

**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.

Civil Action No. 2:18-cv-3478-NIQA

SUPPLEMENTAL MEMORANDUM OF LAW

On October 2, 2019, the Court ordered the parties to file a “supplemental memorandum of law addressing the effect and application, if any, of the recent decision of the United States Court of Appeals for the Fifth Circuit in the matter of *Collins v. Mnuchin*, No. 17-20364, 2019 WL 4233612 (5th Cir. Sept. 6, 2019) (en banc), to Plaintiffs’ claims and the parties’ pending motions in this matter.” ECF No. 38 (“October 2 Order”). Defendant the United States Department of the Treasury (“Treasury”) respectfully submits the following memorandum in response to the Court’s October 2 Order.

Background

As Treasury has explained, this is one of many cases brought by shareholders of the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively, the “GSEs”) and aimed at undoing the “Third Amendment” to preferred stock purchase agreements between Treasury and the Federal Housing Finance Agency (“FHFA”), acting as conservator for the GSEs. The first wave challenged the Third Amendment directly, arguing, among other things, that Treasury and FHFA violated the

Housing and Economic Recovery Act of 2008 (“HERA”) and the Administrative Procedure Act (“APA”) when they agreed to the Third Amendment. With the exception of *Collins*, discussed below, all were unsuccessful. See *Jacobs v. FHFA*, 908 F.3d 884 (3d Cir. 2018); *Saxton v. FHFA*, 901 F.3d 954 (8th Cir. 2018); *Roberts v. FHFA*, 889 F.3d 397 (7th Cir. 2018); *Perry Capital LLC v. Mnuchin*, 864 F.3d 591 (D.C. Cir. 2017); *Robinson v. FHFA*, 876 F.3d 220 (6th Cir. 2017). The second wave of lawsuits challenge the Third Amendment collaterally through constitutional challenges to various aspects of FHFA’s structure and authority. This case falls squarely in this second wave; along with a case that is currently pending in the Western District of Michigan, see *Rop v. FHFA*, 17-cv-497 (W.D. Mich. 2017); and a case that was recently argued before the Eighth Circuit following dismissal by a district court in Minnesota, see *Bhatti v. FHFA*, 332 F. Supp. 3d 1206 (D. Minn. 2018), *appeal argued*, No. 18-2506 (8th Cir. Oct. 15, 2019).

The *Collins* lawsuit is a hybrid, asserting both (1) direct statutory challenges to the Third Amendment and (2) a constitutional claim based on the contention that HERA violates the separation of powers to the extent that it provides for FHFA to be headed by a single Director, removable only for cause. See, e.g., *Collins v. FHFA*, 254 F. Supp. 3d 841, 845-47 (S.D. Tex. 2017). The *Collins* plaintiffs did not assert, as Plaintiffs do here, claims based on the Appointments Clause, Compl. ¶¶ 93-98 (Count III), ECF No. 1, or the nondelegation doctrines, *id.* ¶¶ 99-110 (Counts IV and V). And the instant Plaintiffs do not assert, as the *Collins* plaintiffs did, APA claims contending that, in adopting the Third Amendment, FHFA and Treasury exceeded their statutory authority under HERA or that Treasury acted arbitrarily and capriciously.

The Collins Decision

The district court in *Collins* ruled against the plaintiffs on both their statutory and constitutional claims. A divided Fifth Circuit panel affirmed the district court’s holding with

respect to the statutory claims, but concluded that FHFA was unconstitutionally structured. *Collins v. Mnuchin*, 896 F.3d 640, 652-53, 659-75 (5th Cir. 2018). It determined, however, that the appropriate remedy for such violation was to sever HERA’s for-cause removal provision, and it thus chose to “leave intact the remainder of HERA and FHFA’s past actions—including the Third Amendment.” *Id.* at 676.

The Fifth Circuit reheard the case *en banc* and issued a decision on September 6, 2019. *Collins v. Mnuchin*, 938 F.3d 553 (5th Cir. 2019). It agreed with the panel on the constitutional question and reinstated the part of the panel opinion holding FHFA’s structure unconstitutional. *Id.* at 587-88 (“HERA’s for-cause removal protection infringes Article II. It limits the President’s removal power and does not fit within the recognized exception for independent agencies.”). The court also agreed with the panel that the remedy for this constitutional violation did not include invalidation of prior agency actions, such as the Third Amendment. In rejecting many of the same arguments that Plaintiffs raise here, the Fifth Circuit concluded that it would be inequitable to set aside the Third Amendment based on FHFA’s unconstitutional removal provision where (1) the President nevertheless retained full oversight through his control over Treasury (the Amendment’s counter-party), and (2) the plaintiffs’ theory would invalidate all FHFA actions but they had cherry-picked only those that did not benefit them in hindsight. *Id.* at 592-95. The court stated that it would “not let the Shareholders pick and choose parts of the PSPAs to invalidate when the President had adequate oversight over their adoption and particularly when two different presidents have selected agency heads who have supported the [Third Amendment].” *Id.* at 595.¹

¹ On the other hand, the Fifth Circuit reversed the district court with respect to the statutory claim against FHFA, concluding, contrary to the decisions of the five other courts of appeals to address the issue, that the plaintiffs had stated a plausible claim that FHFA exceeded its statutory conservator powers in executing the Third Amendment. *Collins*, 938 F.3d at 569-85.

Application to this Litigation

The Court requested that the parties address the “effect and application, if any,” of the *Collins* decision on this litigation. October 2 Order at 1. Treasury respectfully submits that its views on this issue are set forth in its September 27, 2019 notice of supplemental authority. ECF No. 37. As a decision of the Fifth Circuit, *Collins* is not binding on this Court and should thus be followed only to the extent it has persuasive value. While Treasury agrees that the FHFA Director’s removal restriction is unconstitutional, it also submits that the Fifth Circuit should not have reached that question. The court erred in holding that shareholders could bring their claim notwithstanding HERA’s shareholder succession clause, because neither the APA nor the Constitution implicitly displace the traditional rule that shareholders may not directly sue for injuries to their corporation. *See* Mem. in Supp. of Treasury’s Mot. to Dismiss at 8-13, ECF No. 15-1; *see also id.* at 13-16 (arguing that Plaintiffs’ constitutional claim is also not presented because, *inter alia*, FHFA is not a governmental actor when acting as conservator). The Fifth Circuit’s reasoning for nonetheless determining that the shareholder plaintiffs stated direct claims and that FHFA wielded executive authority in adopting the Third Amendment is unconvincing, and this Court should not follow it.

The Fifth Circuit was correct, on the other hand, in concluding that the appropriate remedy for the constitutional violation it identified was to sever the removal provision, not, as Plaintiffs contend, to set aside the Third Amendment. Treasury submits that if, contrary to Treasury’s arguments, the Court determines to reach the question of the constitutionality of the FHFA Director’s removal restriction, it should follow the reasoning of *Collins* and decline to set aside the Third Amendment.

It is also worth noting, in assessing what effect to accord *Collins*, that the plaintiffs in that

case filed a petition for a writ of *certiorari* on September 25, 2019. *See Collins v. Mnuchin*, Supreme Court Docket No. 19-422 (filed Sept. 25, 2019). In that petition, the plaintiffs seek Supreme Court review of the Fifth Circuit's constitutional conclusions, specifically (1) whether FHFA's structure violates the separation of powers; and (2) whether the Third Amendment must be set aside based on the constitutional violation the Fifth Circuit identified. *Id.* The Government's response to plaintiff's petition is due on October 30, and the Solicitor General is considering whether to file a petition for writ of *certiorari* with respect to the Fifth Circuit's statutory holdings. Treasury will file a notice updating the Court of any developments regarding potential Supreme Court review of *Collins*.

Conclusion

For the reasons stated in Treasury's briefs, the Court should dismiss Plaintiffs' complaint and, for those reasons and those noted above, should decline to set aside the Third Amendment in any event.

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 document 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.

/s/ R. Charlie Merritt

R. CHARLIE MERRITT