No. 17-20364

In the United States Court of Appeals for the Fifth Circuit

PATRICK J. COLLINS; MARCUS J. LIOTTA;
WILLIAM M. HITCHCOCK,
Plaintiffs-Appellants

v.

JANET YELLEN, SECRETARY, U.S. DEPARTMENT OF TREASURY;
DEPARTMENT OF THE TREASURY; FEDERAL HOUSING FINANCE AGENCY;
SANDRA L. THOMPSON, ACTING DIRECTOR OF THE FEDERAL HOUSING FINANCE AGENCY,
Defendants-Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS, No. 4:16-cv-03113

SUPPLEMENTAL REPLY BRIEF OF PLAINTIFFS-APPELLANTS

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CERTIFICATE OF INTERESTED PERSONS

Patrick J. Collins, et al. v. Janet Yellen, et al., No. 17-20364

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of 5th Circuit Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

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Attorneys whose names are denoted with a single asterisk entered appearances in the district court but have not entered appearances in the Fifth Circuit. Attorneys whose names are denoted with two asterisks appeared on some of the briefs Defendants previously filed in this Court but are no longer employed by the Department of Justice. Attorneys whose names are denoted with three asterisks appeared on the briefs for the Defendants in the Supreme Court but have not entered appearances in this Court.

Plaintiffs originally named Jacob J. Lew in his official capacity as Secretary of the Treasury as a defendant in this case. Secretary Steven T. Mnuchin was substituted for Secretary Lew pursuant to Federal Rule of Civil Procedure 25(d), and Secretary Mnuchin has since been succeeded by Secretary Yellen. While this appeal was pending, Joseph M. Otting was substituted by Mark A. Calabria. Later, Director Calabria was removed by the President and succeeded by Acting FHFA Director Sandra Thompson. In addition to the named parties listed above, all Fannie Mae and Freddie Mac shareholders have a financial interest in the outcome of this case.

Dated: September 8, 2021

/s/ Charles J. Cooper
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ARGUMENT

Large portions of Defendants' supplemental briefs attack a straw man. Plaintiffs' contention is not that President Trump "desired a swift end to the Third Amendment" for its own sake, Treas. Br. 5, but that his Administration actively pursued housing finance reform plans that could not have been completed without changes to the Companies' capital structures that would have benefitted the private shareholders. Despite Defendants' attempts at misdirection, the public record is clear that President Trump would have fired Director Watt but for his for-cause removal protection, and Plaintiffs are thus entitled to a remedy under the Supreme Court's decision. The appropriate remedy is to order Defendants to do what would have been done absent the constitutional violation.

I. Plaintiffs were prejudiced by the unconstitutional statutory restriction on President Trump's authority to fire Director Watt.

A. The only statement from the Trump White House cited in any of the supplemental briefs instructs Treasury to develop a plan for "[e]nding the conservatorships" of Fannie and Freddie. 84 Fed. Reg. 12479 (Mar. 27, 2019). That is what Steven Mnuchin said he wanted to do during his first interview after being nominated to serve as President Trump's Treasury Secretary, *see Mnuchin: Get Fannie Mae, Freddie Mac out of government ownership*, FOX BUSINESS NEWS, at 00:06 to 00:16 (Nov. 30, 2016), https://bit.ly/3iKDZUc, and it is hardly surprising

that a Republican administration did not look with favor upon permanent government control of two of the country's most important financial institutions.

The question, then, is what if anything more the Trump Administration would have done in furtherance of its objective of ending the conservatorships had it been acknowledged from the start that President Trump controlled FHFA. To answer that question, it is necessary to recognize a fundamental problem the Administration faced: despite having recently reported the largest profits in their history, the Companies had no capital because all of it had been paid to Treasury as "dividends" under the Net Worth Sweep. *See* ROA.77. The Companies obviously could not be released from conservatorship while they were in this perilous position.

Director Calabria made clear that his plan for recapitalizing the Companies was to raise new capital in the markets by directing the Companies to sell additional shares of stock. *See* FHFA Press Release, FHFA and Treasury Allow Fannie Mae and Freddie Mac to Continue to Retain Earnings, https://bit.ly/2X0LnU8 (Jan. 14, 2021) ("Until the Enterprises can raise private capital, they are at risk of failing in the next housing crisis." (quoting Director Calabria)).

Treasury's September 2019 housing finance report likewise contemplates tapping the financial markets for new capital by "[i]ssuing shares of common or preferred stock." *See* Dep't of the Treasury, *Housing Finance Reform Plan* at 27 (Sept. 2019), https://bit.ly/2Uyvzre. To be sure, the report also recognized that the

Companies could accrue at least some capital over time through retained earnings by "adjusting the variable dividend on Treasury's senior preferred shares." *Id.* But as the Acting Solicitor General told the Supreme Court in a supplemental filing, recapitalizing the Companies solely through retained earnings will "take multiple years." Letter from Elizabeth B. Prelogar to Clerk of the U.S. Supreme Court, *Collins v. Yellen*, Nos. 19-422 & 19-563 (March 18, 2021). In contrast, writing off the liquidation preference and raising funds by issuing new stock would fully recapitalize the Companies much more quickly and reliably.

The Trump Administration wanted to release Fannie and Freddie from conservatorship "as soon as practicable." *See* Chris Herbert, New Fellows Don Layton and Michael Stegman to Focus on Housing Finance Reform, JOINT CENTER FOR HOUSING STUDIES AT HARVARD UNIV. (July 1, 2019), https://bit.ly/2Vkg0DF. Doing so through a capital raise would have involved five basic steps, the first four of which Director Calabria and Treasury actually took.

First, the Purchase Agreements had to be modified so that the Companies would be permitted to retain the sums investors paid for any newly issued stock rather than handing it all over to Treasury. Director Calabria and Treasury took a first step in that direction when they amended the Purchase Agreements to allow the Companies to retain a combined $55 billion in net worth in September 2019, U.S. Dep't of the Treasury, Treasury Department and FHFA Modify Terms of Preferred

Stock Purchase Agreements for Fannie Mae and Freddie Mac, https://go.usa.gov/xF6NS, and they substantially increased the maximum net worth the Companies can maintain just before President Trump left office, *see Collins v. Yellen*, 141 S. Ct. 1761, 1774 (2021).[1]

Second, the Companies had to stop paying Treasury quarterly cash dividends. Notably, while the Companies were directed to pay tens of billions of dollars in cash dividends to Treasury during Director Watt's tenure, Director Calabria put a stop to this practice within months of coming into office in April 2019. *See* FHFA, Dividends on Enterprise Draws from Treasury, https://bit.ly/3tmDbKa.

Third, the Companies needed a regulatory framework for determining the amount of capital that would be required once they were under private control. *See* Treasury, *Housing Finance Reform Plan*, at 26 ("prescribed regulatory capital requirements" are a "[p]recondition[]" for ending the conservatorships). Director Calabria adopted such a framework—a substantial undertaking that would serve no purpose unless the Companies are recapitalized and released. *See* 85 Fed. Reg. 82,150 (Dec. 17, 2020).

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[1] Defendants make much of the fact that these amendments also increased the liquidation preference on Treasury's senior preferred stock. But against the backdrop of the Net Worth Sweep, these increases merely maintained the status quo, under which Treasury was (and is) entitled to 100% of all earnings the Companies generate and, if the Companies are liquidated, all sums left over after debtholders are paid. As explained in the text, that status quo had to change if the Companies were going to raise new capital by selling additional shares of stock to private investors.

Fourth, the Companies needed to hire investment bankers to prepare a new stock offering—something they also did under Director Calabria's leadership. *See* Fannie Mae Hires Financial Advisor (June 15, 2020), https://bit.ly/3kQGuHa; Freddie Mac Announces Financial Advisor (June 15, 2020), https://bit.ly/3zUxR32.

Fifth, the Companies' capital structures needed to change so that their earnings would not go exclusively to Treasury—otherwise no one would buy the new stock the Companies planned to issue.[2] This fifth step is critical, but Defendants' supplemental briefs almost entirely ignore it. What investor would buy a new issuance of stock from Fannie or Freddie while Treasury was entitled to 100% of all earnings these companies generated forever? As a practical matter, there was simply no way to raise capital by selling new shares of stock without changing their capital structures in a way that would have also made Plaintiffs' shares valuable.

Defendants devote much of their supplemental briefs to lampooning the idea that President Trump wanted to "surrender[ ] billions of dollars of taxpayer value for no consideration." FHFA Br. 14; *see also, e.g.*, Treas. Br. 7. This argument confuses the means the Administration chose to pursue its goals with its ultimate objective. A

[2] Director Calabria made the same point in a speech in April of this year, saying that the Purchase Agreements should be further amended "to deal with the capital stack" and that "given the structure of the balance sheets as they are today, it will be very difficult if not impossible to raise outside capital." James Kleimann, Calabria: We need another round of PSPA amendments, HOUSING WIRE (Apr. 20, 2021), https://bit.ly/38RxU40.

traveler who needs to drive from New Orleans to Fort Worth is likely to pass through Baton Rouge, even though that is not where he is going. So too with either writing down the liquidation preference on Treasury's senior preferred stock or converting the senior preferred stock to common stock. Doing one of those things was necessary to give value to any new issuance of stock by Fannie and Freddie—the fastest and most direct way to achieve the Trump Administration's ultimate objective of recapitalizing the Companies and ending the conservatorships.

Defendants' argument that Plaintiffs' proposed remedy would amount to a giveaway of the government's investment also proceeds from the dubious premise that writing off the liquidation preference on Treasury's senior preferred stock would reduce the value of Treasury's overall holdings in the Companies. In addition to its senior preferred stock, Treasury also owns warrants to purchase 79.9% of the Companies' common stock for a nominal price, *see* ROA.35, and writing down the liquidation preference on the senior preferred stock would make those warrants extremely valuable. It is hardly self-evident that Treasury's current senior preferred stock, which amounts to a 100% equity stake in two companies run by bureaucrats, is worth more than a 79.9% common stock interest in companies on the path to private control.

B. Director Watt clearly stood in the way of the Trump Administration's pursuit of the housing finance reform plans described above, and Defendants are

wrong when they argue otherwise. Treasury suggests that President Trump might not have even fired Director Watt but for the unconstitutional removal restriction, but this argument cannot be taken seriously. As explained in our previous supplemental brief, Director Watt was a former Democratic Congressman who was confirmed to his post with almost no Republican support, and he was the last Obama appointee to run an executive agency. *See* Plfs.' Supp. Br. 7. While the Trump Administration's lawyers argued that FHFA's Director was unconstitutionally insulated from presidential oversight, it is hardly surprising that the President was unwilling to test this theory by firing Director Watt at a time when FHFA was vigorously defending the constitutionality of its structure in court.

Defendants fare no better when they speculate that, if Director Watt had been asked, he might have gone along with the Trump Administration's plan to recapitalize the Companies and release them from conservatorship. Craig Phillips, Secretary Mnuchin's most senior advisor on housing finance reform issues, has stated publicly that the Trump Administration determined it could not work with Director Watt. *See* Interview with Craig Phillips, Former Counselor to the Secretary of the Treasury, SITUSAMC – ON THE HILL, at 10:14 to 11:01 (May 26, 2021), https://bit.ly/3y4zE4J. And while Mr. Phillips himself thought that the Administration might have been able to partner with Director Watt, Mr. Phillips was clear that the White House decided to "wait for Director Watt's term to end and to

have our appointee" before moving forward. *Id.*

Nor could Treasury have carried off comprehensive housing finance reform without FHFA's cooperation. All five of the steps described above required FHFA's active participation. Indeed, even writing down the liquidation preference on Treasury's senior preferred stock or converting it to common stock would have required an amendment to the Purchase Agreements—something Treasury could not do unilaterally.

C. FHFA asserts that "a wide range of concepts and options for GSE reform were on the table" when President Trump was in office, FHFA Br. 16, but the significance of that argument depends on which side bears the burden of persuasion. Defendants resist Plaintiffs' burden-shifting argument, but they cannot dispute that the allocation of the burden in a presidential removal case presents a novel question on which there is no controlling authority. Any non-public evidence of prejudice from an unconstitutional removal restriction will invariably be in the government's exclusive possession, and the cheap shot FHFA takes at Plaintiffs for relying on "podcasts and news stories" only underscores the point. *See* FHFA Br. 9. At the very least, a remand for discovery into these disputed factual issues is warranted.

II. The Court's previous en banc opinion does not prevent it from further considering this case on remand from the Supreme Court.

Defendants argue that the Court's previous remedial ruling forecloses Plaintiffs' arguments. They are wrong for several reasons.

First, the focus of the Court's prior remedial analysis was on the Obama Treasury Department's approval of the Third Amendment and the Trump Administration's continued defense of the Third Amendment in court. *See Collins v. Mnuchin*, 938 F.3d 553, 591–95 (5th Cir. 2019) (en banc). As this case returns from the Supreme Court, the question is whether FHFA and the Trump Treasury Department would have gone "back to the bargaining table" but for Director Watt's for-cause removal protection. *Collins*, 141 S. Ct. at 1781. To the extent that the Court's previous en banc opinion discusses the Trump Administration's views, it focuses narrowly on that Administration's continued defense of the Net Worth Sweep. The Court's prior ruling did not place these issues in the broader context of the Trump Administration's housing finance reform policies or purport to address whether Director Watt's removal protection prevented the Trump Administration from altering the Companies' capital structures in a way that would have benefitted Plaintiffs.

Second, the Court based its previous remedial ruling in part on judicially noticed facts about the actions of FHFA Directors who succeeded Acting Director DeMarco. *See Collins*, 938 F.3d at 594. The facts about the Trump Administration's housing finance reform plans described above and in Plaintiffs' previous supplemental brief are judicially noticeable to the same extent, and many of those facts had not even occurred when this Court issued its previous en banc decision.

The Court should not blind itself to the intervening actions of Director Calabria and statements by Trump Administration officials that strongly support Plaintiffs' argument that they were prejudiced by Director Watt's for-cause removal protection.

Third, at least two of the judges who formed the bare nine-judge en banc majority that previously denied Plaintiffs a remedy thought that backward-looking relief is categorically unavailable in presidential removal cases. *See Collins*, 938 F.3d at 595–96 (Duncan, J., concurring). The Supreme Court disagreed, *see Collins*, 141 S. Ct. at 1788–89, and it is thus appropriate for the en banc Court to reconsider.

III. Plaintiffs' constitutional claim is not barred by Section 4617(f).

This Court's previous en banc decision provides a complete answer to FHFA's belated assertion that Plaintiffs' constitutional claim is foreclosed by 12 U.S.C. § 4617(f). "Where Congress intends to prelude judicial review of constitutional claims its intent to do so must be clear." *Collins*, 938 F.3d at 587 (cleaned up). Like the statute's succession provision, Section 4617(f) "does not cross-reference the Administrative Procedure Act's general rule that agency action is reviewable." *Id.* Section 4617(f) would be unconstitutional if it foreclosed appropriate remedies for constitutional claims, *see Bartlett v. Bowen*, 816 F.2d 695, 705 (D.C. Cir. 1987), but in any event that constitutional problem can be easily avoided by construing Section 4617(f) not to limit the available remedies in constitutional cases.

Date: September 8, 2021

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the typeface requirements of Rule 32(a)(5) of the Federal Rules of Appellate Procedure and the type style requirements of Rule 32(a)(6) of the Federal Rules of Appellate Procedure because this brief has been prepared in a proportionately spaced typeface using Microsoft Word for Microsoft Office 365 in 14-point Times New Roman font. This supplemental reply brief is being submitted pursuant to the directive the Court issued on July 5, 2021.

Dated: September 8, 2021

s/ Charles J. Cooper
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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of Court for the United States Court of Appeals for the Fifth Circuit on September 8, 2021 by using the appellate CM/ECF system. The participants in this case are registered CM/ECF users, and service will be accomplished by the appellate CM/ECF system.

Dated: September 8, 2021

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