**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF TEXAS**
**HOUSTON DIVISION**

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| J. PATRICK COLLINS, *et al.*,<br><br>*Plaintiffs*,<br><br>-vs-<br><br>THE FEDERAL HOUSING FINANCE AGENCY, *et al.*,<br><br>*Defendants*. | **CIVIL ACTION NO. 4:16-CV-03113** |

**PLAINTIFFS' RESPONSE IN OPPOSITION TO**
**DEFENDANTS' MOTION TO DISMISS**

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## INTRODUCTION

The amended complaint makes factual allegations of precisely the sort that the Supreme Court said could entitle Plaintiffs to a retrospective remedy for the FHFA Director's unconstitutional statutory removal protection. Defendants ask the Court to disbelieve those allegations—including allegations based upon a letter written by former President Trump in which he explained how the FHFA Director's for-cause removal protection thwarted his administration's pursuit of its housing finance reform policy goals. Defendants will have an opportunity to dispute the amended complaint's allegations, but a motion to dismiss is the wrong vehicle for litigating factual disputes. The Supreme Court's decision in this case makes clear that Plaintiffs are entitled to prevail on the merits of their removal claims, and it also points to a serious problem with FHFA's funding structure, which combines the powers of the purse and the sword in a single non-independent agency in violation of the Appropriations Clause. The motions to dismiss should be denied in their entirety.

## FACTUAL BACKGROUND AND NATURE AND STAGE OF THE PROCEEDING

### A. FHFA Forces the Companies into Conservatorship, Signs the PSPAs, and Implements the Net Worth Sweep While Its Directors Are Insulated from Removal.

In 2008, Congress enacted the Housing and Economic Recovery Act (HERA), which created FHFA as the new regulator of Fannie Mae and Freddie Mac, two privately owned companies that sell mortgage-backed securities. First Am. Compl., Doc. 80, ¶¶ 13–15, 18 (June 23, 2022) ("Compl."). Under HERA, FHFA was led by a single director who could be removed only for cause. *Id.* ¶ 18. HERA also gave FHFA the authority to take the Companies into conservatorship, which the agency did in September 2008. *Id.* ¶¶ 19, 23.

At the same time, FHFA entered into two agreements with the Treasury Department on behalf of the Companies as their conservator. *Id.* ¶¶ 23–24. These agreements—known as the

Preferred Share Purchase Agreements or "PSPAs"—established an arrangement where Treasury agreed to provide the Companies with funding to permit them to maintain a positive net worth.

In return, Treasury received several forms of consideration. First, it received senior preferred stock that carried an initial "liquidation preference." *Id*. ¶¶ 27–28 A shareholder with a "liquidation preference" has the right to receive funds before any other shareholder in the event the company is ever liquidated. *Id*. ¶ 28. Treasury's initial liquidation preference was $1 billion. *Id.* The liquidation preference increased by one dollar for every dollar the Companies drew on Treasury's funding commitment. *Id.* In addition, because Treasury's shares were "senior preferred stock"—as opposed to "junior preferred" or "common" stock—Treasury was entitled to quarterly dividends before all other shareholders. *Id*. ¶¶ 29–30. Second, FHFA agreed that the Companies would issue warrants entitling Treasury to buy 79.9% of their common stock at a nominal price. *Id*. ¶ 25. Finally, the PSPAs provided for the Companies to pay Treasury a quarterly market-based periodic commitment fee, but that fee was never charged and had to be mutually agreed upon. *Id*. ¶ 31.

In August 2012, FHFA and Treasury entered the "third amendment" to the PSPAs. *Id*. ¶ 37. Among other things, this amendment imposed what is known as the "Net Worth Sweep," which replaced the PSPAs' prior dividend structure. *Id.* Rather than a dividend paid as a percentage of the liquidation preference, the Companies would now pay Treasury their entire net worth every quarter, leaving only a small capital buffer. *Id.* This new structure resulted in massive payments to Treasury, totaling $300 billion—approximately $109 billion *more* than the Companies received from Treasury. *Id*. ¶ 42.

**B. The Removal Restriction Prevents President Trump from Removing President Obama's FHFA Director, Who Obstructs the Trump Administration's Housing Finance Reform Plans.**

In 2013, the Senate confirmed President Obama's nominee to lead FHFA, Democratic congressman Mel Watt. *Id*. ¶ 43–45. Two years later, Donald Trump was elected President. *Id*. ¶ 49. Were it not for the removal restriction, President Trump would have removed Director Watt and installed his own director on "day one" of his administration. *Id*. ¶ 50.

The Trump administration intended to lead the Companies out of conservatorship and return them to private control by selling off Treasury's stake at a large profit. *Id*. These goals were to be accomplished primarily by recapitalizing the Companies through a public sale of common stock. *Id*. ¶ 56.

For the Companies' common stock to trade successfully, however, two things had to occur. First, the Net Worth Sweep had to be eliminated so that the Companies could retain profits because no private investors would purchase stock in a company that has its net worth shipped to the government every quarter. *Id*. ¶¶ 39, 79. Second, and relatedly, Treasury's liquidation preference had to be eliminated because no private investors would purchase stock if Treasury's massive liquidation preference entitled it to billions of dollars before other shareholders. *Id*. ¶¶ 59, 62, 101. The Trump administration planned to eliminate the liquidation preference by either writing it down to zero or converting its senior preferred shares (which carried the liquidation preference) to common stock. *Id*. ¶¶ 59, 62, 101. Either approach would allow Treasury to sell its stake in the Companies for a large profit as part of the recapitalization. *Id*. ¶¶ 59, 62, 101.

The administration's steps to increase the value of Treasury's common stock would necessarily increase the value of Plaintiffs' stock. They own shares of the Companies' common stock and junior preferred stock. *Id*. ¶¶ 6–8. With the end of the Net Worth Sweep and the elimination of Treasury's liquidation preference, Plaintiffs would again have the opportunity to

receive either dividend payments or payments in liquidation. *See Id*. ¶¶ 16, 30, 39. Indeed, for any common shares held by Treasury to have significant value (whether from exercising Treasury's warrants, converting the senior preferred stock to common, or both), Plaintiffs' junior preferred shares necessarily would have to have full value. Plaintiffs would have thus directly benefited from the Trump administration's plan.

That plan required multiple, and often sequential, steps that Treasury and FHFA had to mutually agree upon. *Id*. ¶¶ 78, 85–86. When President Trump took office, however, Director Watt still had two years left on his statutory term and was subject to HERA's removal protection. *Id*. ¶¶ 50–51. The Trump administration and Director Watt disagreed on at least two critical issues. First, they disagreed about implementing the Net Worth Sweep. *Id*. ¶¶ 68–69. Second, they disagreed about whether the executive branch should lead the Companies out of conservatorship without congressional action. *Id*. ¶¶ 65–67. Director Watt thought that any effort to release the Companies from conservatorship should only occur after the enactment of further legislation; the Trump administration thought it both lawful and desirable for the executive branch to act alone. *Id*. ¶¶ 65–67, 71, 75. Indeed, President Trump's eventual pick to lead FHFA repeatedly said that HERA *legally obligated* him to take the Companies out of conservatorship. *Id*. ¶ 67.

These fundamental disagreements prevented the Trump administration from pursuing its goals for the Companies during the first two years of the administration. *Id*. ¶¶ 72–73. As a result, the administration was denied the time necessary to complete the multistep process required to raise capital. *Id*. ¶¶ 87, 92. Although it completed most of the needed work, the delay caused by Director Watt's tenure prevented the administration from accomplishing the final step of eliminating Treasury's liquidation preference. *Id*. ¶¶ 84-86.

### C. The Supreme Court Declares the Removal Restriction Unlawful.

Plaintiffs are shareholders of Fannie Mae and Freddie Mac who sued, arguing (among other things) that the FHFA director's for-cause removal protection is unconstitutional. This Court dismissed the complaint, and the case ultimately reached the Supreme Court. The Supreme Court held that the for-cause removal restriction is unconstitutional. *Collins v. Yellen,* 141 S. Ct. 1761, 1783–84 (2021). Having determined that the removal restriction violated the Constitution, the Court remanded the case for the lower courts to determine whether the unconstitutional restriction "inflict[ed] compensable harm" on the Companies' shareholders. *Id.* at 1789.

## ISSUES TO BE RULED UPON BY THE COURT

The central questions raised in the motions to dismiss are whether the allegations in the complaint are sufficient to support Plaintiffs' presidential removal and Appropriations Clause claims, and, if so, whether Plaintiffs may seek any remedy for those claims. At this stage, the Court must "accept all well-pleaded facts" in the complaint "as true" and draw all reasonable factual inferences in Plaintiffs' favor. *See Bass v. Stryker Corp.*, 669 F.3d 501, 507 (5th Cir. 2012).

## SUMMARY OF ARGUMENT

**I.** Nearly all of Defendants' attacks on the amended complaint's removal claims are foreclosed by the Supreme Court's decision in this case. The Court remanded for further proceedings on the question whether Plaintiffs are entitled to a remedy based upon "the actions" that Senate-confirmed FHFA Directors "have taken to implement the third amendment." *Collins*, 141 S. Ct. at 1787. The amended complaint challenges a subset of those actions—namely, actions that Director Watt took to implement and enforce the third amendment after President Trump took office. The amended complaint plausibly alleges that but for the unconstitutional removal restriction, President Trump would have fired Director Watt at the start of his administration and

set about implementing housing finance reform policies that would have benefitted Plaintiffs. Former President Trump has confirmed as much in a public statement, and the Court cannot disbelieve the former President and the complaint's other factual allegations on a motion to dismiss.

**II.** The Appropriations Clause is an important constitutional limitation on how federal agencies may be funded, and the Supreme Court's holding that FHFA lacks independence from the President makes this agency's funding structure almost entirely unique. FHFA is funded entirely outside the appropriations process in a manner that effectively empowers the President to tax and spend as he pleases without any congressional oversight. This combination of Congress's purse with the President's sword violates the Appropriations Clause. An agency without lawful access to funding cannot act, and for this reason the Third Amendment was ultra vires and must be set aside.

## ARGUMENT

### I. The Court should allow Plaintiffs' removal claims to proceed.

#### A. Plaintiffs' removal claims challenge FHFA's implementation of the Third Amendment and are cognizable under the APA.

1. The Supreme Court held that the FHFA Director's statutory removal protection "violates the Constitution," and remanded this case for further proceedings on "the shareholders' request for relief." *Collins*, 141 S. Ct. at 1787. Despite this ruling, Defendants contend that Plaintiffs somehow do not even challenge agency action in the first place. That argument is foreclosed by the Supreme Court's decision, which held that Plaintiffs could seek retrospective relief for "the actions that confirmed Directors" (as distinct from *acting* directors who were not subject to the removal restriction) "have taken to *implement* the third amendment." *Id.* "The harm," the Supreme Court explained, "is alleged to have continued after the Acting Director was replaced by a succession of

confirmed Directors, and it appears that any one of those officers could have renegotiated the companies' dividend formula with Treasury." *Id.* at 1781. "Accordingly, continuing to implement the third amendment was a decision that each confirmed Director has made since 2012." *Id.* It is this "subset of actions" for which Plaintiffs can seek "retrospective relief." *Id.* at 1787.

Plaintiffs are thus entitled to seek a remedy for "actions that confirmed Directors have taken to *implement* the third amendment." *Collins*, 141 S. Ct. at 1787. The Amended Complaint does precisely that, alleging that the "third amendment imposed the Net Worth Sweep, under which the Companies were required to pay Treasury a quarterly dividend starting in 2013 and continuing forever that is equal to their entire net worth." Compl. ¶ 37. "The Net Worth Sweep stripped the Companies' junior preferred and common stock of all economic value" by "guaranteeing that any profits the Companies generate for equity investors will ultimately go to Treasury, either in the form of dividend payments or payments in liquidation." *Id.* ¶ 39. And specifically, Plaintiffs challenge the actions taken by Director Watt "to implement the third amendment" while "the unconstitutional removal restriction inflicted harm." *See Collins*, 141 S. Ct. at 1788-89; *see also* Compl. ¶¶ 68–69, 79.

As the former President's statement makes clear, the unconstitutional provision inflicted harm from "day one of [his] administration." *Id.* ¶ 50. During that time, FHFA continued to implement the PSPA provisions that deprived Plaintiffs of their shares' economic value—including the provisions entitling Treasury to senior preferred stock, implementing the third amendment's Net Worth Sweep, and providing for Treasury's liquidation preference. *Id.* ¶¶ 1, 69, 79. Thus, Plaintiffs continue to challenge the precise actions that the Supreme Court said could provide the basis for retrospective relief.[1]

[1] Treasury argues that awarding Plaintiffs a remedy for the separation of powers violation found by the Supreme Court would *itself* be a separation of powers violation. Treasury Defs.' Mot.

2. Director Watt's implementation of the Third Amendment, through both quarterly dividends and increases in the liquidation preference, is "conduct" and "action" that harmed Plaintiffs. *See Collins*, 141 S. Ct. at 1789. Regardless of whether this conduct is actionable under the APA, this Court has equitable authority to enjoin it under Count I because it has harmed Plaintiffs within the meaning of Article III. *See Id*. at 1789; Compl. ¶ 98. FHFA focuses much of its argument on *Norton v. S. Utah Wilderness All.*, 542 U.S. 55, 62-64 (2004). But *Norton* is a case about the meaning of the APA, and FHFA is unable to cite any case in which a court has applied it to limit remedies available under the equitable cause of action invoked in Count I.

Regardless, Director Watt's implementation of the Third Amendment easily falls within the APA's definition of agency "action," "which is meant to cover comprehensively every manner in which an agency may exercise its power." *Whitman v. Am. Trucking Assoc.*, 531 U.S. 457, 478 (2001). Likewise, Defendants' failure to return that ill-gotten value to the shareholders as the President intended is not only "unlawful conduct" that harmed Plaintiffs under Article III, but also agency action under the APA, which defines the term "agency action" to include an agency's "failure to act," 5 U.S.C. § 551(13).

Defendants primarily appear to take issue with the fact that some of Plaintiffs' requested injunctive relief is phrased in mandatory rather than prohibitive terms, and they argue that, because of this phrasing, Plaintiffs solely challenge agency *inaction*. But the phrasing of Plaintiffs' requested *remedy* does not alter the particular agency *action* they challenge: the implementation

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to Dismiss 8–9 (July 18, 2022) ("Treas. Br."). That contention cannot be squared with the Supreme Court's decision, which clearly holds that Plaintiffs are entitled to retrospective relief if the removal restriction caused harm. *Collins*, 141 S. Ct. at 1788–89. Any time a new administration controls the executive branch, it may have to take actions to remedy a constitutional violation that occurred during a prior administration. The federal government's duty to obey court orders does not "commandeer" the Executive Branch. Treas. Br. 10. *Cf. Dept. of Homeland Sec. v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1901 (2020) (requiring Trump administration to adhere to Obama administration's DACA program).

of the PSPA provisions that swept the Companies' dividends to Treasury and increased Treasury's liquidation preference while President Trump was in office.

Moreover, even if the Court were to view Plaintiffs as seeking to compel agency action unlawfully withheld, they have alleged such a claim in Count VI under 5 U.S.C. § 706(1). FHFA's argument that this cause of action would not satisfy the requirements of Section 706(1) fails. The APA defines "agency action" to include "the whole or a part of an agency rule, order, license, sanction, relief, or the equivalent or denial thereof, *or failure to act*." 5 U.S.C. § 551(13) (emphasis added). The Supreme Court held in *Norton*, 542 U.S. at 62-64, that "a 'failure to act' is properly understood to be limited, as are the other items in § 551(13), to a *discrete* action." 542 U.S. at 63. In addition, "the only agency action that can be compelled under the APA is action *legally required*." *Id.* at 63.

Here, the agency action sought is discrete and straightforward: The liquidation preference is either zero or it is not. *See* Compl. ¶ 100. Similarly, an order compelling Treasury to convert its preferred stock to common stock is binary: The stock is either senior to other preferred shareholders in receiving dividends or it is not. There would be no "day-to-day agency management" if the Court granted Plaintiffs' requested relief. *Norton*, 542 U.S. at 67. The requested relief is also "legally required." *Id.* at 63. If Plaintiffs prove they suffered harm from the unconstitutional removal restriction, Defendants *must* remedy that harm. They do not have discretion to decide whether Plaintiffs are "entitled to retrospective relief" because the Supreme Court already explained that Plaintiffs would be entitled to a remedy. Thus, if the Court decides that Plaintiffs claims are best understood as seeking to compel agency action unlawfully withheld, Plaintiffs state a claim under § 706(1).

### B. Section 4617(f) does not apply to constitutional claims.

Defendants contend that Plaintiffs' requested relief is barred by 12 U.S.C. § 4617(f). But that provision lacks the clear statement necessary to bar all remedies for a constitutional claim. *See Webster v. Doe*, 486 U.S. 592, 603 (1988). "The Supreme Court has long held that a statutory bar to judicial review precludes review of constitutional claims only if there is 'clear and convincing' evidence that Congress so intended." *Ralls Corp. v. Comm. on Foreign Inv. in U.S.*, 758 F.3d 296, 308 (D.C. Cir. 2014) (citation omitted). The Supreme Court has already implicitly recognized that § 4617(f) contains no such clear statement: After the Court spent pages analyzing and applying § 4617(f) to bar Plaintiffs' *statutory* claim, the Court made no mention of the provision with respect to the *constitutional* claim. The second half of the Court's opinion would have been pointless if, all along, § 4617(f) barred the removal claim.

Although the Court need not reach the issue because § 4617(f) does not apply to constitutional claims, to hold that this statute "den[ies] a judicial forum" for such claims would raise a "serious constitutional question." *Bowen v. Mich. Acad. of Fam. Physicians*, 476 U.S. 667, 681 n.12 (1986); *see also id.* ("All agree that Congress cannot bar all remedies for enforcing federal constitutional rights" (brackets and internal quotation marks omitted)). Indeed, Defendants' reading of § 4617(f) would render that provision unconstitutional as applied to Plaintiffs' constitutional claims. *See Bartlett v. Bowen*, 816 F.2d 695, 705 (D.C. Cir. 1987).

### C. Defendants' remaining arguments for dismissal of the removal claims impermissibly ask the Court to find facts and draw inferences in their favor on a motion to dismiss.

Plaintiffs allege facts showing that the removal restriction caused harm by preventing the Trump administration from implementing policies that would have benefitted Plaintiffs. Defendants ask the Court to disbelieve the factual allegations in the complaint. But a motion to dismiss is the wrong vehicle for adjudicating factual disputes. Defendants will have an opportunity

to try to disprove the alleged facts, but the Court must accept them as true at this stage.

1. The Supreme Court held that even though the removal restriction was never legally enforceable, "it is still possible for an unconstitutional provision to inflict compensable harm." *Collins*, 141 S. Ct. at 1789. For example, if the President made a public statement "expressing displeasure" with the Director and asserting that "he would remove the director if the statute did not stand in the way," then "the statutory provision would clearly cause harm." *Id.* Former President Trump has issued a public statement articulating precisely that. *Id.* His statement could not have been clearer that he would have fired Director Watt and returned the Companies to private ownership were it not for the unlawful removal restriction. *See* Compl., Ex. A, Doc. 80-1 (June 3, 2022). This public statement is dispositive under *Collins*, and the Court certainly cannot choose to disbelieve it at the motion to dismiss stage. *Cf. Nat'l Archives and Recs. Admin. v. Favish*, 541 U.S. 157, 174 (2004) ("clear evidence" required to displace presumption of regularity accorded to government officials' statements).

Defendants contend that the Court should ignore the former President's letter because it was written after he left office. But nothing in the Supreme Court's ruling turns on that distinction. Instead, the Court laid down a general principle: A removal restriction caused harm if it made a real-world difference in who was leading the agency. The former President's letter conclusively establishes that it did. And, as detailed below, the President's letter merely confirms the contemporaneous evidence marshaled in the complaint. Indeed, the Trump letter is wholly consistent with FHFA's and Treasury's last word on their plans while the Trump administration was in office. At the close of the January 2021 letter agreement that allowed the Companies to build additional capital, Treasury and FHFA on behalf of the Companies "commit[ed] to work to restructure Treasury's investment and dividend amount in a manner that facilitates the orderly exit

from conservatorship, ensures Treasury is appropriately compensated, and permits the Enterprise[s] to raise third-party capital and make distributions as appropriate." Compl. ¶ 93.

Treasury also asks the Court to disregard the former President's statement because his administration argued in court that the removal restriction was unconstitutional. But that merely reveals the President considered himself bound by the statute until *a court* declared it unlawful. President Biden appears to have taken the same view: his administration did not defend the for-cause removal restriction either, but he nevertheless waited until a few hours after the Supreme Court's decision in this case to fire Director Calabria. *Id*. ¶ 94.

2. President Trump's actions while in office confirm the facts in his public statement. The Trump administration had two goals: (1) releasing the Companies from conservatorship as promptly as practicable; and (2) ending government ownership of the Companies by selling Treasury's stake at a large profit. *Id*. ¶ 52. The Trump administration's pursuit of both goals was stymied by Director Watt, and neither could be achieved without administrative steps that would have benefitted Plaintiffs.

*Ending the Conservatorships.* There is little doubt that ending the conservatorships was a top objective of the Trump administration. Before the administration even began, the President-elect's nominee for Treasury Secretary said the new administration intended to "get [the Companies] out of government control." *Id*. ¶ 53(b). He later said that "leaving" them "in conservatorship makes no sense." *Id*. ¶ 53(c). President Trump's eventual pick for FHFA Director, then serving as Vice President Pence's chief economist, said "the Trump administration is 'committed' to ending the conservatorship of" the Companies. *Id*. ¶ 53(d).

The administration's actions aligned with these public statements. In 2018, the Executive Office of the President issued a report outlining numerous proposals to "end the conservatorship

of Fannie Mae and Freddie Mac" and "transition[] Fannie Mae and Freddie Mac to fully private entities." *Id.* ¶ 53(e). Through a March 2019 directive—issued shortly after Director Watt departed—President Trump instructed Treasury to consult with FHFA and develop proposals for "[e]nding the conservatorships." *Id.* ¶ 53(f). The September 2019 Treasury report in response to that directive said the Companies "should be recapitalized" and taken out of conservatorship "as promptly as practicable." *Id.* ¶ 53(h) (quotation marks omitted).

Ending the conservatorships, however, could not be done overnight. Due largely to the immense dividend payments made to Treasury thanks to the Third Amendment, the Companies had no capital. *Id.* ¶ 54. Administration officials knew the Companies had to be recapitalized before exiting conservatorship. *Id.* Director Calabria told Congress that the Companies being "well-capitalized" was a "precondition for responsibly ending the conservatorships." *Id.*

Administration officials also knew the Companies could not promptly build the capital necessary to end the conservatorships by merely retaining their quarterly profits. *Id.* ¶ 55. Instead, the Companies needed to raise capital by selling new shares of common stock to private investors. *Id.* ¶ 56. Secretary Mnuchin outlined the broad strokes of the plan to Congress: "So we really see two things. One, retaining earnings, that is one way we will accumulate capital. And then, two, **we will have to raise third-party capital**." *Id* (emphasis added). He thought the Companies "can raise a very significant amount of capital from the private sector." *Id.*

To complete a capital raise by issuing shares of common stock, that stock had to be attractive to investors. *Id.* ¶ 58. At the time, however, Treasury's senior preferred stock had priority over the Companies' other stock, and Treasury's stock carried a massive liquidation preference. *Id.* The result was that no other shareholders in the Companies could ever receive a return on their investments. *Id.* And no private investor would purchase stock knowing that he or she was

guaranteed to receive no return. *Id.* Therefore, Treasury's liquidation preference *had to be eliminated* before the Companies could issue new shares to raise capital, which would then allow an exit from conservatorship. *Id.* ¶ 59. This step could be accomplished by either (1) "writing down the liquidation preference to zero," or (2) "converting Treasury's senior preferred stock to common stock." *Id.*

*Selling Treasury's Stake for Maximal Profit.* Numerous Trump administration officials confirmed that the administration's goal was to end government ownership of the Companies by selling Treasury's stake for a large profit. *Id.* ¶ 60. In November 2016, Mr. Mnuchin said the new administration would "privatize" the Companies because it "makes no sense that the[y] are owned by the government." *Id.* ¶ 60(b). And Director Calabria said he expected that, as part of a public offering of new shares of the Companies' stock, Treasury would "sell off its shares to recoup the taxpayer investment." *Id.* ¶ 60(c). As these statements reflect, Treasury intended to exercise its common stock warrants—which would result in Treasury owning 79.9% of the Companies' common stock—and then sell that common stock to private investors. *Id.* ¶ 61.

As mentioned, however, the Companies' common stock—whether existing or newly issued—could not be sold for a "huge profit" as President Trump intended if the Companies were not attractive to private investors. *Id.* And the Companies could not be attractive so long as the liquidation preference remained in place. *Id.* Therefore, both goals of the Trump administration—ending the conservatorships through a capital raise and selling Treasury's stake for a large profit—required eliminating the liquidation preference. *Id.* ¶ 62. That, as explained, could be accomplished in one of two ways—by writing down the liquidation preference to zero or converting Treasury's senior preferred stock to common stock. *Id.* Treasury recognized as much in its September 2019 report, which responded to the President's March 2019 directive and listed ending the

conservatorships as a top priority of the administration. *Id.* In that report, Treasury recommended that the administration consider (1) "[e]liminating all or a portion of the liquidation preference of Treasury's senior preferred shares"; or (2) "exchanging all or a portion of that interest for common stock or other interests." *Id.*

The process of carrying out the administration's goals of exiting conservatorship and ending government ownership through a profitable sale required extensive planning. *See Id*. ¶ 78. There were five key—and often sequential—steps that were necessary to achieve these goals; the Trump administration was able to complete four of them before time ran out. *Id.*

<u>First</u>, as Secretary Mnuchin explained to Congress, part of the plan was to "accumulate capital" by "retaining earnings." *Id*. ¶ 56. To do this, the PSPAs had to be amended to end the Net Worth Sweep, which hobbled the Companies anew each quarter. *Id*. ¶ 79. Thus, in September 2019, Director Calabria and Treasury amended the PSPAs to permit the Companies to build a combined $45 billion in net worth without paying dividends. *Id*. ¶ 80. A January 2021 amendment increased the amount even more. *Id.*

At the same time, the administration also pursued its goal of maximizing Treasury's profit. To that end, these amendments *increased* the liquidation preference in an amount equal to any earnings retained by the Companies. *Id*. Through this increase, Treasury preserved its ability to maximize its profit if it chose to eliminate the liquidation preference by converting its senior preferred shares to common stock (rather than writing down the liquidation preference to zero). *Id*. ¶¶ 80, 85. All else being equal, the larger the liquidation preference, the more common stock Treasury would receive when converting its shares; and the more common stock Treasury received, the more it would profit from the sale of that common stock. *Id*.

<u>Second</u>, the Companies had to cease paying Treasury quarterly cash dividends. *Id*. ¶ 81.

Director Calabria implemented this change within months of entering office. *Id.*

Third, the Companies needed a regulatory framework for determining the amount of capital necessary to operate under private ownership. *Id.* ¶ 82. The regulatory process for issuing this complex, highly technical rule took months to complete and was not finalized until December 2020, just a few weeks before the Trump administration ended. *Id.* The capital rule had to be in place before any public offering because private investors needed to know how much capital the Companies required in order to predict a return on equity. *Id.*

Fourth, FHFA and the Companies needed to develop regulatory and business plans for the public offering. *Id.* ¶ 83. To that end, Director Calabria directed the Companies to hire financial advisors who, in his words, could "provide needed expertise to evaluate different capital raising options and help chart a roadmap to responsibly end the conservatorships." *Id.* Both Companies did so. *Id.*

Fifth, as explained, Treasury's liquidation preference had to be eliminated so the Companies' common stock was attractive to private investors. *Id.* ¶ 84. Director Calabria said the PSPAs had to be 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." *Id.*; *see also* Mem. of FHFA Defs. in Support of Mot. to Dismiss Pls.' First Am. Compl. 19, Doc. 85 (July 18, 2022) ("FHFA Br.") (conceding that for the Trump Administration to carry out its goals "there might be a need for modification of the Enterprises' capital structures").

Significantly, several of these steps were *sequential*. Compl. ¶ 85. For example, the Companies could neither complete a plan for raising capital nor sell shares without a capital rule that told the market how much money the Companies intended to raise. *Id.* As Director Calabria

stated, "the capital rule . . . must be in place for them to be able to raise capital." *Id.*

And crucially, until the Companies and their financial advisors had a plan in place, Treasury and FHFA could not determine which of the two ways of eliminating the liquidation preference would maximize its profit. *Id.* As explained, Treasury could either write down the liquidation preference or convert its senior preferred shares to common stock. *Id.*

Because of the unconstitutional removal restriction, the Trump administration ran out of time to achieve its goals. Director Calabria repeatedly stated that the Companies would sell new shares of stock to private investors in 2021. *Id*. ¶ 87. Thus, when the Trump administration ended, FHFA and Treasury were on track to complete the public offering about two and a half or three years after Director Watt's term had ended. *Id*. ¶ 88. If President Trump had removed Director Watt at the beginning of his administration and installed his own FHFA Director, the administration could have started its work two years earlier. *Id*. ¶ 89. Therefore, but for the removal restriction, the Companies would have raised capital by selling new shares of common stock in 2019,[2] which would have required the elimination of the liquidation preference so that Treasury could exit its stake through a profitable sale. *Id.*

3. Defendants argue that the President's inability to control FHFA—the Companies' conservator—did not actually matter because he had the ability to control Treasury.[3] This argument completely ignores the Trump administration's commitment to sell Treasury's stake *for a large profit*. Ordering Treasury to give up its interests or trade them for less valuable ones would have been directly contrary to the elected President's stated goals. The elected President could

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[2] Given this timing, FHFA's citation of the statutory prohibition on selling the stock before January 2018 is irrelevant. *See* FHFA Br. 16.

[3] The Federal Circuit recently endorsed this argument *sua sponte* without receiving briefing on any of these issues. *See Fairholme Funds, Inc. v. United States*, 26 F.4th 1274, 1305 (Fed. Cir. 2022).

accomplish *both* of his goals *only* with the cooperation of FHFA because Treasury could maximize its profit only through a capital raise, which (as explained) required FHFA and the Companies to take numerous steps. *Id*. ¶ 86. Crucially, the amendments to the PSPAs *required* FHFA's mutual agreement. *Id.* The entire lesson of the Supreme Court's decision in this case is that the President is not required to give up policy goals or pursue them with one hand tied behind his back due to an unconstitutional removal restriction. He cannot be reduced "to a cajoler-in-chief." *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 502 (2010).

Defendants' complete failure to account for the President's interest in maximizing Treasury's profit also explains why they miss the point of the Trump administration's decision to *increase* the liquidation preference through amendments to the PSPAs. Defendants contend that this increase somehow undermines Plaintiffs' factual narrative, but they never mention—let alone, engage with—the fact that "Treasury permitted the liquidation preference to increase" because "[t]hat increase, all things being equal, would allow Treasury to receive more common stock if it chose to convert its senior preferred shares and thus receive more profit when later selling those shares." Compl. ¶ 85; *see also Id*. ¶ 80.

Defendants also argue for dismissal because there is no allegation that Director Watt "would have opposed an amendment" that "wrote down or converted Treasury's liquidation preference." Treas. Br. 12. But eliminating the liquidation preference was the *last* step on the road to exiting conservatorship. Compl. ¶ 84–85. The harm caused by the removal restriction was that Director Watt refused to take even *the first step*. Unlike the Trump administration, Director Watt believed FHFA should not lead the Companies out of conservatorship without new legislation. *Id.* ¶¶ 65–67, 70–71, 75. Thus, there is no allegation that Director Watt rejected the final step of exiting conservatorship because the Trump administration could not even begin the *first steps* of exiting

conservatorship with Director Watt leading FHFA.

Defendants also argue that the Court should dismiss Plaintiffs' claims because the 2019 Treasury plan included options other than eliminating the liquidation preference or exchanging Treasury's senior preferred shares for common stock. For example, Defendants note that the report mentions the possibility of taking the Companies into "receivership." FHFA Br. 19. But the other options listed in the report, including "receivership," were irreconcilable with all the public statements made by Trump administration officials. *See* Compl. ¶ 63. It also is inconsistent with the Agencies' last word on the matter. *See Id*. ¶ 93. Thus, reading the Treasury report's menu of options alongside other public statements reveals that eliminating the liquidation preference or exchanging Treasury's senior preferred shares for common stock were the only options listed in the report that would permit the Trump administration to achieve its goals. *Id*. ¶ 63.

## II. The Court should allow Plaintiffs' Appropriations Clause claims to proceed.

### A. Plaintiffs' Appropriations Clause claims are properly before the Court.

FHFA is wrong when it argues that Plaintiffs' Appropriations Clause claims cannot be considered on remand. *See* FHFA Br. 12–13. The Supreme Court held that this Court, the en banc Fifth Circuit, and FHFA itself were all mistaken when they assumed that the Director of this agency could not be removed by the President except for cause. *Collins*, 141 S. Ct. at 1788–89. The Court then remanded the case "for further proceedings consistent with [its] opinion," *id.* at 1789, and one implication of that opinion is that FHFA is controlled by the President while being funded entirely outside the appropriations process, *see id.* at 1772 (observing that "FHFA is not funded through the ordinary appropriations process"). The Supreme Court's opinion tees up a serious question about whether this combination of the power of the purse with the power of the sword violates the Appropriations Clause, and Plaintiffs were entirely within their rights to amend the complaint to bring this issue to the fore. Consideration of Plaintiffs' Appropriations Clause

claim thus falls comfortably within the scope of the Supreme Court's mandate, and in any event the Supreme Court's decision constitutes "an intervening change of law by a controlling authority" that gives this Court greater flexibility to consider new theories on remand. *See United States v. McCrimmon*, 443 F.3d 454, 460 (5th Cir. 2006).

FHFA is on no firmer footing when it argues that the Appropriations Clause claims are time-barred. The original complaint was filed within the applicable six-year statute of limitations, *see* 28 U.S.C. § 2401(a), and a new claim asserted in an amended complaint relates back if it "arose out of the conduct, transaction or occurrence set out . . . in the original pleading." Fed. R. Civ. P. 15(c)(1)(B). Plaintiffs' Appropriations Clause claims arise out of FHFA's adoption and implementation of the Third Amendment—the same agency action that the original complaint challenged. It makes no difference to the relation back analysis that Plaintiffs have refined their legal theories to account for the Supreme Court's decision. *See FDIC v. Bennett*, 898 F.2d 477, 480 (5th Cir. 1990) ("The fact that an amendment changes the legal theory on which the action initially was brought is of no consequence if the factual situation upon which the action depends remains the same and has been brought to defendant's attention by the original pleading.").

**B. FHFA's funding structure violates the Appropriations Clause.**

The Court should assess the merits of Plaintiffs' Appropriations Clause claims by focusing on the Constitution's text, structure, and history. On text and structure, Defendants start off on the wrong foot by arguing that the Appropriations Clause places no limits whatsoever on what Congress may do. *See* Treas. Br. 18–19; FHFA Br. 22–23. The Appropriations Clause is located in Article I, Section 9, and every other provision of that section of the Constitution is an express denial of powers to Congress. The Framers saw fit to place the Appropriations Clause alongside other vital limitations on Congress's powers—including, among other things, the prohibitions on

ex post facto laws and peacetime suspensions of the writ of habeas corpus. The Constitution's text thus leaves no doubt that the Appropriations Clause prohibits Congress from ceding its power of the purse to other organs of government.

History confirms this reading of the constitutional text. The Framers saw the power of the purse as "the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people," THE FEDERALIST NO. 58 (Madison)—a perspective that was informed by their familiarity with the British Parliament's struggles with the King prior to the English Revolution, *CFPB v. All Am. Check Cashing, Inc.*, 33 F.4th 218, 225–26 (2022); *see* 2 Joseph Story, *Commentaries on the Constitution of the United States* § 1348 (3d ed. 1858) (warning that if Congress failed to decide how and when money should be used, "the executive would possess an unbounded power over the public purse of the nation; and might apply its moneyed resources at his pleasure"). Few propositions of political philosophy were more widely accepted at the time of the founding than the notion that the appropriations power should be exercised exclusively by the legislature—the branch of government closest to the people. *See* E. James Ferguson, *The power of the purse; a history of American public finance, 1776-1790*, 111 (1961). History thus confirms that the lines of democratic accountability that the Appropriations Clause mandates are "at the foundation of our constitutional order" and must be respected. Kate Stith, *Congress' Power of the Purse*, 97 YALE L.J. 1343, 1344 (1988).

Tradition is another important consideration in separation of powers cases, and FHFA's funding structure is wholly unprecedented. In HERA, Congress expressly disavowed responsibility for how this agency raises and spends money: "The amounts received by [FHFA] from any assessment under this section shall not be construed to be Government or public funds or appropriated money." 12 U.S.C. § 4516(f)(2). Such congressional disclaimers of any exercise

of authority under the Appropriations Clause are highly unusual, *see* Charles Kruly, *Self-Funding and Agency Independence*, 81 GEO. WASH. L. REV. 1733, 1735–36 (2013), and most of the other federal entities that Defendants discuss in their briefs are funded through congressional appropriations of one sort or another, *see, e.g.*, 39 U.S.C. § 2401(a) ("There are appropriated to the Postal Service all revenues received by the Postal Service."); 35 U.S.C. § 42(b) (providing for disposition of "appropriations for defraying the costs of the activities of the Patent and Trademark Office"); 8 U.S.C. § 1356(a) (addressing appropriations for USCIS). Absent express statutory language to the contrary, courts do not "lightly presume that Congress meant to surrender its control over public expenditures by authorizing an entity to be entirely self-sufficient and outside the appropriations process." *Am. Fed'n of Gov't Emp., AFL-CIO, Local 1647 v. FLRA*, 388 F.3d 405, 410 (3d Cir. 2004); *see generally* GAO, Principles of Federal Appropriation Law, at 2-22 to 2-27 (4th ed. 2016), https://bit.ly/3zXnRrg (last visited Aug. 15, 2022).

Even among the small handful of federal agencies that are funded without any kind of appropriation, FHFA is exceptional because it is non-independent. In contrast to the Federal Reserve, the FDIC, and many of Defendants' other examples,[4] FHFA is an Executive Branch agency—meaning that its funding structure gives the President a blank check to tax and spend as he pleases. Agency independence "moderat[es] the threat to the separation of powers created by combining the powers of the purse and the sword," *All Am. Check Cashing*, 33 F.4th at 236, but

[4] Other agencies identified by Defendants that are headed by multi-member boards with some measure of independence from the President include the Farm Credit Administration, 12 U.S.C. § 2242(a), the National Credit Union Administration, 12 U.S.C. § 1752a, and the Public Accounting Oversight Board, *see Free Enter. Fund v. PCAOB*, 561 U.S. 477 (2010) (holding that one of two layers of removal protection for PCAOB violated the separation of powers). FHFA maintained that the Office of the Comptroller of the Currency was independent until the Supreme Court said otherwise two years ago in *Seila Law*, 140 S. Ct. 2183, 2201 n.5 (2020), and in any event that office is a part of the Treasury Department—an agency funded and made accountable for its spending through the normal appropriations process. *See* 12 U.S.C. § 1(a).

the Supreme Court's decision in this case clarifies that no such moderating influence applies to FHFA.

Defendants attempt to distinguish FHFA from the CFPB based upon the relative scope of these two agencies' powers, but their arguments are strikingly similar to others that the Supreme Court has already rejected in this very case. *See Collins*, 141 S. Ct. at 1784–85. If anything, FHFA's funding structure is *more* problematic than that of the CFPB. The CFPB is allowed to collect and spend no more than 12% of the Federal Reserve's budget. 12 U.S.C. § 549(a)(1). In contrast, FHFA can impose *any* assessment on Fannie, Freddie, and the Federal Home Loan Banks that its Director deems "sufficient to provide for reasonable costs . . . and expenses," 12 U.S.C. § 4516(a), and "necessary . . . to maintain a working capital fund," 12 U.S.C. § 4516(a)(3). In practical terms, that amounts to an unlimited power to collect and spend money, for FHFA regulates entities that have *over $8 trillion* of assets from which it may freely draw. Statement of Sandra L. Thompson, FHFA Director, Before the House Comm. On Fin. Servs. (July 20, 2022) https://bit.ly/3AnDFVq (last visited Aug. 15, 2022).

Defendants attempt to downplay Judge Jones's concurrence in *All American* as a "minority opinion," FHFA Br. 24–25; Treas. Br. 21, but nothing in the en banc majority's reasoning in that case is inconsistent with the Jones concurrence. The considered views of five judges on the Fifth Circuit deserve at least as much weight as Defendants' contrary out-of-circuit precedents. That is particularly so because Defendants' cases rejected challenges to the funding structures of FHFA and the CFPB as part of broader separation of powers analyses that the Supreme Court has since repudiated. *Compare, e.g.*, *PHH Corp. v. CFPB*, 881 F.3d 75, 77–80 (D.C. Cir. 2018) (en banc), *with Seila Law LLC v. CFPB*, 140 S. Ct. 2183, 2192 (2020). This Court should follow the Jones concurrence, which is the only judicial opinion that has examined the Appropriations Clause issues

before the Court with careful attention to the Constitution's original public meaning.

Other cases Defendants cite have "no bearing on the constitutionality" of FHFA's funding structure. *See All Am. Check Cashing*, 33 F.4th at 39. The Court in *OPM v. Richmond*, 496 U.S. 414, 424 (1990), and *Reeside v. Walker*, 52 U.S. 272, 291 (1850), merely declined to grant unauthorized monetary remedies. And *Cincinnati Soap Co. v. United States*, 301 U.S. 308, 321 (1937), upheld a tax while noting that the "interjection of the [appropriations] question . . . is premature." Similarly, Defendants' "non-appropriated fund instrumentality" (NAFI) cases involved disputes over the scope of the federal government's waiver of sovereign immunity under the Tucker Act; they do not concern Appropriations Clause objections of the sort presented here. *See, e.g.*, *AINS, Inc. v. United States*, 56 Fed. Cl. 522, 524 (2003).

### C. The Third Amendment must be set aside because FHFA's funding structure violates the Appropriations Clause.

Defendants also fail to make a persuasive argument against awarding a meaningful remedy for Plaintiffs' Appropriations Clause claims. Defendants invoke the Supreme Court's discussion of the remedy for Plaintiffs' removal claims, but removal claims are "remedially speaking, unique." *All Am. Check Cashing*, 33 F.4th at 43 (citing *Collins*, 141 S. Ct. at 1791-93 (Thomas, J., concurring)); *see also id.* at 1788 (majority opinion) (distinguishing removal claims from other separation of powers claims for purposes of remedy). Unlike a violation of the President's removal power, an unconstitutional funding scheme strikes at the heart of an agency's authority to act. An agency with no lawful source of funding cannot act, and "the remedy, invalidation, follows directly from the government actor's lack of authority to take the challenged action in the first place." *All Am. Check Cashing*, 33 F.4th at 42; *cf. Harmon v. Brucker*, 355 U.S. 579, 581–82 (1958) ("Generally, judicial relief is available to one who has been injured by an act of a government official which is in excess of his express or implied powers.").

Treasury invokes the de facto officer doctrine, but neither the Supreme Court nor the Fifth Circuit has ever used that doctrine to deny relief in a suit brought within the statute of limitations that directly challenged unconstitutional government action. The de facto officer doctrine can only be used to cure "a 'merely technical' defect" in an official's statutory authority, *Nguyen v. United States*, 539 U.S. 69, 77 (2003); it does not apply where, as here, "the challenge is based upon nonfrivolous constitutional grounds," *Glidden Co. v. Zdanok*, 370 U.S. 530, 535–36 (1962) (plurality). Treasury is unable to cite *any* case in which a court has applied the de facto officer doctrine to an Appropriations Clause claim, and to extend the doctrine to this context would effectively render this important structural provision of the Constitution a dead letter.

Finally, the "[o]ther equitable considerations" Treasury identifies turn on disputed facts that the Court cannot accept on a motion to dismiss. *See* Tres. Br. 24–25. Being allowed to collect billions of dollars in unlawful dividends over the last decade has worked to Treasury's "benefit, not [its] detriment," and that defeats Treasury's equitable arguments. *Costello v. United States*, 365 U.S. 265, 282–83 (1961). Despite Treasury's rhetoric, the Companies did not benefit from the Third Amendment; it cost them over $124 billion. *See* Compl. ¶ 40. Treasury also fails to explain how third-party market participants could have detrimentally relied on the Third Amendment, which benefitted no one but Treasury. Indeed, far from harming the market, ruling for Plaintiffs would be a boon to it by putting Fannie and Freddie in a stronger financial position. Moreover, Plaintiffs sued within the statute of limitations, and courts cannot use laches "to jettison Congress' judgment on the timeliness of suit." *SCA Hygiene Prods. Aktiebolag v. First Quality Baby Prods., LLC*, 137 S. Ct. 954, 960, 961 n.4 (2017).

## CONCLUSION

For the foregoing reasons, the motions to dismiss should be denied.

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Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that, on August 15, 2022, a copy of the foregoing was electronically filed with the Clerk of Court of the United States District Court for the Southern District of Texas, using the CM/ECF system, which will send a Notice of Electronic filing to all parties of record.

/s/ David H. Thompson
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