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

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INTRODUCTION

In 2012, four years after the financial crisis and just a few months before Fannie Mae and Freddie Mac (the "Companies") were about to realize substantial profits, FHFA and Treasury reversed on their initial assurances to bring the Companies out of conservatorship to claim nearly the entirety of the Companies' net worth for the federal government. They accomplished this through the Net Worth Sweep, which was implemented through the third amendment to the preferred stock purchase agreements ("PSPA"). This requires the Companies to pay Treasury their entire net worth every quarter but for a specified capital reserve. Treasury has consequently received approximately $125 billion more than it would have under the initial PSPAs entered into in the midst of the financial crisis. This nationalization of the Companies and windfall has come at the expense of shareholders' liquidation and dividend rights, which were entirely eliminated by the Net Worth Sweep.

Other cases have been filed challenging several aspects of Companies' nationalizations. Contrary to Defendants' suggestions, this litigation has not been fruitless for shareholders. Multiple courts have found that shareholders have meritorious claims or claims warranting discovery. The District Court for the District of Columbia has denied Treasury and FHFA's motions to dismiss on claims for breach of the implied covenant of good faith and fair dealing. *Fairholme Funds, Inc. v. FHFA*, No. 13-cv-1053 (RCL), 2018 WL 4680197, at *8 (D.D.C. Sept. 28, 2018). The Court of Federal claims permitted extended jurisdictional discovery and is now (for claims first filed in 2013) in the process of briefing motions to dismiss. *See Fairholme Funds, Inc. v. United States*, No. 13-cv-00465-MMS (CFC). And a panel of the Fifth Circuit has held that the separation-of-powers claims brought in this case are correct. *Collins v. Mnuchin*, 896 F.3d 640, 668 (5th Cir. 2018), *rehearing en banc granted* 908 F.3d 151 (5th Cir. 2018).

Here, ***both Defendants concede that the agency that implemented the Net Worth Sweep and terminated Plaintiffs' contract rights was (and remains) unconstitutionally structured.*** Moreover, the unconstitutional structure of the agency resulting from insufficient Executive oversight is only one of the constitutional defects leading to the Net Worth Sweep. The Net Worth Sweep was also implemented by an acting Director, permitted under Supreme Court precedent to serve only for a "limited time," but nevertheless severed all but eight months of an actual Director's full term. In this case, Plaintiffs ask this Court to provide relief from the actions of that unconstitutional agency—and Director—that directly harmed Plaintiffs.

Defendants' rebuttal is to essentially ask this Court to avert its eyes from the constitutional defects and Plaintiffs' injuries. FHFA, but not Treasury, argues that Plaintiffs lack Article III standing although the loss of shareholders' liquidation and dividend rights is the direct consequence of an agency all agree is unconstitutionally composed. Both argue that vacatur is inappropriate because the actions of a federal agency, using powers the Third Circuit has explicitly held were not those of the Companies, are supposedly not governmental in nature. Even if this were true, it is irrelevant as Defendants fail to cite a single case supporting their claim that an unconstitutionally constructed agency gets a pass for some actions but not others. Regardless, it is not true: FHFA's actions were governmental because they exercised powers specifically given to it by Congress for the purpose of enhancing the government's interest at shareholders' expense.

Moreover, Defendants cannot overcome the extensive body of separation-of-power cases showing that plaintiffs are entitled to specific, backward looking relief for separation of powers claims. This is necessary to encourage the enforcement of the Constitution's structural safeguard by providing an actual remedy to the harm caused by the unconstitutional agency: the complete expropriation of shareholders' economic rights for the benefit of Treasury.

For these reasons, the Court should deny Defendants' motions to dismiss and grant Plaintiffs' motion for summary judgment.

ARGUMENT

I. Given Defendants' Acknowledgment Of FHFA's Unconstitutional Structure, Plaintiffs Are Entitled To Relief From The Harm Imposed On Them By The Agency

A. Neither FHFA Nor Treasury Argues That FHFA Was Constitutionally Structured At The Time Of The Third Amendment

After significant briefing, FHFA now joins Plaintiffs and Treasury in admitting that the FHFA is unconstitutionally structured. FHFA Defendants' Memorandum of Law in Opposition to Plaintiffs' Motion for Summary Judgment and Reply Memorandum in Support of Dismissal ("FHFA Resp."), ECF No. 31, at 1; Memorandum in Support of Motion to Dismiss by the U.S. Dept. of the Treasury ("Treasury MTD"), ECF No. 15-1, at 17-19; Memorandum of Law in Support of Plaintiffs' Motion for Summary Judgment and in Opposition to Defendants' Motions to Dismiss ("Pls.' Opening Br."), ECF No. 19-1, at 8-13.[1] It is thus now undisputed that the Net Worth Sweep, which diverts nearly the entirety of the Companies' net worth to the Treasury every quarter, is the result of actions taken by an unconstitutionally structured agency. As explained in Plaintiffs' motion, and undisputed by the Defendants, the Net Worth Sweep has resulted in $280 billion in payments to Treasury—approximately $125 billion more than Treasury would have received under the terms of the original PSPAs and approximately $90 billion more than Treasury ever contributed to the Companies following the 2008 financial crisis. Pls.' Opening Br. 7-8.

[1] FHFA argues that Plaintiffs have waived Count II of the Complaint. FHFA Resp. 32. This is not correct. Count II alleges that FHFA is unconstitutionally structured because, in addition to there being led by a single director that is not removable for cause, FHFA was insulated from oversight in multiple manners. *See* Compl. ¶¶ 88-92. This argument was made at Section I.B of Plaintiffs' opposition and motion for summary judgment. Count II therefore has not been waived. Regardless, the precise basis for holding that FHFA is unconstitutionally structured does not have a practical effect because the relief for both claims is the same: striking the for-cause removal provision and vacatur of the Net Worth Sweep. *See* Section I.B.3.

These payments have prevented the Companies from building significant capital and constitute a wealth transfer from the class shareholders to the senior preferred shareholder, Treasury, for no consideration.

B. Defendants' Efforts To Escape The Unconstitutional Structure Of FHFA Must Be Rejected

Left with an admittedly unconstitutional agency, Defendants urge this Court to put its head in the sand. FHFA argues that Plaintiffs lack standing to bring their claims and both Defendants argue that HERA bars the claims and that the remedy includes anything but providing relief from the harm Plaintiffs have suffered as a result of an unconstitutionally structured agency. These arguments, whether made with respect to the separation-of-powers claims (Counts I and II) or the other constitutional claims (Appointments Clause, Count III; Nondelegation, Counts IV and V), lack merit and are contrary to law.

Moreover, Defendants' arguments would have the effect of leaving not only this unconstitutional structure in place but also discourage future litigants from bringing suit to remedy other constitutionally defective agency structures by depriving them of an effective remedy. The absurdity of this result is illustrated by Treasury's argument that it is actually the FHFA-controlled Companies that are supposed to bring these claims and remedy the constitutional defect of the FHFA. This will never happen—it is only Plaintiffs that have the incentive to bring such a suit, and the practical effect of Defendants' arguments is part of the context in which they should be considered.

1. Plaintiffs' Injury Is Sufficiently Connected To The Constitutional Violations Identified

FHFA's Article III standing argument has been extensively briefed. Memorandum of Law in Support of FHFA Defendants' Motion to Dismiss ("FHFA MTD"), ECF No. 16, at 9-12; FHFA Resp. 3-6. As previously shown, in separation-of-powers cases, "a party is not required to show

that he has received less favorable treatment than he would have if the agency were lawfully constituted . . . ." *Comm. for Monetary Reform v. Bd. of Governors of Fed. Reserve Sys.*, 766 F.2d 538, 543 (D.C. Cir. 1985). *See also Collins*, 896 F.3d at 654, *rehearing en banc granted*, 908 F.3d 151 (adopting this standard); Pls.' Opening Br. 27-31. It is enough that FHFA's implementation of the Net Worth Sweep while unconstitutionally structured "directly and uniquely affected" Plaintiffs. *Collins*, 896 F.3d at 655.

FHFA does not dispute the standard articulated by the D.C. and Fifth Circuits. Instead, it argues that the Fifth Circuit meant that plaintiffs bringing separation-of-powers claims need not "show . . . less favorable treatment than . . . if the agency were lawfully constituted" only where the agency in question "is 'designated to adjudicate their rights.'" FHFA Resp. 5-6 (quoting *Collins*, 896 F.3d at 654). This is plainly wrong. As FHFA is no doubt aware, the plaintiffs in *Collins* are in the *exact same position* as Plaintiffs here: shareholders harmed by the Net Worth Sweep as a consequence of FHFA's actions. *Collins*, 896 F.3d at 651-52. Thus, if the Fifth Circuit did intend to adopt the distinction for which FHFA argues, then it would have had to hold that the plaintiffs there lacked standing because they could not "assert that FHFA is 'designated to adjudicate their rights'" as FHFA argues Plaintiffs here cannot. FHFA Resp. 6. The Fifth Circuit reached the opposite conclusion, holding that plaintiffs like those before this Court do have standing to raise separation of powers arguments, and nowhere contemplated the distinction for which FHFA argues. *Collins*, 896 F.3d at 653-59.

Nor, for that matter, do any of the cases FHFA cites support applying a different standing analysis in separation-of-powers cases for agencies "designated to adjudicate their rights" as opposed to agencies in a "non-adjudicatory setting[]." FHFA Resp. 6. *See Bond v. United States*, 564 U.S. 211, 225 (2011) (merely restating the elements of a standing analysis); *Metro. Wash.*

Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc., 501 U.S. 252, 265 (1991) (concluding harm was traceable because knowledge of the alleged constitutional defect "undoubtedly influenced" decisions made by the agency, with no mention whether the agency was acting in an adjudicatory manner); *Comm. for Monetary Reform*, 766 F.3d at 543 (applying the same standing test regardless of "whether such authority is regulatory, administrative, or adjudicative in nature").

FHFA's other argument is that there is no causal connection because, in its view, the constitutional violation could not result in the harm given that the Net Worth Sweep favored the Executive and the Executive could have ordered Treasury to not enter the agreement. FHFA Resp. 3-5. This argument is nothing more than an attempt to require Plaintiffs to prove what might have happened if the FHFA was constitutionally structured at the time of the Net Worth Sweep. As explained, this is contrary to well-established precedent holding that separation-of-powers plaintiffs need not prove what the "but for" world would have been. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 512 n.12 (2010) ("petitioners' standing does not require precise proof of what the Board's policies might have been in that counterfactual world"). *See also Comm. for Monetary Reform*, 766 F.2d at 543; *Collins*, 896 F.3d at 654.

FHFA's argument also rests on the concept that *Free Enterprise* and the related cases depend on a degree of uncertainty regarding whether the violation of the separation of powers had caused the plaintiffs' injury. But this argument is detached from the facts of *Free Enterprise*, which concerned an obscure regulator's decision to investigate a tiny accounting firm in Nevada. *Id*. at 487-88. There was no credible argument that the President would have intervened to protect this firm if the PCAOB had been subject to one rather than two layers of for-cause removal protection, yet the Supreme Court concluded that the firm had standing to argue that the PCAOB

was unconstitutionally insulated from presidential oversight. *Id*. at 512 n.12. And this is just one of several cases in which plaintiffs invoking the separation of powers or other procedural safeguards were held to have standing even though there was no plausible argument that the violation changed the outcome of the decision being challenged. *See, e.g., Nguyen v. United States*, 539 U.S. 69, 77-78 (2003) (vacating Ninth Circuit decision because one member of three-judge panel was non-Article III judge even though panel's decision was unanimous); *Glidden Co. v. Zdanok*, 370 U.S. 530, 533 (1962) (plurality) (petitioners had standing to argue that non-Article III judges lacked authority to hear their cases even though Court was "unable to say that either judge's participation even colorably denied the petitioners independent judicial hearings"); *FEC v. NRA Political Victory Fund*, 6 F.3d 821, 828 (D.C. Cir. 1993) (target of enforcement action had standing to argue that nonvoting members of the FEC were serving in violation of the Appointments Clause).

Regardless, even accepting FHFA's erroneous premise that separation-of-powers plaintiffs' standing depends on showing that the constitutional violation could have made a difference, Plaintiffs have standing here. FHFA dramatically oversimplifies the difficult political, financial, and policy tradeoffs that the Net Worth Sweep involved—tradeoffs that cannot be reduced to a simple question of amending the PSPAs to be "better" or "worse" from the President's perspective. Without the insulation provided by FHFA's unconstitutional structure, the President may not have been willing to take the political risks involved in implementing the Net Worth Sweep or forced FHFA to have the Companies implement policies, such as the reduction of certain mortgage principals, that would have made the Net Worth Sweep unnecessary.

With respect to whether the fact that the Net Worth Sweep was implemented by an acting Director rather than a Director negates Plaintiffs' standing, FHFA Resp. 4-5, nothing in FHFA's

opposition aids the notion that Congress intended FHFA to be a hybrid agency, independent when led by a Senate-confirmed Director but executive when led by an acting Director, Pls.' Opening Br. 15-16; *Collins*, 896 F.3d at 656. FHFA's opposition cites to an academic article arguing that the independent versus executive distinction is a false dichotomy and "so-called independent agencies are simply a type of executive agency." Kirti Datla & Richard L. Revesz, *Deconstructing Independent Agencies (and Executive Agencies)*, 98 Cornell L. Rev. 769, 773 (2013). No effort is made to base this analysis in the Supreme Court's precedents or Congress's treatment of agencies, such as the latter's specific designation of FHFA as "an independent agency of the Federal Government" with a Director removable only for cause. 12 U.S.C. §§ 4511(a), 4512. It should therefore be rejected.

FHFA's alternative argument is that various methods of interpretation require treating acting Directors as removable at will because the statute does not specifically say they are removable only for cause. FHFA Resp. 4-5; *see also* Memorandum in Opposition to Plaintiffs' Motion for Summary Judgment and in Support of Treasury's Motion to Dismiss ("Treasury Resp."), ECF No. 29, at 10-11 (making same argument in different context). This argument, however, leads to absurd results because the statute also says nothing about what powers acting Directors have. *See* 12 U.S.C. §§ 4512, 4513. Thus, according to FHFA's reasoning, acting Directors have *none of the powers* of the Director because the statute does not specifically give acting Directors those powers. This cannot be, and is not, correct. Instead, Congress did not think it necessary to repeat in 12 U.S.C. § 4512(f) what it already said with respect to Director's rights and powers because 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).

Finally, FHFA argues that Plaintiffs Wazee and Brown lack standing because they purchased their stock after the Net Worth Sweep. FHFA Resp. 7-8. Plaintiffs have explained that their standing is derived from their purchase of the stock because, under Delaware law, a purchaser of stock "acquires all rights in the security that the transferor had or had power to transfer." Del. Code. Tit. 6, § 8-302(a). Pls.' Opening Br. 30-31 (discussing § 8-302 and *In re Activision Blizzard, Inc. Stockholder Litig.*, 124 A.3d 1025 (Del. Ch. 2015)). "All rights in the security as used in the statutes means rights in the security itself as opposed to personal rights." *Fairholme Funds, Inc.*, 2018 WL 4680197, at *8 (citing *Schultz v. Ginsburg*, 965 A.2d 661, 667 n.12 (Del. 2009)). "In other words, '[w]hen 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 for any recovery or other remedy, travel with the shares.'" *Id.* (quoting *In re Activision*, 124 A.3d at 1049-51).

FHFA entirely ignores Section 8-302 and *In re Activision*, instead citing to *Omnicare, Inc. v. NCS Healthcare, Inc.*, 809 A.2d 1163 (Del. Ch. 2002), for a "policy against purchasing lawsuits involving the *internal* relations of Delaware corporations" that is "codified in the derivative suit context by 8 Del. C. § 327." *Id.* at 1169 (emphasis added). Plaintiffs' claims here are not about "internal relations," so the rule does not apply here. Moreover, *In re Activision* explains that "Section 327 does not apply to direct claims" like those brought here. 124 A.3d 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." *Id.*

Regardless, FHFA's argument is undermined by the fact that both plaintiffs are still subject to the FHFA. *Collins*, 896 F.3d at 657. FHFA claims to not know what actions may happen in

the future, FHFA Resp. 8-9 n.4, but the answer is obvious: every quarter going forward, FHFA will transfer nearly the entire net worth of the Companies to Treasury.

FHFA also argues that state law is "is irrelevant to the federal jurisdictional and separation-of-powers principles that underlie Article III." FHFA Resp. 8. This only matters if federal law with respect to shareholder rights and the transfer of those rights (including litigation claims) is different and FHFA cites nothing to support that notion. As previously explained, the cases FHFA does cite are inapposite. Pls.' Opening Br. 30-31.[2]

2. HERA Does Not Bar Plaintiffs' Claims

Plaintiffs explained at length in their opening brief why their claims are not barred by HERA's succession provision at 12 U.S.C. § 4617(b)(2)(A)(i) (the "Succession Provision"). Plaintiffs' claims seek to redress harm that was suffered only by Plaintiffs themselves, not by the Companies, and therefore Plaintiffs' claims are direct in nature and the Succession Provision is inapplicable. *See* Pls.' Opening Br. 32-37. In its Opposition Brief, Treasury again misrepresents the nature of Plaintiffs' claims and Delaware law, to which Plaintiffs will briefly respond.

Contrary to Treasury's position, Plaintiffs are not seeking to "set[ ] aside" the well-established principles differentiating direct and derivative actions. Plaintiffs' claims are direct as a matter of law. Treasury seeks to obfuscate this truth by misconstruing Plaintiffs' claims and the harm Plaintiffs suffered. 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

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[2] FHFA also argues that Plaintiffs lack standing because "vacatur defeats redressability." FHFA Resp. 16-18. FHFA does not argue that Plaintiffs lack standing on the basis of redressability if vacatur is an appropriate remedy. Because it is, *see* Section I.B.3 *infra*, Plaintiffs satisfy this element of Article III standing. Even if vacatur is not appropriate, however, declaratory and injunctive relief is appropriate to remedy the ongoing injury. *Collins*, 896 F.3d at 657-58.

corporation or the stockholders, individually)?" *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).

Treasury states that Plaintiffs "assert that their claims are direct because the Third Amendment allegedly altered the value of their shares in relation to Treasury's," and then Treasury argues that Plaintiffs' claims are derivative because they are for "equity dilution." Treasury Resp. 5. This strawman argument is a blatant mischaracterization of Plaintiffs' claims. Nowhere do Plaintiffs allege a claim for equity dilution, nor do they seek to recover some diverted or diluted value of their shares. Equity dilution occurs where a corporation issues new shares to certain shareholders for inadequate consideration, thereby shrinking the equity ownership of all other shareholders and causing the value of their ownership to fall. This is not the harm Plaintiffs have suffered or for which they are seeking to remedy.[3]

As alleged in the Complaint, and as explained in Plaintiffs' Opening Brief, Plaintiffs were harmed directly by the Net Worth Sweep because it eliminated Plaintiffs' rights to dividends and liquidation preferences. The loss of these rights did not harm the Companies themselves, who suffered no harm stemming from the destruction of Plaintiffs' rights to share in the profits the Companies generated. *See Acker v. Transurgical, Inc.*, No. C.A. 201-N, 2004 WL 1230945, at *1 (Del. Ch. Apr. 22, 2004) (noting that the shifting of money from one shareholder to another does not harm the company as there is no decline in the value of the company, and thus the harm was not derivative in nature). Rather, it was Plaintiffs who had their economic rights to dividends and

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[3] Accordingly, Treasury's citations to *Feldman v. Cutaia*, 956 A.2d 644 (Del. Ch. 2007) and *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, 152 A.3d 1248, 1254 (Del. 2016) are simply an apples-to-oranges comparison. Those cases both addressed claims for equity dilution, which is not what Plaintiffs are alleging here. The same can be said for *Saxton v. FHFA*, 245 F. Supp. 3d 1063 (N.D. Iowa 2017) and *Roberts v. FHFA*, 889 F.3d 397 (7th Cir. 2018), where the plaintiffs were seeking to recover for the Companies the dividends paid to Treasury pursuant to the Third Amendment.

a liquidation preference taken away from them and it is the loss of those rights that Plaintiffs seek to remedy. Treasury does not and cannot explain how the expropriation of a personal right of shareholders in breach of the shareholders' agreements is somehow a corporate harm, nor how compensation for that breach of those personal shareholder contract rights somehow would flow first to the Companies and to Plaintiffs only derivatively. *See Collins*, 896 F.3d at 654 ("Divesting the Shareholders' property rights caused a direct injury.").[4]

Because Plaintiffs do not seek compensation for harm suffered by the Companies, but rather compensation and remedy for the breach of their individual contract rights, the *Tooley* analysis dictates that Plaintiffs' claims are direct, not derivative.

3. Vacatur Of The Net Worth Sweep Is The Appropriate Remedy To The Constitutional Violations Identified

a. Invalidating The Net Worth Sweep Is Necessary

Plaintiffs demonstrated in its opening brief that vacating past decisions of an unconstitutional agency is the norm in separation-of-powers cases. Pls.' Opening Br. 17. Defendants point to no contrary authority. Treasury relies on *John Doe Co. v. CFPB*, 849 F.3d 1129, 1133 (D.C. Cir. 2017), but nowhere responds to Plaintiffs' distinction of the case on the basis that it lacks any past action to invalidate. Pls.' Opening Br. 18-19; Treasury Resp. 11. *Bennett v. Spear*, 520 U.S. 154, 174, 177-78 (1997). Ignoring this, FHFA argues that *Free Enterprise* "specifically denied" relief similar to the vacatur sought here, FHFA Resp. 9, but this completely distorts the decision. Nowhere in the Supreme Court's decision does it contemplate, much less "specifically deny," whether prior actions of the agency should be invalidated. The language FHFA points to is only about whether the unconstitutional structure of PCOAB required

[4] Further, as Treasury concedes, Plaintiffs have suffered an injury sufficient to establish Article III standing. *See* Treasury Resp. 7. Therefore, HERA's Succession Provision is irrelevant as Plaintiffs have standing to prosecute their claims. *Collins*, 896 F.3d at 654-59.

the Court to "blue pencil" or strike provisions *in addition to* the good-cause removal provision. *Free Enterprise*, 561 U.S. at 508-10. The briefs of the case do not discuss whether past actions of the agency should be vacated and the opinion states that, by the time the case reached the Court, the agency's investigation had concluded and "produced no sanction," *id*. at 490, thus making vacatur of the decision to start investigating an empty formalism.

Both Defendants distinguish *Bowsher v. Synar*, 478 U.S. 714 (1986), on the basis that it involved a statute that provided an alternative process should the initial one be found unconstitutional. FHFA Resp. 14; Treasury Resp. 12-13. They omit, however, that the statute was silent regarding relief for *past* presidential sequestration orders that were implemented under the initial process. *See* Pub. L. No. 99-177 § 274, 99 Stat. 1027 (1985). The Court crafted this relief itself, vacating the final decision of the official who was unconstitutionally insulated. *Bowsher*, 478 U.S. at 736. This is the relief sought here.

FHFA also argued that *Bowsher* is distinguishable because it relates to "a specific unconstitutional process." FHFA Resp. 13. But the same is true here. The crux of Plaintiffs' challenge to FHFA's structure is that the process FHFA used to impose and implement the Net Worth Sweep—exercising government power without meaningful oversight from the President, Congress, or the judiciary—violated the separation of powers.

Defendants lastly contend that this case is different than others because it does not directly arise from an adjudication of Plaintiffs' rights or because the case was brought later than in some cases. FHFA Resp. 14-15; Treasury Resp. 11-12. They fail to cite to any case supporting the proposition that the relief available for violations of the separation of powers depends on the nature of the agency's action. Cases collected by Plaintiffs show that no such principle is warranted. Pls.' Opening Br. 17-18. The same is true for how soon the separation-of-powers claim is brought.

Any equities that may be appropriate to weigh were weighed by Congress when it passed the six-year statute of limitations. 28 U.S.C. § 2401. Moreover, Treasury speculation with respect to reliance interests on the Net Worth Sweep and claim that the violation here is "harmless" cannot withstand scrutiny. The Net Worth Sweep has been the subject of ongoing litigation since 2013 and benefited no one other than the federal government at the expense of the Companies' shareholders.

b. Defendants Cannot Escape FHFA's Unconstitutional Structure, And Require Plaintiffs To Show What Would Occur But For That Structure, By Claiming The Net Worth Sweep Was Not Executive Action

FHFA and Treasury argue that vacating the Net Worth Sweep is not proper on the erroneous basis that its implementation "does not implicate the separation of powers." Treasury Resp. 7-10; FHFA Resp. 9-13. This argument is nothing more than an attempt to circumvent the Supreme Court's standing precedents, which Treasury concedes Plaintiffs satisfy,[5] regarding whether separation-of-powers plaintiffs must show that the agency would have taken the same action it did if it were not unconstitutionally structured. The Supreme Court has been clear that plaintiffs need not make this showing. *Free Enterprise*, 561 U.S. at 512 n.12 ("petitioners' standing does not require precise proof of what the Board's policies might have been in that counterfactual world"). *See also Comm. for Monetary Reform*, 766 F.2d at 543; *Collins*, 896 F.3d at 654. The separation of powers in the Constitution, however, are 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).

All parties now agree that FHFA was unconstitutionally structured when it implemented the Net Worth Sweep. This is true regardless of the nature of its actions. In any action it took, as

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[5] *See* Pls.' Opening Br. 29 (collecting Treasury's prior statements).

a regulator, as a conservator, or in any other capacity, it was still controlled by a Director that was unconstitutionally removed from the President's oversight. Defendants cite to no case supporting their claim that an unconstitutionally structured agency becomes constitutionally structured when it takes certain types of actions. *Freytag v. Commissioner*, 501 U.S. 868 (1991), which Treasury accurately describes as holding that officers cannot be officers for some functions and employees for others (as Treasury does, Treasury Resp. 7-8), reveals the general principle that the Constitution's structural safeguards do not depend on formalistic distinctions like those made by Defendants. The Fifth Circuit was thus correct when it stated that "[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.

Nevertheless, even if it were necessary for the Net Worth Sweep to be governmental in nature, it is. Tellingly, with respect to *Jacobs v. FHFA*, 908 F.3d 884 (3d Cir. 2018), neither Defendant grapples with the language emphasized by Plaintiffs in its brief: HERA "gave the Agency not only powers inherited from [the Companies], but also a host of other powers. And the Agency acted within *those* statutory powers." *Id*. at 894 (emphasis added). Pls.' Opening Br. 14-15; FHFA Resp. 11-12; Treasury Resp. 9. It is not the case that the Third Circuit merely acknowledged that the Conservator receive "other powers beyond those inherited from [the Enterprises]," FHFA Resp. 11 (quoting *Jacobs*, 908 F.3d at 894), or only acted "consistent" with those powers, Treasury Resp. 9. The Third Circuit held that FHFA ***exercised*** the powers given to it by Congress and not inherited from the Companies when it implemented the Net Worth Sweep.

Treasury attempts to elide this by claiming that federal authorization to undertake an action does not always make the action governmental. Treasury Resp. 9; *see also* FHFA Resp. 30-31 (making same argument in its nondelegation section). This general proposition, while broadly

true, ignores the context of this case. The power given, and exercised, for the Net Worth Sweep was the ability to further not the Companies' or shareholders' interest but to further "the public interest," acting "in its own best *governmental* interests." *Jacobs*, 908 F.3d at 893 (quoting *Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 608 (D.C. Cir. 2017)) (emphasis added). So even while the transaction may be within FHFA's power to "take over Fannie and Freddie's assets and operate their businesses," including through "renegotiation of an existing lending agreement," FHFA Resp. 11 (quoting *Jacobs*, 908 F.3d at 890), it lacked the power to engage in these activities for anything other than furthering shareholders and the Companies' interest *but for* HERA. HERA repurposed the conservatorship from a device to temporarily manage the Companies to a tool that can be used to further the public's interest—at the expense of the Companies' shareholders—by nationalizing the Companies. This expropriation of property, and disregard for private interests in favor of governmental ones, is quintessential governmental action. *See Slattery v. United States*, 583 F.3d 800, 826-29 (Fed. Cir. 2009). A point made only more apparent by the fact that the Net Worth Sweep would be impossible absent the Director's powers under 12 U.S.C. §§ 4511(b) and 4513(a)(1)(B). *See* Pls.' Opening Br. 15.

Lastly, FHFA makes an obtuse argument that the judgment Plaintiffs seek is "precluded by law." FHFA Resp. 18. It cites no law other than a principle that courts do not make unnecessary rulings, which is an uncontroversial if irrelevant principle here. Vacatur of the Net Worth Sweep is necessary to provide Plaintiffs relief from the harm they have suffered.

II. FHFA Violated The Nondelegation Doctrine When It Imposed The Net Worth Sweep

Neither FHFA nor Treasury disputes that an unconstitutional delegation to a private party has occurred if FHFA exercised governmental power and acted as a private party when it implemented the Net Worth Sweep. FHFA Resp. 30-31; Treasury Resp. 18. Their primary argument is that FHFA did not exercise governmental power, which is fully addressed above and

in prior briefing. *See* Section I.B.C *supra*; Pls.' Opening Br. 13-16, 25-26; FHFA MTD 32-36; FHFA Resp. 3-7, 30-31; Treasury MTD 14-16; Treasury Resp. 7-11, 18.

Regarding the intelligible principle standard, Defendants fail to identify any principle that FHFA *must* take into account in deciding how to exercise its powers as a conservator. FHFA points to 12 U.S.C. § 1455(l) and 12 U.S.C. § 1719(g), FHFA Resp. 31, but neither of these address FHFA's conservatorship powers—both address only when *Treasury* can purchase securities. Treasury points to the D.C. Circuit's statement that the statute "charged FHFA's Director with overseeing the prudential operations of [the GSEs] and ensuring that they operate in a safe and sound manner," Treasury Resp. 18-19 (quoting *Perry Capital*, 864 F.3d at 607), but omits the language immediately prior to its quote stating that HERA does "not compel it in any judicially enforceable sense," *Perry Capital*, 864 F.3d at 607. This is fatal from a nondelegation perspective, which requires a principle to which FHFA "is directed to conform." *Mistretta v. United States*, 488 U.S. 361, 372 (1989). And when a statute only provides what an agency "may" consider, it does not provide what it *must* consider such that it is being directed to conform to that consideration. Thus, it is not the provision of some or even broad discretion that runs afoul of the nondelegation doctrine (as Defendants misconstrue Plaintiffs' argument), but the provision of *unbound* discretion that makes the delegation unlawful. Neither Defendant has identified such constraints on FHFA's exercise of its powers, which makes it an unconstitutional delegation.

III. FHFA Approved The Net Worth Sweep When Its Director Was Acting In Violation Of The Appointments Clause

A. Mr. DeMarco Served As Acting Director For More Than A Limited Time

Defendants do not dispute that an inferior officer can only be charged with the duties of a principal officer for a "*limited time*, and under special and *temporary* conditions." *United States v. Eaton*, 169 U.S. 331, 343 (1898) (emphasis added). Plaintiffs explained in their prior brief the

appropriate bench mark for assessing what constitutes a "limited time" is the Recess Appointments Clause. Pls.' Opening Br. 20-21. FHFA argues that recess appointments are different than inferior officers acting as principal officers because the former "hold" the office while the latter "acts" in the office. FHFA Resp. 25. But FHFA does not explain why this difference is meaningful or supports its position. To the extent the distinction matters, one who "hold[s]" an office pursuant to the Recess Appointments Clause should be permitted to serve for a longer period than one who merely "act[s]" in the office without having gone through either of the procedures the Constitution specifies for appointments of principal officers. FHFA cites an OLC opinion that concluded that the Vacancies Reform Act permits the President to designate a recess appointee whose term has expired to succeed himself in an "acting" capacity. *See* Designation of Acting Solicitor of Labor, 2002 WL 34461082, at *3 (O.L.C. 2002). But that opinion does not address when such a former recess appointee would become a principal officer.

FHFA also argues that acting officials are distinct because Congress sets the duration of their assumption of principal-officer duties by statute. FHFA Resp. 25. But the limitation on how long an inferior officer can assume these duties is derived not from statute, but from the Constitution. *See Eaton*, 169 U.S. at 343. Congress cannot override the Constitution's structural safeguards.[6]

However, if the Court rejects the two-year test, there is consensus that a "reasonable under the circumstances" test would be the appropriate alternative. Neither Defendant proposes any other test; FHFA applies the OLC test discussed by Plaintiffs and Treasury applies a "reasonableness" test similar to the OLC text. FHFA Resp. 28-29; Treasury Resp. 16-17.

[6] Treasury dismisses the Recess Appointment Clause analogy on the basis that there is no precedent supporting it. Treasury Resp. 14. But this is only a consequence of the fact that the length of an acting officer's tenure has rarely been the focal point of Appointments Clause litigation.

Defendants try to make Mr. DeMarco's tenure look reasonable by pointing to the financial crisis (that occurred nearly a year prior to when the vacancy first arose), the Executive's inability to obtain the Senate's approval, and by breaking the duration of that tenure up by attempts to fill the position. None of this, however, can waive away the fact that Mr. DeMarco served for all but eight months of an actual Director's term ostensibly as a "temporary" acting official. *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). Moreover, the only question presented is whether the duration was too long, not (as FHFA principally focuses) on who is to blame for that duration.

Defendants' primary opposition to application of the reasonableness test is that it presents a political question. FHFA Resp. 26-28; Treasury Resp. 15-16. *See also Bhatti v. FHFA*, 332 F. Supp. 3d 1206, 1218-21 (D. Minn. 2018). This argument forgets, however, that the underlying test—that inferior officers can undertake the duties of principal officers for only a "limited time, and under special and temporary conditions," *Eaton*, 169 U.S. at 343—is a test set out by the Supreme Court. Defendants are thus arguing that the Supreme Court set out a test that is judicially unmanageable.

There is no precedent for this. The "Judiciary has a responsibility to decide cases properly before it, even those it would gladly avoid." *Zivotofsky ex rel. Zivotofsky v. Clinton*, 566 U.S. 189, 194 (2012) (quotation and citation omitted). A "political question" arises "where there is a textually demonstrable constitutional commitment of the issue to a coordinate political department; or a lack of judicially discoverable and manageable standards for resolving it." *Id*. at 195. The time frame constituting more than a "limited time" cannot be an issue for which there "textually

demonstrable constitutional commitment" for a "coordinate political department" to decide because the "limited time" standard is a judicially made standard. And there is no basis to argue that the Supreme Court set out a judicially unmanageable standard, particularly when one Justice recently specifically contemplated its application. *SW Gen., Inc.*, 137 S. Ct. at 946 n.1 (Thomas, concurring).

Determining how long is more than a limited time thus is not a political question. To be sure, if the Court believes that *OLC* specified some factors it believes courts cannot readily assess, then the Court can reject them or diminish their import. OLC's views are not binding on this Court. But that does not mean the underlying inquiry must be avoided: the Supreme Court held that inferior officers can assume the duties of principal officers for only a "limited time" such that inferior officers serving for longer than such a time frame must be held to be unlawfully carrying out those responsibilities. For Mr. DeMarco, it is impossible to conceive of his service as acting Director as for a "limited time" 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 SW Gen., Inc.*, 137 S. Ct. at 946 n.1 (Thomas, concurring).

B. Mr. DeMarco Was Unconstitutionally Appointed Without Senate Confirmation When The President Selected Him As Acting Director

Moreover, even if the Court holds that Mr. DeMarco did not serve for more than a limited time or that whether he did is a political question, it should hold that Mr. DeMarco was unconstitutionally appointed because the President *selected* him to serve as the acting director. FHFA's reliance on *Eaton*, FHFA Resp. 23-24 & n.10, is misplaced. There, the statute in question specified that a temporarily absent principal officer (the consul) would by filled in an acting capacity by a specific inferior officer (the vice consul). *Eaton*, 169 U.S. at 336 ("Vice consuls and vice commercial agents shall be deemed to denote consular officers, who shall be substituted,

temporarily, to fill the places of consuls general, consuls or commercial agents, when they shall be temporarily absent or relieved from duty.") (quoting Act of Feb. 1, 1876 § 1674). Here, as in the statute analyzed in *SW General*, the statute does not provide for the automatic assumption of duties by an inferior officer but allows for the President to select among three inferior officers. 12 U.S.C. § 4512(f); *SW General*, 137 S. Ct. at 936. This selection is an appointment because it constitutes the President directing a particular person to undertake the duties of a principal officer. *SW General*, 137 S. Ct. at 945-46 (Thomas, concurring). However, because the statute does not require Senate confirmation of the appointment, any selection made under it violates the Appointments Clause's requirement that appointments receive such confirmation. *Id*.

C. Neither The *De Facto* Officer Doctrine Nor Laches Bars Plaintiffs' Claims Under The Appointments Clause

Beyond the merits arguments, Defendants raise a number of timeliness and procedural arguments. They make the same standing, remedy, and governmental action arguments raised with respect to the separation-of-powers claims (FHFA Resp. 19-20, Treasury Resp. 17-18), and Plaintiffs incorporate their responses here (*see* Section I.B *supra*). FHFA also claims that the reasonableness test is not adequately pled but never responds to Plaintiffs' point that it is appropriately included as an alternative theory to the claim made in Count III. Pls.' Opening Br. 22 n.8; FHFA Resp. 25-26. To the extent amendment is necessary, FHFA points to no prejudice from allowing Plaintiffs to do so.

FHFA, but not Treasury, also argues that relief is barred by the *de facto* officer doctrine. Plaintiffs previously explained that this doctrine applies only to technical defects but not constitutional defects in officers' authority. Pls.' Opening Br. 24-25; *Glidden Co.*, 370 U.S. at 536 (plurality) (doctrine does not apply "when the challenge is based upon nonfrivolous constitutional grounds"). *See also Nguyen*, 539 U.S. at 77; *Ryder v. United States*, 515 U.S. 177, 180 (1995)

(doctrine intended "to protect the public by insuring the orderly functioning of the government despite *technical defects* in title to office.") (emphasis added). Nothing in the recent case from the First Circuit suggests that it considered this argument. *See Aurelius Inv., LLC v. Commonwealth of Puerto Rico*, 915 F.3d 838, 862-63 (1st Cir. 2019). Moreover, Plaintiffs explained—without response from FHFA—that they have satisfied the test for the doctrine as set out by the D.C. Circuit. Pls.' Opening Br. 25.

FHFA relies heavily on the District of Minnesota's decision in *Bhatti v. FHFA*, 332 F. Supp. 3d 1206 (D. Minn. 2018). That court also acknowledged, however, that several Supreme Court cases support the proposition that the *de facto* officer doctrine does not apply to constitutional claims. *Id*. at 1223. *Bhatti* erred in dismissing those cases. Its reliance on *Buckley v. Valeo*, 424 U.S. 1, 142 (1976), is misplaced. In *Ryder*, the Supreme Court expressed doubt about whether *Buckley* had applied the *de facto* officer doctrine in the first place and limited *Buckley*'s remedial holding to its facts. 515 U.S. at 184. Moreover, "in *Buckley*, the constitutional challenge raised by the plaintiffs was decided in their favor, and the declaratory and injunctive relief they sought was awarded to them." *Id*. at 183. Thus, even if the relevant portion of Buckley were still good law, it would not provide a basis for withholding all relief here.

Additionally, the *Bhatti* Court's narrow reading of the cases limiting the doctrine to technical defects as applying only to judicial rulings is incorrect. The Court observed that "[t]he overturning of a lower-court judgment is a routine outcome of judicial review," *Bhatti*, 332 F. Supp. 3d at 1224, but the same could be said for judicial review of administrative decisions like the Net Worth Sweep. Nor do freestanding "concerns of finality and the orderly functioning of government" apply with greater force here than with a challenge to the legal

authority of a judge. *Id*. at 1224 n.8. Indeed, as the doctrine of *res judicata* underscores, finality is of greater importance where judicial rulings are concerned. Yet even in that context, non-technical, and especially constitutional, violations are not protected by the *de facto* officer doctrine "even though the defect was not raised in a timely manner." *Nguyen*, 539 U.S. at 78; *accord Wrenn v. District of Columbia*, 808 F.3d 81, 84 (D.C. Cir. 2015).

Finally, with respect to Treasury's laches argument, the six-year statute of limitations is the complete response. Treasury Resp. 17-18. The Supreme Court has "never applied laches to bar in their entirety claims for discrete wrongs occurring within a federally prescribed limitations period." *Petrella v. MGM, Inc.*, 572 U.S. 663, 680 (2014); *see also SCA Hygiene Prods. Aktiebolag v. First Quality Baby Prods., LLC*, 137 S. Ct. 954, 961 (2017). It was "inherently reasonable" for Plaintiffs to sue within the period that Congress specified, *Grant v. Swarthout*, 862 F.3d 914, 919 (9th Cir. 2017), and that is so "regardless of the remedy sought," *Lyons Partnership, L.P. v. Morris Costumes, Inc.*, 243 F.3d 789, 798 (4th Cir. 2001).

Moreover, "[t]he elements of the equitable defense of laches are '(1) lack of diligence by the party against whom the defense is asserted, and (2) prejudice to the party asserting the defense.'" *E.E.O.C. v. Great Atl. & Pac. Tea Co.*, 735 F.2d 69, 80 (3d Cir. 1984) (quoting *Costello v. United States*, 365 U.S. 265, 282 (1961)). Plaintiffs did not act unreasonably in suing within the statute of limitations. And, as explained above, Treasury's suggestion that third-party reliance interests have built up around an action that benefited no one but the federal government and has been the subject of active litigation since 2013 cannot withstand serious scrutiny. It will suffer no undue prejudice from the invalidation of the Net Worth Sweep.

IV. Treasury Is An Appropriate Defendant

In arguing that the claims against it should be dismissed, Treasury does not dispute that it was an integral part of implementing the Net Worth Sweep or that the relief sought by Plaintiffs

requires Treasury being a party to this case. Treasury Resp. 19-20; Pls.' Opening Br. 37-39. Treasury also does not contend that it is something other than a necessary party. And nor could it. *Fiscus v. Combus Fin. AG*, No. 03-cv-1328, 2007 WL 4164388, at *5 (D.N.J. Nov. 20, 2007) (collecting cases for the proposition that "[t]here is substantial case law to support the proposition that a contracting party is the paradigm of an indispensable party") (citations omitted). Moreover, as a relevant agency needed for relief, Treasury is appropriately named as a defendant. *See Juliana v. United States,* 339 F. Supp. 3d 1062 (D. Or. 2018); *CASA de Md., Inc. v. Trump*, No. GJH-18-845, 2018 WL 6192367 (D. Md. Nov. 28, 2018). Alternatively, at minimum, Treasury is a necessary party to this case, and if it were determined later that it were more appropriately described as a necessary party rather than a defendant, such change could be easily accomplished through amendment at a later stage.

CONCLUSION

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

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 15th day of March 2019, a true and correct copy of Plaintiffs' Reply in Support of Motion for Summary Judgment was 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.

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