have, notwithstanding Treasury's ultimate role in imposing the Net Worth Sweep, it may have imposed other policies earlier that would have avoided the Net Worth Sweep. For instance, FHFA's acting director Mr. DeMarco "refused to approve the Obama Administration's proposal to reduce the principal on certain mortgages"—an approach which may have obviated any perceived need for the Net Worth Sweep. Compl. ¶ 68.

But beyond the near truism that a different organizational structure and level of executive control "might have" produced a different result, Plaintiffs do not have to prove what the agency action would have been had it not been unconstitutionally structured. As the Fifth Circuit recently explained in dismissing this precise argument based on Supreme Court precedent, standing for separation-of-powers claims is subject to a more relaxed inquiry:

> Party litigants with sufficient concrete interests at stake may have standing to raise constitutional questions of separation of powers with respect to an agency designated to adjudicate their rights.' Under this standard, 'a party is not

> required to show that he has received less favorable treatment than he would have if the agency were lawfully constituted.' In essence, the prophylactic, structural nature of the separation of powers justifies permitting claims beyond those where a 'specific harm . . . can be identified.'

Collins, 896 F.3d at 654 (citations omitted). Plaintiffs do not have to prove that they would have fared better under the FHFA/Treasury determinations of how to treat shareholder rights if the FHFA had been constitutionally structured—a standard that would be difficult to ever meet in the face of a separation of powers violation, thereby insulating such violations from judicial review.

Rather, as the Fifth Circuit found, it is enough that "[t]he Shareholders assert that the unconstitutionally structured FHFA caused them direct economic injury." *Id.* There is no question Plaintiffs have alleged that here. "The Shareholders are directly and uniquely affected by the net worth sweep." *Id.* Contrary to the FHFA's premise, Plaintiffs do not have to prove that one of the legislative elements or conditions (*e.g.*, the inability to remove the director without cause) was itself directly the cause of Plaintiffs' harm—i.e., that Plaintiffs harm would not have occurred if the agency had been constitutionally structured. It is enough that a plaintiff is harmed by the acts of an unconstitutionally structured agency:

> Because the FHFA was unconstitutionally insulated from executive control, the Shareholders argue that its actions are presumptively unconstitutional and thus void. In *Landry v. FDIC*, the D.C. Circuit noted that separation-of-powers matters justify a relaxed causation inquiry because 'it will often be difficult or impossible for someone subject to a wrongly designed scheme to show that the design—the structure—played a causal role in his loss.' We endorse that inquiry here.

Id. at 655 (quoting *Landry v. FDIC*, 204 F.3d 1125, 1130-31 (D.C. Cir. 2000)); *see also* *Buckley v. Valeo*, 424 U.S. 1, 117, (1976).

As the Fifth Circuit went on to point out, this principle has been established by the Supreme Court as well:

> In *Free Enterprise Fund*, for example, the Court considered the causation prong of standing in the context of a separation-of-powers claim. Like the Agencies

> in the instant case, the Public Company Accounting Oversight Board ("PCAOB") argued that petitioners lacked standing because their injuries were not fairly traceable to an invalid appointment. The Court rejected this argument, finding that 'standing does not require precise proof of what the CAOB's policies might have been' had the agency's structure met constitutional requirements.

Collins, 896 F.3d at 657 (quoting *Free Enterprise Fund*, 561 U.S. at 477) (internal citations omitted). *See also Glidden Co.*, 370 U.S. 530 ("Article III, § 1, however, is explicit and gives the petitioners a basis for complaint without requiring them to point to particular instances of mistreatment in the record"); *Clinton*, 524 U.S. at 431-33 (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). "Thus, to establish standing, the Shareholders are not required to show what the FHFA may have done had it been constitutionally structured." *Collins*, 896 F.3d at 657.

Indeed, Treasury (represented by the U.S. Department of Justice) has agreed with this position in related cases. In its Opposition to Petition for Rehearing En Banc in the *Collins* action, Treasury conceded that the shareholder plaintiffs in that action had Article III standing, stating:

> That the Court correctly denied on the merits the particular remedy plaintiffs sought does not mean plaintiffs lacked standing to assert a constitutional claim, because the remedy the Court provided did redress the injury it identified stemming from FHFA's role as regulator. And any question whether the shareholders rather than the enterprises themselves may challenge the acts of FHFA as regulator does not present an Article III issue.

Opposition to Petition for Rehearing En Banc at 16 n.3, *Collins v. Mnuchin,* No. 17-20364 (5th Cir. Sept. 13, 2018). *See also* Brief for the Treasury Department at 26 n.3, *Bhatti v. FHFA*, No. 18-2506 (8th Cir. Nov. 14, 2018) ("plaintiffs correctly argue . . . they 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.")

Second, FHFA argues that "the Third Amendment is also not traceable to HERA's for-cause removal standard because FHFA was led at the time of Third Amendment by an *Acting* Director not covered by that standard." This argument fails for the reasons described immediately above—standing does not require proof of direct causation at such a granular level. Moreover, the acting Director *is* covered by that standard, *see Collins*, 896 F.3d at 656 and Part I.C, and even if not covered by the for-cause removability standard, he was impermissibly in office at the time of the Third Amendment, *see* Parts I-III. But in any event, the fact that the Third Amendment was entered into by the acting Director cannot possibly salvage the constitutionality of the FHFA's structure. Irrespective of the constitutional status of the acting Director, Plaintiffs were directly harmed by actions taken by an unconstitutionally structured agency, which is all that is required for Plaintiffs to have Article III standing.

Third, FHFA argues that Plaintiffs Wazee and Brown lack Article III standing because they did not purchase their stock until after the Third Amendment. This argument fails for two reasons. As an initial matter, shareholder rights run with the stock. Delaware law goes so far as to codify this important rule, specifying that upon delivery of a security to a purchaser, the purchaser "acquires all rights in the security that the transferor had or had power to transfer." DEL. CODE ANN. tit. 6, § 8-302(a). This ensures that "the several holders are entitled to equal rights irrespective of the time when they acquired their shares." *In re Activision Blizzard, Inc. Stockholder Litig.*, 124 A.3d 1025, 1047 (Del. Ch. 2015). Once a shareholder's claim accrues, it travels with the security into the hands of a subsequent purchaser. *See, e.g.*, *id.* at 1050 ("When a share of stock is sold, the property rights associated with the shares, including any claim for breach of those rights and the ability to benefit from any recovery or other remedy, travel with the shares."). It is for shareholders such as Plaintiffs Wazee and Brown to enforce those rights. The

general "voluntary harm" cases on which FHFA relies are completely inapposite, as they do not even involve the relevant issues of a subsequent stock purchaser's shareholder rights. *Grocery Mfrs. Ass'n v. EPA*, 693 F.3d 169, 177 (D.C. Cir. 2012) (petroleum members voluntarily opting to produce a new fuel); *Pennsylvania v. New Jersey*, 426 U.S. 660, 664 (1976) (state legislatures enacting tax credits that reduced their tax intake); *In re McNeil Consumer Healthcare*, 877 F. Supp. 2d 254, 276 (E.D. Pa. 2012) (incidental costs voluntarily incurred by consumers in connection with a product recall, such as "time spent investigating the recall").

In any event, the Court need not reach this issue at this point because, even beyond the Third Amendment, there is no question that Plaintiffs Wazee and Brown as shareholders continue to be subject to the regulatory authority and rulings of an unconstitutionally structured FHFA, and therefore are experiencing a continuing harm that is sufficient to give them standing. *See Collins*, 896 F.3d at 657.

B. Plaintiffs Have Redressable Injuries

FHFA argues that Plaintiffs lack standing because their injuries are not redressable. This argument fails for two reasons.

First, for all of the reasons set forth Part I.C, setting aside the Third Amendment is an appropriate remedy available to Plaintiffs. This remedy unquestionably would redress Plaintiffs' injuries.

Second, even relief other than voiding the Third Amendment—such as declaratory or injunctive relief—would redress some of Plaintiffs' injury. As the Fifth Circuit noted, shareholders "allege an *ongoing* injury—being subjected to the enforcement or regulation by an unconstitutionally constituted body. This is consistent with standing in separation-of-powers cases." *Collins*, 896 F.3d at 657-58.

V. Plaintiffs' Claims Are Not Barred by HERA

Treasury incorrectly argues that HERA's succession provision, 12 U.S.C. § 4617(b)(2)(A)(i) (the "Succession Provision"), bars Plaintiffs' claims because they are derivative in nature. Treasury's argument is incorrect because Plaintiffs' claims are direct, not derivative, and therefore the Succession Provision is inapplicable. *See Perry Capital*, 864 F.3d at 624-25 ("The Recovery Act thereby transfers to the FHFA all claims a shareholder may bring derivatively on behalf of a Company whilst claims a shareholder may lodge directly against the Company are retained by the shareholder in conservatorship . . . .").

A. Plaintiffs' Claims Are Direct Under Applicable Federal Law

According to Treasury, even if, as Plaintiffs claim, FHFA and all of its conduct since the agency's inception are unconstitutional, the Succession Provision prohibits the Companies or anyone acting on their behalf from seeking judicial redress for the constitutional claims. If that is in fact what the Succession Provision means, then the Succession Provision itself is unconstitutional. To require the Companies and their stockholders to accept FHFA as their exclusive representative to pursue claims alleging that FHFA itself is unconstitutional would violate the Due Process Clause, which does not countenance such a conflict of interest.[11]

Fortunately, the Court need not confront this constitutional conundrum because all of Plaintiffs' claims must be treated as direct under federal law. As Treasury has acknowledged, 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. 9-10, and while federal courts often look to state law principles when distinguishing between direct and derivative claims,

[11] *See, e.g., Richards v. Jefferson Cty.*, 517 U.S. 793, 801 (1996) (conflicted class representative); *Wood v. Georgia*, 450 U.S. 261, 271-72 (1981) (criminal defense lawyer); *Ward v. Village of Monroeville*, 409 U.S. 57, 61-62 (1972) (judge).

they will not do so when the application of state law "would be inconsistent with the federal policy underlying the cause of action." *Kamen*, 500 U.S. at 99; *see Guenther v. Griffin Constr. Co.*, 846 F.3d 979, 983 (8th Cir. 2017). The federal policy underlying Plaintiffs' constitutional claims is clear: "The declared purpose of separating and dividing the powers of government . . . was to 'diffus[e] power the better to secure liberty.'" *Bowsher*, 478 U.S. at 721 (alteration in original) (quoting *Youngstown Sheet & Tube Co.*, 343 U.S. at 635 (Jackson, J., concurring)). To the extent that treating Plaintiffs' claims as derivative under state law would frustrate federal policy by leaving it up to FHFA to decide whether to assert constitutional claims against itself, Plaintiffs' claims must be treated as direct under 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). Here, even if FHFA agreed with Plaintiffs' separation of powers arguments, it could not satisfy the case or controversy requirement of Article III to bring suit by suing itself. *See United States v. ICC*, 337 U.S. 426, 430 (1949) (recognizing the "general principle that no person may sue himself"); *SEC v. Federal Labor Relations Auth.*, 568 F.3d 990, 997 (D.C. Cir. 2009) (Kavanaugh, J., concurring). Thus, if Plaintiffs cannot bring this suit, then no one can—a troubling result given that "[t]he structural principles secured by the separation of powers protect the individual." *Bond v. United States*, 564 U.S. 211, 222 (2011).

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 only 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*, 564 U.S. at 222 (emphasis added).

B. Plaintiffs' Claims Are Direct Under Applicable State Law

As Treasury acknowledges, where a plaintiff's standing turns on the "allocation of governing power within [a] corporation," federal law looks to state law principles. *Kamen*, 500 U.S. at 99; *Starr Int'l Co.*, 856 F.3d at 965-66. Pursuant to their respective charters, and to the extent not inconsistent with federal law, Fannie Mae is subject to Delaware law, while Freddie Mac is subject to Virginia law.

"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.*, No. Civ. A. 379, 2005 WL 1713067, at *8 n.41 (Del. Ch. July 13, 2005); *cf. Pareto v. FDIC*, 139 F.3d 696, 699-700 (9th Cir. 1998) (observing that under California law minority shareholders may sue directly to challenge "a majority stockholders' breach of a fiduciary duty to minority stockholders, which resulted in the majority stockholders retaining a disproportionate share of the corporation's ongoing value"). This follows from the well-accepted test for determining whether a shareholder claim is direct or derivative in nature was set forth by the Supreme Court of Delaware in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A. 2d 1031 (Del. 2004). *See In re G-I Holdings, Inc.*, 755 F.3d 195, 207 (3rd Cir. 2014) (citing *Tooley*, 845 A. 2d at 1036). Under *Tooley*, the test for whether the claim is derivative or direct turns "*solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" *Tooley*, 845 A.2d at 1033. For a claim to be direct in nature, the alleged injury "must be independent of any alleged injury to the corporation [and] [t]he stockholder must demonstrate that

the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation." *Id.* at 1039.

Treasury's assertion that the harm Plaintiffs are seeking to remedy was suffered by the Companies rather than their stockholders mischaracterizes Plaintiffs' claims. The Net Worth Sweep rearranged the Companies' capital structure so that dividends that would have been shared with Plaintiffs are not instead paid exclusively to another shareholder, Treasury. Contrary to Treasury's contention, *see* Treasury Br. 11, Plaintiffs do not seek to recover for the Companies the dividends paid to Treasury pursuant to the Third Amendment. Rather, Plaintiffs seek to recover for themselves and their fellow stockholders the damage to the stockholders' equity ownership rights, i.e., their rights to dividends and liquidation distributions that are rights personal to each stockholder and not derivative of the Companies' rights. Nor are Plaintiffs seeking to remedy the "decline in the value of their shares." *Id.* at 12. On the contrary, Plaintiffs' pleading focuses on the nullification of the expectations and substantive rights of the stockholders individually. *See, e.g.,* Compl. ¶¶ 20, 22, 24, 34-39, 43, 47-48, 51, 85. Thus, the harm Plaintiffs allege is that the Third Amendment expropriated the economic rights held by the private shareholders of Fannie and Freddie. Accordingly, the answer to the first question in the *Tooley* test—who suffered the harm—is not the Companies, but the shareholders.[12] *See* Compl. ¶¶ 37, 51.

[12] Contrary to Treasury's argument, *Starr International* is easily distinguishable. *Starr International* involved a classic dilution claim that Delaware law treats as derivative. *See Feldman v. Cutaia*, 956 A.2d 644, 655 (Del. Ch. 2007) ("A claim for wrongful equity dilution is premised on the notion that the corporation, by issuing additional equity for insufficient consideration, made the complaining stockholder's stake less valuable. Equity dilution claims are typically viewed as derivative under Delaware law."). While the plaintiff in *Starr International* attempted to avoid this general rule by arguing its claims were "dual-natured," the Federal Circuit held that the claims were not properly characterized as both direct and derivative because such a dual-nature claim requires that there be a controlling stockholder that abuses its powers at the expense of minority holders to increase its relative ownership and voting power through a conflicted transaction. This situation was not present in *Starr International*, thereby rendering the dilution claims exclusively

The second prong of the *Tooley* analysis—who would receive the benefit of any recovery or remedy—also demonstrates that Plaintiffs' claims are direct. The primary relief Plaintiffs seek is the restoration of their wrongfully expropriated rights as shareholders of the Companies. Plaintiffs' economic rights were nullified through the implementation of the Third Amendment, which made it impossible for private shareholders to ever receive a dividend or liquidation distribution from the Companies. Compl. ¶¶ 36-37, 48. The restoration of those rights, via vacating the implementation of the Third Amendment, directly benefits the private shareholders, not the Companies. That the Companies may also be collaterally benefitted if the Third Amendment is set aside is just a secondary effect of implementing the only remedy which will re-establish Plaintiffs' rights and ameliorate the harm suffered by shareholders. Indeed, "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); *see also Tooley*, 845 A.2d at 1038 (citing *Grimes* with approval). For example, the Delaware Court of Chancery held in *Gatz v. Ponsoldt* 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. *Gatz,* No. Civ. A. 174, 2004 WL 3029868, at *7-*8 (Del. Ch. Nov. 5, 2004). Because Plaintiffs seek similar relief, their claims are direct.

Regardless, the possibility that both Plaintiffs and the Companies may benefit if the Third Amendment is voided does not somehow transform Plaintiffs' well-pled claims from direct to derivative. Delaware law holds that the same set of facts may give rise to *both* direct *and* derivative

---

derivative. *See Starr Int'l*, 856 F.3d at 968-69. Plaintiffs' constitutional claims here are not premised on a dilution theory at all, and therefore *Starr International* is inapposite.

claims. *See Loral Space & Commc'ns, Inc. v. Highland Crusader Offshore Partners, L.P.*, 977 A.2d 867, 869 (Del. 2009) (finding stockholders had a direct claim arising from the same transaction as derivative claim); *San Antonio Fire & Police Pension Fund v. Bradbury*, No. C.A. 4446-VCH, 2010 WL 4273171, at *9 n.68 (Del. Ch. Oct. 28, 2010) ("[t]he same facts may support both direct and derivative claims").

C. Plaintiffs Have Standing to Challenge the Constitutionality of FHFA Under Article III

Irrespective of whether Plaintiffs' claims are characterized as direct or derivative, as discussed above, Plaintiffs have standing to challenge the constitutionality of FHFA as persons who have been harmed by FHFA's unconstitutional structure and actions. *See* Part IV. Treasury has not disputed Plaintiffs' Article III standing in this action, and has essentially conceded the existence of Article III standing in the *Collins* action, which alleges nearly identical claims. By conceding Article III standing, Treasury necessarily concedes that Plaintiffs have suffered a direct, i.e., not derivative, injury because a direct injury in fact is a prerequisite to Article III standing. *Constitution Party of Pa. v. Aichele*, 757 F.3d 347, 360 (3d Cir. 2014). If Plaintiffs' only injury were derivative of the Companies', then there could be no Article III standing. Thus, Treasury's concession that Plaintiffs have Article III standing eviscerates its own Succession Provision argument.

VI. Treasury Is an Appropriate Defendant

Finally, Treasury argues that it should be dismissed as a defendant because it is not alleged that Treasury "engaged in any actionable conduct." Treasury Br. 26. The only case cited by Treasury in support of its argument is a discrimination case reciting generic Rule 12(b)(6) standards and having nothing to do with the proper defendant in a separation of powers case. Treasury's argument is wrong both factually and legally.

First, Plaintiffs *do* allege "actionable" conduct on the part of Treasury. Treasury is a party to the PSPAs at issue and a central actor in the harm cause to Plaintiffs. Plaintiffs allege that Treasury drove the Third Amendment which wiped out Plaintiffs' shareholder rights and interest. Treasury was involved in (if not the ultimate determiner of) the decision to place the companies into receivership. Compl. ¶ 17. Treasury had assured investors such as Plaintiffs the companies were financially sound. Compl. ¶ 18. Treasury indicated to investors such as Plaintiffs that they would retain their shareholder rights. Compl. ¶ 20. Treasury insisted on the terms of PSPAs in return for loaning the Companies money. Compl. ¶ 21. Treasury assured investors that the "[c]onservatorship preserves the status and claims of the preferred and common shareholders." Compl. ¶ 24. By 2012, Treasury knew that the companies would be profitable in coming years. Compl. ¶ 31-33. Nonetheless, Treasury imposed the Third Amendment on the Companies and took Plaintiff shareholders' rights and interests, proclaiming that the Third Amendment was intended to ensure that "every dollar of earnings that Fannie Mae and Freddie Mac generate will benefit taxpayers." Compl. ¶ 37. As a result, all profits that may have gone to Plaintiffs went straight to Treasury. "[R]egardless of how much money the Companies send to Treasury, all of the Senior Preferred Stock will remain outstanding, and Treasury will continue to take all of the Companies' net worth." Compl. ¶ 38. The Third Amendment was implemented "to promote the economic and political interests of one stockholder—the U.S. Treasury—at the expense of all others." Compl. ¶ 39. Treasury imposed the Third Amendment to "help extradite the wind down of Fannie Mae and Freddie Mac, [and] make sure that every dollar of earnings each firm generates is used to benefit taxpayers . . . ." Compl. ¶ 41. A senior White House advisor involved in the process explained that Treasury was "ensuring that [the Companies] can't recapitalize"—i.e., that

Plaintiffs would never get their money back. Compl. ¶ 44. If not the tip of the spear, Treasury was certainly the shaft.

But more importantly, Treasury is an appropriate defendant because it is a relevant executive agency that may prove necessary for the relief sought by Plaintiffs. Treasury is a party to the agreements at issue. Treasury is receiving the money that might otherwise be directed to Plaintiffs. Plaintiffs' shareholder rights have effectively been transferred to Treasury. Plaintiffs' claimed relief includes injunctive relief specifically against Treasury, and seeks the return of monies from Treasury. Compl. 35 (Prayers for Relief 2 & 3). Moreover, Plaintiffs seek to invalidate a contract to which Treasury is a party. Federal courts addressing the question of the appropriate defendant in a separation of powers case have focused on whether a particular defendant is necessary (and sufficient) to grant the relief sought should plaintiff prevail. *See generally Juliana v. United States,* No. 15-cv-1517, 2018 WL 4997032, at *8 (D. Or. Oct. 15, 2018) ("The inquiry is not into the President's action or inaction in relationship to the injuries complained of, but rather into the relief requested, and whether or not equitable remedies involving the President himself are essential to that relief"); *CASA de Md., Inc. v. Trump*, No. GJH-18-845, 2018 WL6192367, at *15 (D. Md. Nov. 28, 2018) ("it is ordinarily sufficient to seek to enjoin the officers who attempt to enforce the President's directive"). Although these cases were in the context of avoiding a separation of powers issue by naming the President, the reasoning and rationale of considering such issues from the perspective the need to grant effective relief should apply in this context as well. At a minimum, it is not appropriate for Treasury to be dismissed at this early stage of the proceedings. *See id.* (keeping President in the case at motion to dismiss stage even though "relief against the President himself is extraordinarily unlikely . . . .").

CONCLUSION

For these reasons, the Court should grant Plaintiffs' cross motion for summary judgment and deny the Government's motion to dismiss.

Respectfully submitted,

Dated: December 21, 2018

KESSLER TOPAZ MELTZER & CHECK, LLP

By: */s/ Eric L. Zagar*
Eric L. Zagar
P.A. 76596
280 King of Prussia Rd.
Radnor, PA 19087
Tel: (610) 667-7706
Fax: (610) 667-7056
ezagar@ktmc.com

BOIES SCHILLER FLEXNER LLP
Hamish P.M. Hume
James A. Kraehenbuehl
1401 New York Ave. NW
Washington, DC 20005
Tel: (202) 237-2727
Fax: (202) 237-6131
hhume@bsfllp.com
jkraehenbuehl@bsfllp.com

Counsel for Plaintiffs

CERTIFICATE OF SERVICE

I hereby certify that on the 21st day of December 2018, a true and correct copy of Memorandum of Law in Support of Plaintiffs' Motion for Summary Judgment and in Opposition to Defendants' Motions to Dismiss and supporting documents thereto were filed electronically and is available for viewing and downloading from the Court's CM/ECF system, which will send notification of such filing to counsel of record in this matter who are registered on the CM/ECF system.

/s/ Eric L. Zagar
Eric L. Zagar

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

WAZEE STREET OPPORTUNITIES FUND IV, LP, et al., Plaintiffs, -vs.- THE FEDERAL HOUSING FINANCE AGENCY, et al., Defendants.	No. 2:18-cv-03478-NIQA

STATEMENT OF MATERIAL FACTS IN
SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

1. Fannie Mae and Freddie Mac are stockholder-owned corporations.

2. Fannie Mae and Freddie Mac purchase mortgages originated by private banks and bundle them into mortgage-related securities to be sold to investors.

3. From 1992 until 2008, the Office of Federal Housing Enterprise Oversight ("OFHEO") was the Companies' primary regulator.

4. In July 2008, Congress enacted the Housing and Economic Recovery Act of 2008 ("HERA"), which established FHFA to replace OFHEO as the Companies' regulator, and granted Treasury temporary authority to assist the Companies through the purchase of securities.

5. FHFA is an "independent agency" headed by a Director who is removable from office by the President only "for cause." 12 U.S.C. § 4512(b)(2).

6. HERA provides that when FHFA acts as conservator, it "shall not be subject to the direction or supervision of any other agency of the United States," 12 U.S.C. § 4617(a)(7), and that FHFA is to be funded through assessments that are "not . . . construed to be Government or public funds or appropriated money," 12 U.S.C. § 4516(f)(2).

7. On September 6, 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorship.

8. According to a September 7, 2008 FHFA press release, the conservatorship was "designed to stabilize a troubled institution with the objective of returning the entities to normal business operations. FHFA will act as the conservator to operate the Enterprises until they are stabilized." *See* Declaration of Eric L. Zagar in Support of Plaintiffs' Motion for Summary Judgment ("Zagar Decl.") Ex. A. FHFA also issued a Fact Sheet indicating that, "[u]pon the [FHFA] Director's determination that the Conservator's plan to restore the Company to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship." *See* Zagar Decl. Ex. B.

9. In Fannie Mae's September 11, 2008 Form 8-K, it stated that "FHFA, as Conservator, has the power to repudiate contracts entered into by Fannie Mae prior to the appointment of FHFA as Conservator if FHFA determines, in its sole discretion, that performance of the contract is burdensome and that repudiation of the contract promotes the orderly administration of Fannie Mae's affairs. FHFA's right to repudiate any contract must be exercised within a reasonable period of time after its appointment as Conservator." *See* Zagar Decl. Ex. C.

10. By regulation, FHFA determined that "a reasonable period shall be defined as a period of 18 months following the appointment of a conservator." 12 C.F.R. § 1237.5; ¶ 20(d).

11. When the Companies were placed into conservatorship, Treasury entered into Preferred Stock Purchase Agreements ("PSPAs") with FHFA, which acted on behalf of both Companies. The PSPAs for Fannie Mae and Freddie Mac are identical in all material respects. *See* Zagar Decl. Exs. D and E.

12. Through the PSPAs, Treasury agreed to make investments in the Companies in exchange for Senior Preferred Stock plus warrants to acquire common stock equal to 79.9% of the common stock in the Companies.

13. Under the instruments laying out the terms of the Senior Preferred Stock for each Company:

a. Treasury was given the right to receive a senior preferred dividend each quarter in an amount equal (on an annual basis) to 10% of the outstanding principal value of the Senior Preferred Stock if the dividend was paid in cash;

b. If a Company elected not to pay the dividend in cash, Treasury would receive a dividend in the form of additional Senior Preferred Stock with a face value equal to 12% of the outstanding principal value of the Senior Preferred Stock;

c. The principal value of the Senior Preferred Stock in each Company would equal the amount invested by Treasury in each Company, plus $1 billion to reflect a commitment fee with respect to each Company (plus any stock dividends distributed based upon the 12% dividend right referenced above);

d. The Senior Preferred Stock ranked senior in priority to all other Fannie Mae and Freddie Mac stock, so that no dividends or liquidation distributions could be paid to any other owner of stock in the Companies until Treasury had received its dividend or liquidation distributions under its Senior Preferred Stock (the liquidation preference was equal to the principal value of the Senior Preferred Stock plus any unpaid dividends);

e. Treasury also received warrants to acquire 79.9% of the common stock of each Company for a nominal price;

f. Treasury was also given the right to receive a quarterly periodic commitment fee, to be set for five-year periods by agreement of the Companies and Treasury, but Treasury had the option to waive the fee for up to a year at a time.

14. HERA gave Treasury temporary authority to purchase securities issued by the Companies. *See* 12 U.S.C. §§ 1455(l), 1719(g). To exercise that authority, the Secretary of the Treasury was required to determine that purchasing the Companies' securities was "necessary to . . . provide stability to the financial markets; . . . prevent disruptions in the availability of mortgage finance; and . . . protect the taxpayer." 12 U.S.C. §§ 1455(l)(1)(B), 1719(g)(1)(B). In making those determinations, the Secretary was required to consider six factors:

> (i) The need for preferences or priorities regarding payments to the Government.
>
> (ii) Limits on maturity or disposition of obligations or securities to be purchased.
>
> (iii) The [Companies'] plan[s] for the orderly resumption of private market funding or capital market access.
>
> (iv) The probability of the [Companies] fulfilling the terms of any such obligation or other security, including repayment.
>
> (v) The need to maintain the [Companies'] status as . . . private shareholder-owned compan[ies].
>
> (vi) Restrictions on the use of [the Companies'] resources, including limitations on the payment of dividends and executive compensation and any such other terms and conditions as appropriate for those purposes.

12 U.S.C. §§ 1455(l)(1)(C), 1719(g)(1)(C).

15. FHFA directed the Companies to book substantial loss reserves—recording anticipated mortgage loan losses before they were actually incurred—and required the Companies to eliminate from their balance sheets the value of deferred tax assets that would only be of use if the Companies became profitable (i.e., generated positive taxable income).

16. Treasury's authority under HERA to purchase the Companies' securities expired on December 31, 2009. *See* 12 U.S.C. §§ 1455(l)(4), 1719(g)(4). After that date, HERA authorized Treasury only "to hold, exercise any rights received in connection with, or sell" previously purchased securities. 12 U.S.C. §§ 1455(l)(2)(D), 1719(g)(2)(D).

17. During 2009, Treasury and FHFA amended the PSPAs twice. First, in May 2009, Treasury agreed to expand its funding commitment to $200 billion per Company from $100 billion per Company. Then, on December 24, 2009, it agreed to a funding commitment that would be sufficient to allow the Companies to satisfy their 2010, 2011, and 2012 capitalization requirements and a funding commitment up to a limit determined by an agreed-upon formula for subsequent years. *See* Zagar Decl. Exs. F, G, H and I.

18. The Companies posted profits of more than $10 billion for the first two quarters of 2012.

19. Between the beginning of 2007 and the second quarter of 2012, more than $234 billion had been set aside by the Companies to absorb anticipated loan losses, whereas loan losses of just over $125 billion were actually recognized during that period, such that the projected losses had been overestimated by $109 billion.

20. On August 17, 2012, FHFA and the Treasury agreed to the so-called "Third Amendment" to the PSPAs. *See* Zagar Decl. Exs. J and K.

21. The Third Amendment provides that in place of the 10% coupon due on Treasury's Senior Preferred Stock under the original PSPAs, Treasury would receive a dividend equal to 100% of the Companies' net worth (minus a small reserve that was set to shrink to zero in 2018).

22. Because the PSPAs provided that in the event of a liquidation of Fannie Mae or Freddie Mac, the Government would receive a liquidation distribution that included an additional Net Worth Sweep dividend, the Third Amendment guaranteed that even if the Companies were liquidated, Treasury would receive 100% of their net worth in that liquidation. No matter how much value the Companies generate, the Third Amendment provides that 100% of it has to go to Treasury.

23. Under the Third Amendment, the amount of cash the Companies transfer to Treasury as a dividend does not reduce the amount of the Senior Preferred Stock outstanding.

24. The Companies have not been permitted to redeem Treasury's Senior Preferred Stock.

25. In an August 17, 2012 press release announcing the Third Amendment, Treasury said that the changes would "help expedite the wind down of Fannie Mae and Freddie Mac, make sure that every dollar of earnings each firm generates is used to benefit taxpayers, and support the continued flow of mortgage credit during a responsible transition to a reformed housing finance market." It called the Third Amendment a full sweep of "every dollar of profit that [the] firm earns going forward," and that the amendment will fulfill the "commitment made in the Administration's 2011 White Paper that [Fannie Mae and Freddie Mac] will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." *See* Zagar Decl. Ex. L.

26. The Companies have paid approximately $280 billion in dividends to Treasury. Of that amount, approximately $50 billion was paid before the Net Worth Sweep, and approximately $230 billion was paid after the Net Worth Sweep.

27. When Congress created FHFA, James Lockhart, the Director of OFHEO, became Director of FHFA. *See* 12 U.S.C. § 4512(b)(5). Mr. Lockhart was FHFA Director when the Companies signed the original PSPAs.

28. Mr. Lockhart resigned as FHFA Director on August 5, 2009.

29. Following Mr. Lockhart's resignation as FHFA Director, he was not replaced with a Senate-confirmed official for over four years.

30. HERA provides that "[i]n the event of the . . . resignation . . . of the Director, the President shall designate" one of the FHFA's three Deputy Directors "to serve as acting Director until . . . the appointment of a successor" who is nominated by the President and confirmed by the Senate. 12 U.S.C. § 4512(f). The Deputy Directors are appointed by the FHFA Director. 12 U.S.C. § 4512(c)-(e).

31. On August 25, 2009, President Obama designated Edward DeMarco, a Deputy Director appointed by Mr. Lockhart, to serve as FHFA's acting director.

32. Mr. DeMarco served as acting director of FHFA for 52 months.

33. President Obama did not nominate a replacement FHFA Director until 15 months after Mr. Lockhart resigned.

34. Following the Senate's rejection of the nomination of Joseph A. Smith Jr. on December 22, 2010, President Obama did not again nominate someone as FHFA Director for 29 months.

35. Congressman Melvin L. Watt was sworn in as FHFA Director on January 6, 2014.

Respectfully submitted,

Dated: December 21, 2018

KESSLER TOPAZ MELTZER & CHECK, LLP

By: */s/ Eric L. Zagar*_______________
Eric L. Zagar, Esquire
P.A. 76596
280 King of Prussia Rd.
Radnor, PA 19087
Tel: (610) 667-7706
Fax: (610) 667-7056
ezagar@ktmc.com

BOIES SCHILLER FLEXNER LLP
Hamish P.M. Hume
James A. Kraehenbuehl
1401 New York Ave. NW
Washington, DC 20005
Tel: (202) 237-2727
Fax: (202) 237-6131
hhume@bsfllp.com
sgrigsby@bsfllp.com
jshaw@bsfllp.com
jkraehenbuehl@bsfllp.com

Counsel for Plaintiffs

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

WAZEE STREET OPPORTUNITIES FUND IV, LP, et al., Plaintiffs, -vs.- THE FEDERAL HOUSING FINANCE AGENCY, et al., Defendants.	No. 2:18-cv-03478-NIQA

DELCARATION OF ERIC L. ZAGAR IN SUPPORT OF
PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

I, Eric L. Zagar, here declare as follows:

1. I am a partner of the law firm of Kessler Topaz Meltzer & Check, LLP, counsel of record for Plaintiffs. I make this declaration in support of Plaintiffs' Motion for Summary Judgment to place before the Court certain documents and facts referenced therein.

2. Fannie Mae and Freddie Mac are stockholder-owned corporations.

3. Fannie Mae and Freddie Mac purchase mortgages originated by private banks and bundle them into mortgage-related securities to be sold to investors.

4. From 1992 until 2008, the Office of Federal Housing Enterprise Oversight ("OFHEO") was the Companies' primary regulator.

5. In July 2008, Congress enacted the Housing and Economic Recovery Act of 2008 ("HERA"), which established FHFA to replace OFHEO as the Companies' regulator, and granted Treasury temporary authority to assist the Companies through the purchase of securities.

6. FHFA is an "independent agency" headed by a Director who is removable from office by the President only "for cause." 12 U.S.C. § 4512(b)(2).

7. HERA provides that when FHFA acts as conservator, it "shall not be subject to the direction or supervision of any other agency of the United States," 12 U.S.C. § 4617(a)(7), and that FHFA is to be funded through assessments that are "not . . . construed to be Government or public funds or appropriated money," 12 U.S.C. § 4516(f)(2).

8. On September 6, 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorship.

9. According to a September 7, 2008 FHFA press release, the conservatorship was "designed to stabilize a troubled institution with the objective of returning the entities to normal business operations. FHFA will act as the conservator to operate the Enterprises until they are stabilized." FHFA also issued a Fact Sheet indicating that, "[u]pon the [FHFA] Director's determination that the Conservator's plan to restore the Company to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship." Attached hereto as Exhibits A and B, respectively, are true and correct copies of the FHFA Press, dated September 7, 2008 and FHFA Questions and Answers on Conservatorship, dated September 7, 2008.

10. In Fannie Mae's September 11, 2008 Form 8-K, it stated that "FHFA, as Conservator, has the power to repudiate contracts entered into by Fannie Mae prior to the appointment of FHFA as Conservator if FHFA determines, in its sole discretion, that performance of the contract is burdensome and that repudiation of the contract promotes the orderly administration of Fannie Mae's affairs. FHFA's right to repudiate any contract must be exercised within a reasonable period of time after its appointment as Conservator." Attached hereto as Exhibit C is a true and correct copy of Form 8-K filed on September 11, 2008 by Fannie Mae with the SEC.

11. By regulation, FHFA determined that "a reasonable period shall be defined as a period of 18 months following the appointment of a conservator." 12 C.F.R. § 1237.5; ¶ 20(d).

12. When the Companies were placed into conservatorship, Treasury entered into Preferred Stock Purchase Agreements ("PSPAs") with FHFA, which acted on behalf of both Companies. The PSPAs for Freddie Mac and Fannie Mae are identical in all material respects. Attached hereto as Exhibits D and E, respectively, are true and correct copies of Amended and Restated Senior Preferred Stock Purchase Agreement between Treasury and Freddie Mac, dated September 24, 2008 and Amended and Restated Senior Preferred Stock Purchase Agreement between Treasury and Fannie Mae, dated September 24, 2008.

13. Through the PSPAs, Treasury agreed to make investments in the Companies in exchange for Senior Preferred Stock plus warrants to acquire common stock equal to 79.9% of the common stock in the Companies.

14. Under the instruments laying out the terms of the Senior Preferred Stock for each Company:

a. Treasury was given the right to receive a senior preferred dividend each quarter in an amount equal (on an annual basis) to 10% of the outstanding principal value of the Senior Preferred Stock if the dividend was paid in cash;

b. If a Company elected not to pay the dividend in cash, Treasury would receive a dividend in the form of additional Senior Preferred Stock with a face value equal to 12% of the outstanding principal value of the Senior Preferred Stock;

c. The principal value of the Senior Preferred Stock in each Company would equal the amount invested by Treasury in each Company, plus $1 billion to reflect a commitment

fee with respect to each Company (plus any stock dividends distributed based upon the 12% dividend right referenced above);

d. The Senior Preferred Stock ranked senior in priority to all other Fannie Mae and Freddie Mac stock, so that no dividends or liquidation distributions could be paid to any other owner of stock in the Companies until Treasury had received its dividend or liquidation distributions under its Senior Preferred Stock (the liquidation preference was equal to the principal value of the Senior Preferred Stock plus any unpaid dividends);

e. Treasury also received warrants to acquire 79.9% of the common stock of each Company for a nominal price;

f. Treasury was also given the right to receive a quarterly periodic commitment fee, to be set for five-year periods by agreement of the Companies and Treasury, but Treasury had the option to waive the fee for up to a year at a time.

15. HERA gave Treasury temporary authority to purchase securities issued by the Companies. *See* 12 U.S.C. §§ 1455(l), 1719(g). To exercise that authority, the Secretary of the Treasury was required to determine that purchasing the Companies' securities was "necessary to . . . provide stability to the financial markets; . . . prevent disruptions in the availability of mortgage finance; and . . . protect the taxpayer." 12 U.S.C. §§ 1455(l)(1)(B), 1719(g)(1)(B). In making those determinations, the Secretary was required to consider six factors:

(i) The need for preferences or priorities regarding payments to the Government.

(ii) Limits on maturity or disposition of obligations or securities to be purchased.

(iii) The [Companies'] plan[s] for the orderly resumption of private market funding or capital market access.

(iv) The probability of the [Companies] fulfilling the terms of any such obligation or other security, including repayment.

(v) The need to maintain the [Companies'] status as . . . private shareholder-owned compan[ies].

(vi) Restrictions on the use of [the Companies'] resources, including limitations on the payment of dividends and executive compensation and any such other terms and conditions as appropriate for those purposes.

12 U.S.C. §§ 1455(l)(1)(C), 1719(g)(1)(C).

16. FHFA directed the Companies to book substantial loss reserves—recording anticipated mortgage loan losses before they were actually incurred—and required the Companies to eliminate from their balance sheets the value of deferred tax assets that would only be of use if the Companies became profitable (*i.e.*, generated positive taxable income).

17. Treasury's authority under HERA to purchase the Companies' securities expired on December 31, 2009. *See* 12 U.S.C. §§ 1455(l)(4), 1719(g)(4). After that date, HERA authorized Treasury only "to hold, exercise any rights received in connection with, or sell" previously purchased securities. 12 U.S.C. §§ 1455(l)(2)(D), 1719(g)(2)(D).

18. During 2009, Treasury and FHFA amended the PSPAs twice. First, in May 2009, Treasury agreed to expand its funding commitment to $200 billion per Company from $100 billion per Company. Then, on December 24, 2009, it agreed to a funding commitment that would be sufficient to allow the Companies to satisfy their 2010, 2011, and 2012 capitalization requirements and a funding commitment up to a limit determined by an agreed-upon formula for subsequent years. Attached hereto as Exhibits F and G, respectively, are true and correct copies of Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement between

Treasury and Freddie Mac, dated May 6, 2009 and Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement between Treasury and Fannie Mae, dated May 6, 2009. Also attached hereto as Exhibits H and I, respectively, are true and correct copies of Second Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement between Treasury and Freddie Mac, dated December 24, 2009 and Second Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement between Treasury and Fannie Mae, dated December 24, 2009

19. The Companies posted profits of more than $10 billion for the first two quarters of 2012.

20. Between the beginning of 2007 and the second quarter of 2012, more than $234 billion had been set aside by the Companies to absorb anticipated loan losses, whereas loan losses of just over $125 billion were actually recognized during that period, such that the projected losses had been overestimated by $109 billion.

21. On August 17, 2012, FHFA and the Treasury agreed to the so-called "Third Amendment" to the PSPAs. Attached hereto as Exhibits J and K, respectively, are true and correct copies of Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement between Treasury and Freddie Mac, dated August 17, 2012 and Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement between Treasury and Fannie Mae, dated August 17, 2012.

22. The Third Amendment provides that in place of the 10% coupon due on Treasury's Senior Preferred Stock under the original PSPAs, Treasury would receive a dividend equal to 100% of the Companies' net worth (minus a small reserve that was set to shrink to zero in 2018).

23. Because the PSPAs provided that in the event of a liquidation of Fannie Mae or Freddie Mac, the Government would receive a liquidation distribution that included an additional Net Worth Sweep dividend, the Third Amendment guaranteed that even if the Companies were liquidated, Treasury would receive 100% of their net worth in that liquidation. No matter how much value the Companies generate, the Third Amendment provides that 100% of it has to go to Treasury.

24. Under the Third Amendment, the amount of cash the Companies transfer to Treasury as a dividend does not reduce the amount of the Senior Preferred Stock outstanding.

25. The Companies have not been permitted to redeem Treasury's Senior Preferred Stock.

26. In an August 17, 2012 press release announcing the Third Amendment, Treasury said that the changes would "help expedite the wind down of Fannie Mae and Freddie Mac, make sure that every dollar of earnings each firm generates is used to benefit taxpayers, and support the continued flow of mortgage credit during a responsible transition to a reformed housing finance market." It called the Third Amendment a full sweep of "every dollar of profit that [the] firm earns going forward," and that the amendment will fulfill the "commitment made in the Administration's 2011 White Paper that [Fannie Mae and Freddie Mac] will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." Attached hereto as Exhibit L is a true and correct copy of Treasury Press Release, dated August 17, 2012.

27. The Companies have paid approximately $280 billion in dividends to Treasury. Of that amount, approximately $50 billion was paid before the Net Worth Sweep, and approximately $230 billion was paid after the Net Worth Sweep.

28. When Congress created FHFA, James Lockhart, the Director of OFHEO, became Director of FHFA. *See* 12 U.S.C. § 4512(b)(5). Mr. Lockhart was FHFA Director when the Companies signed the original PSPAs.

29. Mr. Lockhart resigned as FHFA Director on August 5, 2009.

30. Following Mr. Lockhart's resignation as FHFA Director, he was not replaced with a Senate-confirmed official for over four years.

31. HERA provides that "[i]n the event of the . . . resignation . . . of the Director, the President shall designate" one of the FHFA's three Deputy Directors "to serve as acting Director until . . . the appointment of a successor" who is nominated by the President and confirmed by the Senate. 12 U.S.C. § 4512(f). The Deputy Directors are appointed by the FHFA Director. 12 U.S.C. § 4512(c)-(e).

32. On August 25, 2009, President Obama designated Edward DeMarco, a Deputy Director appointed by Mr. Lockhart, to serve as FHFA's acting director.

33. Mr. DeMarco served as acting director of FHFA for 52 months.

34. President Obama did not nominate a replacement FHFA Director until 15 months after Mr. Lockhart resigned.

35. Following the Senate's rejection of the nomination of Joseph A. Smith Jr. on December 22, 2010, President Obama did not again nominate someone as FHFA Director for 29 months.

36. Congressman Melvin L. Watt was sworn in as FHFA Director on January 6, 2014.

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

Executed this 21st day of December, 2018, at Radnor, Pennsylvania.

Eric L. Zagar