No. 18-2506

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

ATIF F. BHATTI, et al.,

Plaintiffs-Appellants

v.

FEDERAL HOUSING FINANCE AGENCY, et al.,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA (No. 17-2185)

SUPPLEMENTAL REPLY BRIEF OF PLAINTIFFS-APPELLANTS

Scott G. Knudson
Taft, Stettinius & Hollister LLP
2200 IDS Center
80 South Eighth Street
Minneapolis, Minnesota 55402
(612) 977-8400

Charles J. Cooper
David H. Thompson
Peter A. Patterson
Brian W. Barnes
Cooper & Kirk, PLLC
1523 New Hampshire Avenue, N.W.
Washington, D.C. 20036
Telephone: (202) 220-9600

Counsel for Plaintiffs-Appellants

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

ARGUMENT 1

I. Plaintiffs were prejudiced by the unconstitutional statutory restriction on President Trump's authority to fire Director Watt. 1

II. None of Plaintiffs' constitutional claims are barred by Section 4617(f). 9

III. *Collins* forecloses application of the de facto officer doctrine to Plaintiffs' Appointments Clause claim. 10

TABLE OF AUTHORITIES

Cases **Page**

Bartlett v. Bowen, 816 F.2d 695 (D.C. Cir. 1987) 9

Collins v. Yellen, 141 S. Ct. 1761 (2021) 4, 9, 10

Nguyen v. United States, 539 U.S. 69 (2003) 10

Webster v. Doe, 486 U.S. 592 (1988)..9

Statutes

12 U.S.C. § 4617(f)..9

Administrative Materials

84 Fed. Reg. 12,479 (Mar. 27, 2019) 1

85 Fed. Reg. 82,150 (Dec. 17, 2020)..5

Other Authorities

Dep't of the Treasury, *Housing Finance Reform Plan* (Sept. 2019), https://bit.ly/2Uyvzre 2, 3, 4

Fannie Mae Hires Financial Advisor (June 15, 2020), https://bit.ly/3kQGuHa 5

FHFA, Dividends on Enterprise Draws from Treasury, https://bit.ly/3tmDbKa 4

Freddie Mac Announces J.P. Morgan as Financial Advisor (June 15, 2020), https://bit.ly/3zUxR32..5

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................................3

Interview with Craig Phillips, Former Counselor to the Secretary of the Treasury, SITUSAMC – ON THE HILL (May 26, 2021), https://bit.ly/3y4zE4J............7, 8

James Kleimann, Calabria: We need another round of PSPA amendments, HOUSING WIRE (Apr. 20, 2021), https://bit.ly/38RxU40................................5

Letter from Elizabeth B. Prelogar to Clerk of the U.S. Supreme Court, *Collins v. Yellen*, Nos. 19-422 & 19-563 (March 18, 2021) 3

Mnuchin: Get Fannie Mae, Freddie Mac out of government ownership, FOX BUSINESS NEWS (Nov. 30, 2016), https://bit.ly/3iKDZUc 1

Press Release, FHFA and Treasury Allow Fannie Mae and Freddie Mac to Continue to Retain Earnings, https://bit.ly/2X0LnU8 (Jan. 14, 2021) 2

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 4

Appellate Case: 18-2506 Page: 4 Date Filed: 09/23/2021 Entry ID: 5079949

ARGUMENT

Large portions of Defendants' supplemental briefs attack a straw man. Plaintiffs' argument is not that President Trump "desired a swift end to the Third Amendment" for its own sake, Suppl. Br. for the Treasury Dept. at 6 (Sept. 9, 2021), 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 in *Collins*. 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. 12,479 (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* JA34. The Companies obviously could not be released from conservatorship while they remained in this perilous position.

Director Calabria made clear that, as a prelude to ending the conservatorships, his plan was to recapitalize the Companies by raising new capital in the markets through the sale of additional shares of stock. *See* Suppl. Opening Br. of Plfs-Appellants at 5 (Aug. 10, 2021) ("Plfs' Supp. Br."); 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 reform plan 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 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 could retain the sums investors paid for any newly issued stock rather than immediately 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

Appellate Case: 18-2506 Page: 7 Date Filed: 09/23/2021 Entry ID: 5079949

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 that 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

[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.

Appellate Case: 18-2506 Page: 8 Date Filed: 09/23/2021 Entry ID: 5079949

purpose unless the Companies are recapitalized and released. *See* 85 Fed. Reg. 82,150 (Dec. 17, 2020).

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 J.P. Morgan as Financial Advisor (June 15, 2020), https://bit.ly/3zUxR32.

Fifth, the Companies' capital structures needed to change so that Treasury would not be the only shareholder to benefit if the Companies were profitable in the future—otherwise no one would buy the new stock the Companies planned to sell.[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 dividends these companies paid 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.

[2] Director Calabria made the same point in a speech two months before President Biden fired him, 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.

Appellate Case: 18-2506 Page: 9 Date Filed: 09/23/2021 Entry ID: 5079949

Defendants devote much of their supplemental briefs to lampooning the idea that President Trump wanted to "surrender" the multi-billion-dollar liquidation preference on Treasury's senior preferred stock. *See* Suppl. Br. of Defs.-Appellees FHFA and Sandra L. Thompson at 12 (Sept. 9, 2021) ("FHFA Supp. Br."). This argument confuses the means the Administration chose to pursue its goals with its ultimate objective. A traveler who needs to drive from Kansas City to Saint Paul is likely to pass through Des Moines, 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 owns warrants to purchase 79.9% of the Companies' common stock for a nominal price, *see* JA20, 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

Appellate Case: 18-2506 Page: 10 Date Filed: 09/23/2021 Entry ID: 5079949

stock, which amounts to a 100% equity stake in two companies run by bureaucrats, is worth more than a 79.9% interest in companies on a 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. 6. 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 that 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

Appellate Case: 18-2506 Page: 11 Date Filed: 09/23/2021 Entry ID: 5079949

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 would have required an amendment to the Purchase Agreements—something Treasury could not do unilaterally.

FHFA asserts that "numerous potential reform options" were on the table when President Trump was in office, FHFA Supp. Br. 15 n.7, 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

Appellate Case: 18-2506 Page: 12 Date Filed: 09/23/2021 Entry ID: 5079949

possession. At the very least, a remand for discovery into these disputed factual issues is warranted.[3]

II. None of Plaintiffs' constitutional claims are barred by Section 4617(f).

When FHFA's Director makes a decision without the constitutionally required degree of presidential oversight, the agency "exceeds [its] powers or functions" and 12 U.S.C. § 4617(f) "imposes no restrictions" on the available remedies. *See Collins*, 141 S. Ct. at 1776. "[C]ontinuing to implement the third amendment was a decision that each confirmed [FHFA] Director has made since 2012," and this decision is thus subject to constitutional challenge without regard to Section 4617(f). *See id.* at 1781. The broader reading of Section 4617(f) that FHFA promotes would render the statute unconstitutional. *See Bartlett v. Bowen*, 816 F.2d 695, 705 (D.C. Cir. 1987); *cf.* Plfs' Reply Br. 20–21. Fortunately, the Court need not reach that constitutional issue because Section 4617(f) lacks a clear statement specifying that the provision applies to constitutional claims. *See Webster v. Doe*, 486 U.S. 592, 603 (1988).

---

[3] FHFA is wrong when it asserts that Plaintiffs forfeited the remedial arguments in their supplemental brief. The Complaint alleges that "Plaintiffs are suffering ongoing injuries as a result of FHFA's expropriation of the Companies' resources and private shareholders' rights," JA39, and asks the courts to "enjoin[ ] Defendants . . . from implementing . . . the third amendment," JA47. Presented with a similar prayer for relief and all the same arguments in *Collins*, the Supreme Court remanded the case so that the lower courts could consider whether a Senate-confirmed Director who implemented the third amendment would have "altered his behavior in a way that would have benefited the shareholders." 141 S. Ct. at 1789. The *Collins* remand leaves no room for a finding of forfeiture in this parallel case.

III. *Collins* forecloses application of the de facto officer doctrine to Plaintiffs' Appointments Clause claim.

A government actor who serves in violation of the Appointments Clause "exercise[s] power that the actor did not lawfully possess," *Collins*, 141 S. Ct. at 1788, and such constitutionally invalid exercises of power must be set aside. Plaintiffs' argument is not that *Collins* " 'silently overrule[d]' the longstanding de facto officer doctrine," FHFA Supp. Br. 19, but that the *Collins* Court's discussion of remedies in Appointments Clause cases is inconsistent with extending the de facto officer doctrine beyond "merely technical" statutory violations, *see Nguyen v. United States*, 539 U.S. 69, 77 (2003).

FHFA also says that "all agree" that Mr. DeMarco was "properly *appointed*," FHFA Supp. Br. 19, but that is not so. By the time Mr. DeMarco signed the third amendment to the Purchase Agreements, he had served as FHFA's "acting" Director for more than two years and well in excess of any temporal limit that the Constitution could conceivably impose for acting agency heads. Mr. DeMarco was not properly appointed to serve as a principal officer, and the appropriate remedy for this violation of the Appointments Clause is to set aside the third amendment.

Date: September 22, 2021

Respectfully submitted,

/s/ Charles J. Cooper
Charles J. Cooper
David H. Thompson
Peter A. Patterson
Brian W. Barnes
COOPER & KIRK, PLLC
1523 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 220-9600

Scott G. Knudson
Taft, Stettinius & Hollister LLP
2200 IDS Center
80 South Eighth Street
Minneapolis, Minnesota 55402
(612) 977-8400

Counsel for Plaintiffs-Appellants

CERTIFICATE OF COMPLIANCE

This brief complies with the ten-page limit set by this Court's July 16, 2021 order granting the parties' joint request for supplemental briefing.

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 the 2016 version of Microsoft Word in 14-point Times New Roman font.

As required by Eighth Cir. R. 28A(h), this brief has been scanned for viruses and is virus-free.

/s/ Charles J. Cooper
Charles J. Cooper

CERTIFICATE OF SERVICE

I hereby certify that on September 22, 2021, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Eighth Circuit by using the CM/ECF system. I certify that all participants in this case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

/s/ Charles J. Cooper
Charles J. Cooper