IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

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

PLAINTIFFS' SUPPLEMENTAL MEMORANDUM OF LAW

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Pursuant to this Court's Order dated October 2, 2019, Plaintiffs respectfully submit this supplemental memorandum of law addressing the effect and application of the recent decision of the United States Court of Appeals for the Fifth Circuit in the matter of *Collins v. Mnuchin*, 938 F.3d 553 (5th Cir. 2019) ("Opinion"). We attach as Exhibit A to this submission a true and correct copy of the Fifth Circuit's *en banc* Opinion for ease of reference.

INTRODUCTION

As set forth in Section I below, Plaintiffs respectfully submit that this Court should follow the Fifth Circuit's holding that the FHFA is unconstitutionally structured. By a vote of 12-4, the Fifth Circuit *en banc* Opinion in *Collins* correctly held that the FHFA is unconstitutionally structured because it vests full authority in a single Director who cannot be removed from office by the President, other than "for cause." The *en banc* Fifth Circuit's reasoning and holding in this regard can be found at *Collins*, 938 F.3d at 587-591 (this opinion also reinstates the original panel decision, as explained in Section I(E) below).[1] Plaintiffs agree with the reasoning and holding set forth in this portion of the Opinion (and the reinstated portion of the original panel decision), and respectfully submit that this Court should hold likewise.

A different majority of the Fifth Circuit held that the only remedy Plaintiffs could obtain based on that constitutional violation was to strike the "for cause" clause from the provision governing the removal of the FHFA's Director from office. *Id.* at 591-595. Plaintiffs do not agree with this portion of the Opinion. Instead, as set forth in Section II below, Plaintiffs respectfully submit that the Court should follow the dissenting opinion (*id.* at 626-629) (authored by Judge Willett and joined by six other judges) and hold that when an unconstitutional agency takes action

[1] That portion of the Opinion was joined by nine judges, but Judges Southwick, Haynes, and Graves concurred solely in the conclusion that the FHFA "is unconstitutionally structured." *Id.* at 591 n.1. The dissenting views on this constitutional law issue can be found at *id.* 614-629.

that harms the plaintiff, the proper remedy is to vacate that agency action. In this case, that means vacating the FHFA's agreement to the Third Amendment to Treasury's Senior Preferred Stock Purchase Agreement—i.e., the "Net Worth Sweep."

We note that on September 25, 2019, the plaintiffs in *Collins* filed a petition for certiorari with the Supreme Court, asking it to review both the constitutional question and the remedy question. *See* Petition for Writ of Certiorari at i, *Collins v. Mnuchin,* No. 19-422 (U.S. Sept. 25, 2019).

We also note that the Supreme Court recently granted certiorari in a case that presents the question of whether the Consumer Financial Protection Bureau ("CFPB") is unconstitutionally structured because, like the FHFA, it is governed by a single Director who cannot be removed at will by the President. *See Seila Law LLC v. Consumer Fin. Prot. Bureau*, No. 19-7, 2019 WL 5281290 (U.S. Oct. 18, 2019). In *Seila*, the questions presented are whether the CFPB is unconstitutionally structured and, if it is, whether 12 U.S.C. § 5491(c)(3) can be severed from the Dodd-Frank Act; it does not present a question as to what the proper remedy should be when a plaintiff is injured by a final agency action taken by an agency that is unconstitutionally structured. Petition for Writ of Certiorari at I, *Seila Law LLC v. Consumer Fin. Prot. Bureau* (U.S. June 28, 2019).[2]

Thus, the Supreme Court will be addressing the issue of the constitutionality of "independent" agencies structured with a sole Director who can be removed by the President only "for cause"—in the CFPB case, the statute authorizes removal only for "inefficiency, neglect of

[2] In *Seila*, as in *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010) discussed below, there was no CFPB action that had become final against the plaintiff and therefore no need to address the issue of vacating that action. *Consumer Fin. Prot. Bureau v. Seila Law LLC*, 923 F.3d 680 (9th Cir. 2019), cert. granted sub nom. *Seila Law LLC*, 2019 WL 5281290 . Instead, the *Seila* plaintiffs were challenging a CFPB petition to enforce a civil investigative demand (CID). *Id*. at 682.

duty, or malfeasance in office." The Supreme Court's resolution of that question may well control the issue of whether the FHFA is unconstitutionally structured. But unless and until the Supreme Court grants the certiorari petition in the *Collins* case, it is not clear whether the Supreme Court will be addressing the question of what backward-looking remedy flows from a finding of such unconstitutionality. We therefore respectfully submit that the Court should proceed to decide the issues pending before it, rather than staying this matter pending Supreme Court decisions.

I. THIS COURT SHOULD FOLLOW THE FIFTH CIRCUIT'S CORRECT HOLDING THAT THE FHFA IS UNCONSTITUTIONAL

The Fifth Circuit held that the FHFA is unconstitutional because Congress insulated the Director of the FHFA from Presidential removal with a "for cause" provision. As the Fifth Circuit correctly held, the Supreme Court has permitted this insulation from Presidential removal power only where the independent agency is governed by multiple members who provide a check and balance against one another's control of the agency. *Collins,* 938 F.3d at 587. Where Congress vests the entire power of an independent agency in the hands of a single director, and protects that director from removal by the President, the agency is unconstitutional. *Id.* at 587-588. This Court should adopt that holding, which garnered the votes of twelve of the sixteen judges in the *en banc* Fifth Circuit decision. *Id.* at 587-591, n.1.

In reaching this conclusion, the Fifth Circuit rejected the arguments Defendants have advanced in this case. We briefly summarize its holdings on each such issue below.

A. This Court Should Follow The Fifth Circuit's Correct Holding That Plaintiffs Who Own Stock In Fannie Mae Or Freddie Mac Have Standing To Challenge The FHFA's Unconstitutional Structure

In this case, the FHFA has argued that under HERA plaintiffs do not have standing to challenge the constitutionality of FHFA's structure. FHFA Defendants' Memorandum of Law in Opposition to Plaintiffs' Motion for Summary Judgment and Reply Memorandum in Support of

Dismissal at 3-9 (ECF 31). The Fifth Circuit directly rejected this argument in *Collins*. 938 F.3d at 585-587.

As in this case, the plaintiffs in *Collins* are shareholders who "own shares in Fannie Mae and Freddie Mac." *Compare id*. 562 *with* Plaintiffs' Class Action Complaint at 1 (ECF No. 1). As in this case, those shareholder-plaintiffs were injured by the FHFA's agreeing with the United States Treasury to enter into the Third Amendment to the Treasury's Senior Preferred Stock Purchase Agreements ("PSPAs"). Under the Third Amendment, Fannie Mae and Freddie Mac must pay 100% of their net worth to Treasury each quarter, minus a small reserve that was set to shrink to zero in 2018 (and then was modified to stay at $3 billion, which amount was also promised to Treasury through another agreement). ECF No. 1 (Complaint) at 19-20.

The Fifth Circuit held that "[t]he Shareholders suffered injury in fact." *Collins,* 938 F.3d at 586. As the Fifth Circuit recognized, "The required injury to challenge agency action is minimal." *Id.* Under the facts of these cases, the Fifth Circuit correctly found that "pumping large profits to Treasury instead of restoring the GSEs' capital structure is an injury in fact." *Id.*

The Fifth Circuit specifically rejected the FHFA argument that was emphasized in its submissions to this court: "that a President-controlled FHFA would have adopted the net worth sweep." *Id.*; *compare* ECF No. 31 at 35. The Fifth Circuit held that "standing does not require proof that an officer would have acted differently in the 'counterfactual world' where he was properly authorized." 938 F.3d at 586 (citing *Free Enter. Fund*, 561 U.S. at 512 n.12). That is because, as the Supreme Court held in the *Free Enterprise Fund* case, "the separation of powers does not depend on the views of individual Presidents, nor on whether 'the encroached-upon branch approves the encroachment.'" *Id*. (quoting *Free Enter. Fund* at 497). *See also id.* (quoting *Bowsher v. Synar*, 478 U.S. 714, 730 (1986)) ("The separated powers of our Government cannot

be permitted to turn on judicial assessment of whether an officer exercising executive power is likely to be fired"); *id.* at n.224 ("There is certainly no rule that a party claiming constitutional error in the vesting of authority must show a direct causal link between the error and the authority's adverse decision") (quoting *Landry v. FDIC*, 204 F.3d 1125, 1131 (D.C. Cir. 2000)).

B. This Court Should Follow The Fifth Circuit's Correct Holding That HERA's Succession Provision Does Not Bar Shareholders' Claims

As in this case, the defendants in *Collins* argued that the "succession" clause in HERA barred the plaintiffs from bringing their constitutional challenge.[3] The Fifth Circuit correctly rejected that argument. 938 F.3d at 587.

First, it correctly held that "[a] plaintiff with Article III standing can maintain a direct claim against the government action that violates the separation of powers." *Id.* (citing *Free Enter. Fund*, 561 U.S. at 487-91). In other words, Article III standing is sufficient to bring a separation-of-powers constitutional claim, and therefore the prudential concerns relating to the shareholder standing rule do not apply to such claims. The Fifth Circuit also cited to the Supreme Court's decision in *Bond v. United States*, 564 U.S. 211, 223 (2011), which "collected numerous separation-of-powers cases litigated by individuals with an otherwise-justicable case or controversy." *Collins,* 938 F.3d at 587.

Second, the Fifth Circuit held that "where Congress intends to preclude judicial review of constitutional claims its intent to do so must be clear." *Id*. (quoting *Webster v. Doe*, 486 U.S. 592, 603 (1988)). The Fifth Circuit correctly held that the succession provision did not meet this "heightened showing" that judicial review of a constitutional claim was intended to be precluded by HERA.

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[3] HERA's succession provision, found at 12 U.S.C. § 4617(b)(2)(A), provides that FHFA as conservator generally succeeds to the rights of the regulated entities and its shareholders "with respect to the regulated entity and the assets of the regulated entity."

C. This Court Should Follow The Fifth Circuit's Correct Holding That It Is Irrelevant To Plaintiffs' Standing That The Third Amendment Was Agreed To By An Acting Director

As it has in this case, FHFA argued in *Collins* that plaintiffs could not bring their constitutional challenge because when FHFA agreed to the Third Amendment, FHFA was governed by an "Acting" Director, who (FHFA claims) is not subject to the limited removal provisions of a normally appointed Director. *Compare Collins,* 938 F.3d at 588-589 *with* ECF No. 31 at 6-7. The Fifth Circuit correctly rejected this argument, holding that HERA "unequivocally" says that it is creating an "independent" agency, and that both "history and Supreme Court precedent" make clear that "Presidential removal is the 'sharp line of cleavage' between independent agencies and executive ones." *Collins,* 938 F.3d at 589. Thus, the Fifth Circuit held that "[t]he removal restriction applied to the acting Director." *Id.* This Court should follow this analysis, and should reject the argument that FHFA is able to dodge constitutional scrutiny because it happened to have agreed to the Third Amendment while an "Acting" Director was in charge.

D. This Court Should Follow The Fifth Circuit's Correct Holding That The FHFA Was Exercising Governmental Power When It Agreed To The Net Worth Sweep

In this case, the Treasury has argued that the FHFA was acting solely as a conservator when it agreed to the Third Amendment, and therefore was not exercising any Executive power in a manner that could trigger separation of powers concerns. Memorandum in Opposition to Plaintiffs' Motion for Summary Judgment and in Support of Treasury's Motion to Dismiss at 7-11 (ECF No. 29). The Treasury made the same argument in *Collins*, and the Fifth Circuit correctly rejected it. *Collins,* 938 F.3d at 589-591.

The Fifth Circuit held that "[w]hether an agency exercises government power as conservator or receiver 'depends on the context of the claim.'" *Id.* at 590 (citing and quoting *Slattery v. United States*, 583 F.3d 800, 827 (Fed. Cir. 2009)). In *Slattery,* the Federal Circuit held

that even though the FDIC was acting as a receiver when it retained a surplus from the seized bank's assets, it was exercising the power of the United States—and therefore the shareholders could bring claims against the United States based on that conduct. *Id.* The Fifth Circuit correctly held that the Third Amendment (and particularly its Net Worth Sweep) is more similar to the conduct at issue in *Slattery* than in the case cited by Treasury (*United States v. Beszborn*, 21 F.3d 62 (5th Cir. 1994)). Because the Third Amendment "transferred the wards' assets to the government," and was implemented by the FHFA, "a federal agency, empowered by a federal statute, enriching the federal government," it represented an exercise of the power of the federal government, and therefore is subject to challenge on separation of powers grounds. *Collins,* 938 F.3d at 590.

E. This Court Should Follow The Fifth Circuit's Correct Holding That HERA Violated The Constitution By Creating A Single-Director "Independent" Agency

The Fifth Circuit reinstated Part II(B)(2) of the panel decision holding that the FHFA's structure is unconstitutional. *Id.* at 588 (reinstating opinion found at *Collins v. Mnuchin*, 896 F.3d 640, 659-75 (5th Cir. 2018)). That decision sets forth in detail the authorities supporting Plaintiffs' position here, and we respectfully submit that this Court should adopt and follow it.

The original panel decision analyzes at length the extent to which Supreme Court precedent permits Congress to create so-called "independent" agencies that are insulated, to some degree, from Presidential oversight and control. *Collins,* 896 F.3d at 659-75. As shown in that opinion, separation of powers is central to the Constitution's overall design and structure. *See id.* at 659 ("when one branch tries to impair the power of another, this upsets the co-equality of the branches and degrades the Constitution's deliberate separation of powers. Accordingly, the Supreme Court 'has not hesitated to strike down provisions of law that *either* accrete to a single Branch powers more appropriately diffused among separate Branches *or* that undermine the authority and

independence of one or another coordinate Branch.'") (quoting *Mistretta v. United States*, 488 U.S. 361, 381 (1989)). For this reason, when Congress creates a so-called "independent" agency that is designed to be insulated to some degree from Presidential oversight and control, a serious separation of powers concern necessarily arises. As the Fifth Circuit explained:

> The President's oversight role originates in Article II. The Constitution vests the 'executive Power' in the President and obligates him to 'take Care that the Laws be faithfully executed.' Independent agencies are staffed by subordinate executive officers, so the President bears the ultimate responsibility for overseeing those officials. Accordingly, '[s]ince 1789, the Constitution has been understood to empower the President to keep these officers accountable—by removing them from office, if necessary.' The President cannot shirk this oversight obligation: 'Abdication of responsibility is not part of the constitutional design.'
>
> If an independent agency is *too* insulated from Executive Branch oversight, the separation of powers suffers. First, excessive insulation impairs the President's ability to fulfill his Article II oversight obligations. By limiting his ability to oversee subordinates, Congress weakens the President's ability to fulfill his 'constitutionally assigned duties, and thus undermines . . . the balance of constitutionally prescribed power among the branches.'

Id. at 661 (quoting U.S. Const. art. II § 1, cl. 1; § 3; *Free Enter. Fund*, 561 U.S. at 483; *Clinton v. City of New York*, 524 U.S. 417, 452 (1998) (Kennedy, J., concurring); Martin H. Redish & Elizabeth J. Cisar, *"If Angels Were to Govern": The Need for Pragmatic Formalism in Separation of Powers Theory*, 41 Duke L.J. 449, 501 (1991)).

In light of these separation of powers concerns, "agencies may be independent, but they may not be isolated." *Id.* at 662.

After a careful review of Supreme Court precedent applying the foregoing separation of powers principles, the Fifth Circuit held that the FHFA was unconstitutionally insulated from Presidential oversight. The Fifth Circuit based that conclusion on "the combined effect of the: (1) for-cause removal restriction; (2) single-Director leadership structure; (3) lack of a bipartisan

leadership composition requirement; (4) funding stream outside the normal appropriations process; and (5) Federal Housing Finance Oversight Board's purely advisory oversight role." *Id* at 666.

The *en banc* Fifth Circuit summarized this ultimate conclusion by holding that the FHFA "does not fit within the recognized exception for independent agencies" which, as established in *Humphrey's Executor v. United States*, 295 U.S. 602, 628-32 (1935), "has applied only to multi-member bodies of experts." *Collins,* 938 F.3d at 587. The *en banc* court continued: "A single director lacks the checks inherent in multilateral decision making and is more difficult for the President to influence." *Id.* at 587-588. The Court went on to reject distinctions argued by the dissenting judges that would have upheld the "for cause" provision as constitutional. *Id.*

We reiterate that twelve of the sixteen judges on the Fifth Circuit reached the conclusion that the FHFA is unconstitutional. Indeed, the Treasury department itself has agreed with that conclusion, as did the FHFA during the initial part of this litigation. *See* Memorandum in Support of Motion to Dismiss by the U.S. Dept. of Treasury at 17-19 (ECF No. 15-1); FHFA Defendant's Memorandum of Law in Opposition to Plaintiffs' Motion for Summary Judgment and Reply Memorandum in Support of Dismissal at 1 (ECF No. 31); and FHFA Defendants' Notice of Change in Position (ECF No. 35). This Court should adopt the same conclusion.

II. THIS COURT SHOULD FOLLOW THE DISSENTING VIEWS OF THE SEVEN FIFTH CIRCUIT JUDGES WHO HELD THAT THE PROPER REMEDY IS TO VACATE THE NET WORTH SWEEP

Of the twelve judges who concluded that the FHFA is unconstitutionally structured, a majority of seven held that the appropriate remedy was to vacate the Net Worth Sweep that was adopted by the unconstitutional FHFA and that caused injury to the *Collins* plaintiffs (just as it did to the shareholder-plaintiffs here). *Collins,* 938 F.3d at 626-629. By contrast, of the nine judges who rejected that remedy, four had rejected the conclusion of unconstitutionality in the first place, and therefore were obviously inclined to opt for the narrowest remedy possible. *Compare id.* at

591-595 (majority holding on remedy for constitutional law violation joined by Judges Stewart, Dennis, Higginson, and Costa) *with id*. at 614-626 (dissents on merits of constitutional law violation joined by same four judges). Thus, there is some cause for viewing the decision on the remedy as a much closer decision than the core constitutional law question, and the dissenting views of seven judges on the remedy question as carrying considerable persuasive weight.

In any event, we respectfully submit that the views articulated in Judge Willett's dissenting opinion on the remedy (joined by six other judges) are correct, and for those reasons this Court should vacate the Net Worth Sweep. *Id.* at 626-629.

As Judge Willett's opinion recognized, the specific question presented is controlled by the Supreme Court's decision in *Bowsher v. Synar*, 478 U.S. 714 (1986). In *Bowsher*, the Supreme Court addressed provisions of the Gramm-Rudman-Hollings Act that provided for the Comptroller General to release an annual budget report, which the President was then required to implement by ordering sequestration of specified funds in the federal budget. After President Reagan complied with this requirement on February 1, 1986, a union whose retired members stood to lose cost-of-living adjustments to their pensions brought suit and argued that the law was unconstitutional because the Comptroller General was removable from office by Congress, not by the President. A three-judge district court ruled in favor of the union, and, in addition to nullifying the statute prospectively, declared the prior Presidential sequestration order issued pursuant to the unconstitutional regime (which injured the union and its members) to be "without legal force and effect." *Synar v. United States*, 626 F. Supp. 1374, 1404 (D.D.C. 1986). The Supreme Court affirmed that remedy, holding that "the judgment and order of the District Court are affirmed." *Bowsher*, 478 U.S. at 736.

The Fifth Circuit's seven dissenting judges correctly recognized that *Bowsher* "is the only Supreme Court case that presented the issue" presented in *Collins* (and in this case). Specifically, it is the only Supreme Court case where a plaintiff brought suit to vacate a prior action taken by an official who was given power by Congress that was declared unconstitutional because it violated the President's removal power (i.e., the President's power to remove officials working for the Executive branch). As Judge Willett's opinion explains, "an unconstitutionally-insulated officer may not exercise executive power." *Collins,* 938 F.3d at 627. Accordingly, action taken by such an "unconstitutionally-insulated officer" must be set aside as invalid. *Id*.

The defendants have argued that the Supreme Court gave conflicting guidance in its decision in *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010), but that is not correct. As Judge Willett explained, "no Board action had become final against the plaintiff" in that case. *Collins,* 938 F.3d at 627. Instead, "the plaintiff had standing for prospective relief" because the PCAOB had the power to regulate the plaintiff, an accounting firm. *Id.* Thus, in *Free Enterprise Fund*, a prospective remedy based on excising specific provisions of the statute gave the plaintiff complete relief. The issue of vacating a prior action causing injury to the plaintiff was not presented. *Id.*

Judge Willett further explained that vacatur of past action is called for by the numerous cases invalidating past actions taken by officials whose appointments violated the Appointments Clause. After all, unconstitutional insulation from removal is the flip side of an unconstitutional appointment. In both cases, an official is unconstitutionally given power, and therefore the exercise of that power that injures a plaintiff must be invalidated.

> Unconstitutional protection from removal, like unconstitutional appointment, is a defect in authority. Appointments Clause decisions routinely set aside agency action. In *Lucia v. SEC*, the [Supreme] Court held that administrative law judges must be appointed by a 'head of department,' not by staff. As remedy, the Court granted a new hearing before a different ALJ. It disapproved curing the defective appointment by a quick (already-issued) ratification of the ALJ's

> appointment. Similarly, in *NLRB v. Canning*, the Court held that three NLRB Members were unconstitutionally appointed without Senate advice and consent. It affirmed the Court of Appeals's decision that the NLRB order, issued without a properly-appointed quorum, was 'invalid.'
>
> These cases are apt because there, as here, a **defect in authority made agency action unlawful.**

Id. at 627 (emphasis added) (footnotes and citations omitted).

Judge Willett also persuasively rejected Treasury's argument that vacatur is subject to equitable discretion that should not be exercised here. *Id*. at 628-629. He further recognized, however, that setting aside agency action is "an equitable remedy," and that "[w]hen a contract is rescinded, restitution is generally in order . . . ." *Id*. at 629. For that reason, he "would recognize the district court's authority, on remand, to decide the parties' rights and duties to restore their rightful position." *Id.* In other words, the district court has the authority to order that the excess dividends paid to Treasury under the Third Amendment be returned and/or treated as a redemption of Treasury's liquidation preference, steps that would be needed to remedy the injury suffered by shareholder-plaintiffs.

Judge Willett's dissenting opinion on the remedy issue, joined by six other Fifth Circuit judges, applies with full force here, and should be adopted.

CONCLUSION

For the foregoing reasons, the decision by the *en banc* Fifth Circuit in *Collins* supports granting Plaintiffs' motion for summary judgment, declaring the FHFA to be unconstitutionally structured, vacating and enjoining the Third Amendment as "rescinded," and ordering restitution in the form of a return of all excess dividends paid to Treasury pursuant to the Third Amendment.

Dated: October 23, 2019

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on October 23, 2019, a true and correct copy of the foregoing Plaintiffs' Supplemental Memorandum of Law was electronically filed and is available for viewing and downloading from the Court's CM/ECF system which will send notification of such filing to all counsel of record.

/s/ Eric L. Zagar
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