No. 19-563

In the Supreme Court of the United States

STEVEN T. MNUCHIN, SECRETARY OF THE TREASURY, *et al.*,

Petitioners,

v.

PATRICK J. COLLINS, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE RESPONDENTS

Charles Flores
BECK REDDEN LLP
1221 McKinney St.
Houston, Texas 77010
(713) 951-3700

Charles J. Cooper
Counsel of Record
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
ccooper@cooperkirk.com

Counsel for Respondents

QUESTIONS PRESENTED

In 2012, the Federal Housing Finance Agency (FHFA) and the Treasury Department nationalized Fannie Mae and Freddie Mac. FHFA and Treasury claimed at the time that this action was necessary because the Companies could not afford to pay dividends on senior preferred stock owned by Treasury. Discovery in another case later revealed that this explanation is false. FHFA and Treasury knew that Fannie and Freddie were about to report the largest profits in their history—profits far in excess of amounts Treasury could have received through dividends on its senior preferred stock. FHFA did not want the Companies to accumulate capital, so it agreed to change the terms of Treasury's senior preferred stock to entitle Treasury to a quarterly "dividend" equal to the Companies' entire net worth, less a small capital buffer. When the complaint in this case was filed, this quarterly net worth sweep had already netted the federal government a $124 billion windfall. The questions presented are:

1. Whether FHFA exceeded its statutory powers under 12 U.S.C. § 4617 when it agreed to transfer the Companies' net worth to Treasury in perpetuity in exchange for no meaningful consideration; and

2. Whether under the statute's succession clause, 12 U.S.C. § 4617(b)(2)(A), FHFA succeeded to shareholders' right to sue FHFA for wiping out their investments.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES AND REGULATIONS

OTHER AUTHORITIES

OPINIONS BELOW

The opinion of the en banc Court of Appeals (Pet. App. 1a-147a) is reported at 938 F.3d 553. The opinion of the three-judge panel of the Court of Appeals (Pet. App. 150a-253a) is reported at 896 F.3d 640. The District Court's opinion (Pet. App. 254a-267a) is reported at 254 F. Supp. 3d 841.

JURISDICTION

The en banc Court of Appeals issued its judgment on September 6, 2019. This Court has jurisdiction under 28 U.S.C. § 1254(1).

INTRODUCTION

Defendants' certiorari petition says that to move forward with plans to reform the Nation's housing finance system, they need certainty regarding the legal status of the Net Worth Sweep—a 2012 decision that nationalized Fannie Mae and Freddie Mac. In view of this representation, Plaintiffs agree that the Court should grant the first question presented in Defendants' petition, which seeks review of the en banc Fifth Circuit's entirely correct decision that FHFA exceeded its statutory authority as conservator when it agreed to award the Treasury Department all the Companies' positive net worth in perpetuity. For precisely the same reason, however, the Court should also grant Plaintiffs' petition, which asks the Court to decide whether the Net Worth Sweep must be set aside because FHFA is unconstitutionally structured. Absent intervention by this Court on *both* Defendants' first question presented and the issues raised in Plaintiffs' petition, litigation over the Net Worth Sweep may drag on for several more years, thus depriving Defendants of the certainty they say they need to pursue their reform plans.

In contrast, the Court should deny Defendants' second question presented, which concerns whether as conservator FHFA succeeded to shareholders' right to sue FHFA under 12 U.S.C. § 4617(b)(2)(A). The en banc Fifth Circuit correctly held that shareholders are within the zone of interests protected by the statute that FHFA violated and that shareholders are therefore entitled to sue FHFA directly. There was no dissent on this issue below, the Fifth Circuit decided it correctly, and this Court would need to decide several questions that no lower court has addressed before it could resolve the issue in Defendants' favor.

STATEMENT

I. Fannie and Freddie are forced into conservatorship and subjected to the Purchase Agreements with Treasury.

This Nation's multi-trillion-dollar housing finance market, and familiar features of that market such as readily available, pre-payable, 30-year fixed rate mortgages, are built on the foundation of two for-profit, privately owned entities—Fannie Mae and Freddie Mac. The Companies do not themselves originate mortgages but instead purchase, guaranty, and securitize them, thus providing liquidity to the residential mortgage market.

Fannie and Freddie were well-positioned to weather the decline in home prices and financial turmoil of 2007 and 2008. Compl. ¶ 46. While banks and other financial institutions involved in the mortgage markets had heavily invested in increasingly risky mortgages in the years leading up to the financial crisis, Fannie and Freddie had taken a more conservative approach that meant that the mortgages that they insured were far safer than those insured by the nation's largest banks. *Id.* And although both Companies recorded losses in 2007 and the first two quarters of 2008—losses that largely reflected a temporary decline in the market value of their holdings caused by declining home prices—both Companies continued to generate enough cash to easily pay their debts and retained billions of dollars of capital that could be used to cover any future losses. *Id.*

In July 2008, Congress enacted the Housing and Economic Recovery Act (HERA), Pub. L. No. 110-289, 122 Stat. 2654 (2008). HERA created FHFA to replace the Companies' prior regulator and authorized FHFA to appoint itself conservator or receiver in certain statutorily specified circumstances. *See* 12 U.S.C. § 4617(a). As conservator, FHFA is authorized to take "such action as may be—(i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." 12 U.S.C. § 4617(b)(2)(D). This rehabilitative mission contrasts with FHFA's mission when it acts as a receiver, which is to "place the regulated entity in liquidation" and distribute the entity's assets according to a statutorily prescribed order of priorities. *Id.* §§ 4617(b)(2)(E), 4617(c)(1).

On September 6, 2008—despite the Companies' sound condition—FHFA abruptly forced them into conservatorship. Compl. ¶ 58. FHFA has repeatedly acknowledged that as conservator it has a statutory mandate to "preserve and conserve each company's assets and property and to put the companies in a sound and solvent condition." *Id.* ¶ 53; *see also id.* ¶ 55 (collecting additional such statements by FHFA).

In addition to establishing FHFA, HERA also gave Treasury temporary authority to purchase the Companies' securities. *See* 12 U.S.C. §§ 1455(*l*), 1719(g). Concurrent with FHFA's imposition of conservatorship, Treasury exercised this authority by entering into agreements with FHFA to purchase equity in the Companies ("Preferred Stock Purchase Agreements" or "PSPAs"). Compl. ¶ 62. The PSPAs allowed the Companies to draw up to $100 billion each from Treasury as needed to avoid a negative net worth—an amount that was subsequently increased to allow the Companies to draw unlimited sums from Treasury until the end of 2012, and thereafter capped at the amount drawn from 2010 through 2012, plus $200 billion per Company. Compl. ¶¶ 66, 80–82.

In return for Treasury's funding commitment, FHFA agreed that the Companies would provide several forms of consideration. First, the PSPAs created a new class of securities with very favorable terms to Treasury, known as Senior Preferred Stock ("Government Stock"). For each Company, the Government Stock had an initial liquidation preference of $1 billion, an amount that would increase by one dollar for every dollar drawn on Treasury's funding commitment. *Id.* ¶ 68.[1] The original PSPAs also required the Companies to pay quarterly dividends on the Government Stock's liquidation preference. These dividends

[1] If the Companies liquidate, Treasury's liquidation preference entitles it to receive the sum specified before more junior preferred and common shareholders receive anything.

could be paid in cash, at an annual rate of 10%, or in kind, by increasing the liquidation preference by an annual amount of 12%. *Id.* ¶ 70. Defendants repeatedly acknowledged the payment in kind option, *see, e.g.*, *id.* ¶¶ 71–72, and paying the dividends in kind would not have reduced the amount available under Treasury's funding commitment. *Id.* ¶ 75.

Second, FHFA agreed that the Companies would issue warrants entitling Treasury to acquire 79.9% of their common stock at a nominal price. *Id.* ¶ 67. As Treasury noted at the time, the warrants were designed to "provide potential future upside to the taxpayers," *id.*, but this upside would be shared with the Companies' other preferred and common shareholders.

Third, the PSPAs provided for the Companies to pay Treasury a quarterly periodic commitment fee. *Id.* ¶ 76. Prior to the Net Worth Sweep, Treasury consistently waived this fee, and the PSPAs provided that it could only be set with the agreement of the Companies at a market rate. For its part, Freddie forecasted its "sensitivity" to imposition of the periodic commitment fee beginning in 2013 at $0.4 billion per year, *id.* ¶ 119—a modest sum for a company that during 2013 reported comprehensive income of $51.6 billion, FEDERAL HOME LOAN MORTGAGE CORPORATION, FORM 10-K at 1 (Feb. 14, 2014).

The original PSPAs thus diluted, but did not eliminate, the economic interests of the Companies' private shareholders. As FHFA's Director assured Congress shortly after the agreements were signed, the Companies' "shareholders are still in place," and "both the preferred and common shareholders have an economic interest in the companies," which "going forward . . . may [have] some value." *Id.* ¶ 11.

II. Unwarranted accounting decisions artificially increase the Companies' draws from Treasury, and the Companies return to sustained profitability.

Under FHFA's supervision, the Companies were forced to dramatically write down the value of their assets and to incur substantial non-cash accounting losses in the form of loan loss reserves and write-offs of deferred tax assets.[2] Compl. ¶¶ 83–86. Tens of billions of dollars of these accounting adjustments were based on wildly pessimistic and unrealistic assumptions about the Companies' future financial prospects. *Id.* ¶ 83. By June 2012, FHFA had forced Fannie and Freddie to draw $161 billion from Treasury to make up for the paper losses caused by these accounting decisions. *Id.* ¶ 87. The Companies drew $26 billion more to pay dividends to Treasury. *Id.* Because the Companies were forced to draw funds from Treasury to cover the unnecessarily large paper losses and because the PSPAs tied the Companies' dividend obligations to the size of the outstanding liquidation preference, the dividends owed to Treasury were artificially inflated with each additional unnecessary draw.

As a result of these transactions, Treasury's liquidation preference swelled to $189 billion. *Id.* But based on the Companies' performance in the second quarter of 2012, it was apparent that the Companies'

---

[2] Loan loss reserves reduce reported net worth to reflect anticipated future losses. Deferred tax assets are used to reduce taxable income on future earnings. The book value of a tax asset depends on the likelihood that the corporation will earn sufficient income to use the tax asset.

private shares still had significant value. *Id.* ¶¶ 89–103. The Companies were thriving, paying cash dividends on the Government Stock without drawing additional funds from Treasury. And given the high quality of newer loans backed by the Companies, Treasury and FHFA knew the Companies would enjoy stable profitability for the foreseeable future and thus would begin to rebuild significant amounts of capital. *Id.* ¶¶ 90–91. Minutes of a July 2012 Fannie management meeting circulated widely within FHFA indicated that the Company was entering a period of "golden years" of earnings, *id.* ¶ 96, and projections attached to those minutes showed that Fannie expected its cumulative dividend payments to Treasury to exceed its total draws by 2020 and that over $118 billion of Treasury's commitment would remain available after 2022. *Id.* Similar projections were shared with Treasury less than two weeks before the Net Worth Sweep was imposed. *Id.* ¶ 99.

FHFA and Treasury also knew that the Companies were about to reverse many of the unjustified paper losses previously imposed upon them. *Id.* ¶¶ 100–02. At an August 9, 2012 meeting, just eight days before the Net Worth Sweep was announced, Fannie's Chief Financial Officer told senior Treasury officials that release of the valuation allowance on Fannie's deferred tax assets would likely occur in mid-2013 and would generate profits in the range of $50 billion—a prediction that proved to be remarkably accurate. *Id.* ¶ 100. Treasury was keenly interested in the deferred tax assets, which would have catalyzed the Companies' capital rebuilding process by instantly returning tens of billions of dollars to their balance sheets. Indeed, Treasury had discussed this issue with a financial consultant as early as May 2012, *id.* ¶ 98, and a key item on Treasury's agenda for the August 9 meeting was how quickly Fannie forecasted releasing its reserves, *id.* ¶ 94.

III. FHFA and Treasury impose the Net Worth Sweep to thwart Fannie's and Freddie's rehabilitation and enrich the federal government at the expense of private shareholders.

By August 2012, FHFA and Treasury knew that the Companies were on the precipice of generating huge profits, far in excess of the dividends owed on the Government Stock. But a buildup in capital at the Companies would have complicated the Administration's plans to keep Fannie and Freddie in perpetual conservatorship and to prevent their private shareholders from seeing any return on their investments. *Id.* ¶ 19. Therefore, on August 17, 2012, just days after the Companies announced robust second quarter earnings indicating that they had earned more than enough to pay Treasury's dividends in cash without making a draw from the funding commitment, FHFA and Treasury imposed the Net Worth Sweep to ensure, as Treasury put it, that "every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers." *Id.* ¶ 135. The Net Worth Sweep accomplishes this objective by replacing the prior dividend structure with one that requires Fannie and Freddie to pay Treasury their entire net worth on a quarterly basis, minus a small capital buffer.[3] *Id.* ¶ 112. FHFA and Treasury thus nationalized the

---

[3] The Net Worth Sweep agreement also suspended operation of the periodic commitment fee, but, as explained above, the fee had consistently been waived and was projected to be a relatively modest amount.

Companies, thereby ensuring that they could not be rehabilitated or operate in a sound condition. *Id.* ¶ 109.

As FHFA and Treasury expected, the Net Worth Sweep has resulted in massive and unprecedented payments to the federal government. From the fourth quarter of 2012, the first fiscal quarter subject to the Net Worth Sweep, through the second quarter of 2016, the most recently reported fiscal quarter when this suit was filed, Fannie and Freddie generated $195 billion in comprehensive income. *Id.* ¶ 25. But rather than using that income to prudently build capital reserves and prepare to exit conservatorship, the Companies instead were forced to pay that entire amount as "dividends" to Treasury—approximately $124 billion more than Treasury would have received under the original PSPAs if the Companies had elected to declare cash dividends. *Id.*

Importantly, Defendants knew that Treasury would benefit enormously from the Net Worth Sweep. Indeed, it was impossible for Treasury to make less money under the Net Worth Sweep than under the prior regime. There is no scenario—none—in which the Treasury is worse off under the Net Worth Sweep. Previously, Treasury received a dividend that floated, on a net basis, from 0 to $18.9 billion—in a year in which the companies made no money, the companies would borrow $18.9 billion from Treasury to the pay the dividend resulting, on a net basis, in zero dollars to Treasury. Compl. ¶¶ 87, 152. Under the Net Worth Sweep, the dividend floats from zero to infinity—reaching $130 billion in 2013 alone. *Id.* ¶ 124.

IV. Defendants' petition makes numerous factual statements that contradict the complaint.

Every first-year law student learns that the complaint's well-pleaded factual allegations must be taken as true for purposes of a motion to dismiss. Defendants' petition seeks interlocutory review of the denial of a motion to dismiss, but it fails to follow that most basic rule of civil procedure:

Defendants' Petition	**Complaint's Allegation**
In 2008, "[t]he enterprises needed to raise more capital in order to stay in business—but private investors were unwilling to provide that capital." SG Pet. 3.	In 2008, "both Companies continued to generate enough cash to easily pay their debts," Compl. ¶ 46, "[n]either Company was in danger of insolvency," *id.*, and they "had the capacity to raise additional capital through the financial markets," *id.* ¶ 47.
The Companies "had to draw more money from Treasury just to pay Treasury's dividends." SG Pet. 6.	The Companies "never were required to pay a cash dividend to Treasury but rather had the discretion to pay dividends in kind." Compl. ¶ 70.
The Net Worth Sweep was adopted to arrest a "vicious cycle—drawing money to pay dividends,	"[W]orry about the Companies exhausting Treasury's funding commitment was not the

in turn enlarging the dividends." This cycle "was particularly troubling because the size of Treasury's commitment was scheduled to become fixed, and therefore finite, at the end of 2012." SG Pet. 6.	true reason for the Net Worth Sweep." Compl. ¶ 19. Instead, "the Net Worth Sweep was adopted . . . out of concern that the Companies would make *too much* and thus would complicate the Administration's plans to keep Fannie and Freddie in perpetual conservatorship and to prevent their private shareholders from seeing any return on their investments." *Id.*
"By early 2012, the dividends that the enterprises owed Treasury had reached nearly $19 billion a year, exceeding their projected income and threatening their solvency." SG Pet. 6.	"[B]y August 2012, [Defendants] knew that Fannie and Freddie . . . would generate earnings well in excess of the Companies' dividend obligations to Treasury for the foreseeable future." Compl. ¶ 102. "Indeed, in an internal document authored the day before the sweep was announced, Treasury specifically identified the Companies' improving operating performance and the potential for near-term earnings to *exceed* the 10% dividend

	as reasons for imposing the Net Worth Sweep." *Id.* ¶ 24.
"Through [the Net Worth Sweep], Fannie and Freddie would never again incur more debt just to make their quarterly dividend payments, thereby precluding any dividend-driven downward debt spiral." SG Pet. 7.	Under the Net Worth Sweep, Fannie paid Treasury a second quarter 2013 dividend of $59.4 billion—a sum it raised "primarily through the issuance of debt securities." Compl. ¶ 145.

When the first lawsuit challenging the Net Worth Sweep on statutory grounds was filed in 2013, Defendants submitted an administrative record and moved for summary judgment. The record purported to support the same narrative that Defendants present in their petition, in which the Net Worth Sweep was necessary because the Companies' poor financial outlook supposedly trapped them in a "vicious cycle" of drawing on Treasury's funding commitment to pay Treasury's dividends. SG Pet. 6, 19–20. The D.C. Circuit was the first court of appeals to reject a statutory challenge to the Net Worth Sweep, and in doing so it described the facts in accordance with Defendants' narrative. *See Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 599–601, 607 (D.C. Cir. 2017).

Meanwhile, in parallel litigation in the Court of Federal Claims, Defendants were ordered to produce documents relevant to their decision to impose the Net Worth Sweep. Those documents, many of which are described in Plaintiffs' complaint, tell a very different story. Among other things, they reveal:

- In the weeks before the Net Worth Sweep was announced, Fannie shared financial projections with both FHFA and Treasury showing that it would be able to pay a 10% cash dividend on the Government Stock well into the future. Compl. ¶¶ 96, 99.
- The same day that Fannie's Chief Financial Officer told senior Treasury officials that Fannie anticipated making accounting adjustments that would cause it to report an additional $50 billion in profits within the next year, an FHFA official wrote that Treasury was making a "renewed push" to impose the Net Worth Sweep. *Id.* ¶ 24.
- Treasury internally described the purpose of the Net Worth Sweep this way: "By taking all [the Companies'] profits going forward, we are making clear that [they] will *not* ever be allowed to return to profitable entities." *Id.* ¶ 19.
- A White House official involved with the Net Worth Sweep privately told a commentator that he was "exactly right on substance and intent" when he said that "[t]he most significant issue here is whether Fannie and Freddie will come back to life because their profits will enable them to re-capitalize themselves and then it will look as though it is feasible for them to return as private companies backed by the government. . . . What the Treasury Department seems to be doing here . . . is to deprive them of all their capital so that doesn't happen." *Id.* ¶ 107.

Plaintiffs used these and other documents obtained from the Court of Federal Claims discovery to make detailed factual allegations in the complaint in this case showing that that "worry about the Companies exhausting Treasury's funding commitment was not the true reason for the Net Worth Sweep." Compl. ¶ 19. Yet throughout this case, Defendants have refused to credit Plaintiffs' factual allegations when seeking dismissal on the pleadings. The Court should not be misled by Defendants' efforts to bolster their disputed factual narrative with quotations from *Jacobs v. FHFA*, 908 F.3d 884 (3d Cir. 2018), and *Perry Capital LLC v. Mnuchin*, 864 F.3d 591 (D.C. Cir. 2017). The Government's repeated efforts to contradict the factual allegations in the complaint should be ignored.

V. Proceedings Below

Plaintiffs are Fannie and Freddie shareholders who sued under the Administrative Procedure Act arguing that the Net Worth Sweep must be set aside both because it exceeded the statutory authority of FHFA and Treasury and because FHFA is unconstitutionally structured. The District Court had jurisdiction under 28 U.S.C. § 1331. The District Court dismissed the complaint, ruling that all of Plaintiffs' claims fail as a matter of law. Pet. App. 261a–267a. Although the parties had filed cross-motions for summary judgment on Plaintiffs' constitutional claim, the only dispositive motion before the District Court on Plaintiffs' statutory claims was a motion to dismiss.

On appeal, a divided three-judge panel rejected Plaintiffs' claim that Defendants exceeded their statutory powers by imposing the Net Worth Sweep. The majority explained its reasoning for this conclusion in a single paragraph. Pet. App. 167a. In a lengthy dissent, Judge Willett argued that, contrary to the decisions of some other courts of appeals, "Congress did not vest the FHFA with unbounded, unreviewable power." Pet. App. 222a. The panel was also divided over Plaintiffs' constitutional claim, with a majority concluding that FHFA is unconstitutionally structured and Chief Judge Stewart disagreeing in dissent. *See* 195a–213a (panel majority); Pet. App. 217a–221a (Stewart, J., dissenting).

Plaintiffs and FHFA both petitioned for rehearing en banc, and the Fifth Circuit granted both petitions. In an opinion for the majority by Judge Willett, the Court of Appeals ruled that, on the facts alleged, the Net Worth Sweep exceeded FHFA's statutory authority. The majority concluded that as conservator FHFA is required to seek to put the Companies "in a sound and solvent condition" and to "preserve and conserve" the Companies' assets. 12 U.S.C. § 4617(b)(2)(D); Pet. App. 34a-45a. The complaint's allegations plausibly alleged that "the net worth sweep actively undermined pursuit" of those objectives. Pet. App. 47a. The majority also rejected Defendants' argument that under HERA's succession clause, 12 U.S.C. § 4617(b)(2)(A), during conservatorship only FHFA may sue FHFA for exceeding its statutory powers. Pet. App. 25a–33a.

Judge Haynes, joined by five other judges, dissented and argued that the Net Worth Sweep did not exceed FHFA's statutory authority. Pet. App. 108a–113a. No judge wrote an opinion disagreeing with the majority's conclusion that Plaintiffs' statutory claim survives HERA's succession clause.

By a vote of twelve to four, the en banc Fifth Circuit agreed with the panel majority's conclusion that FHFA is unconstitutionally structured. Pet. App. 56a-58a, 65a n.1 & 2. However, a separate nine to seven majority concluded that FHFA's unconstitutional structure does not provide a basis for setting aside the Net Worth Sweep. Pet. App. 65a–72a. On September 25, 2019, Plaintiffs filed a cert petition concerning the Fifth Circuit's constitutional ruling. *See Collins v. Mnuchin*, No. 19-422.

ARGUMENT

I. The Court should grant both the first question presented in Defendants' petition and Plaintiffs' petition.

A. Defendants are certainly correct that the decision below "casts a cloud of uncertainty over key aspects of ongoing efforts aimed at comprehensive reform of the national housing finance market," SG Pet. 25, and Plaintiffs agree that the Court should grant the first question presented in Defendants' petition—but for the same reason, the Court should also grant Plaintiffs' petition.

As Defendants explain in their petition, Treasury has announced plans to reform the Nation's housing finance system by permitting the Companies to rebuild capital and ultimately exit conservatorship. FHFA's Director has publicly said that consummating this plan will require the Companies to raise substantial additional capital in the private markets. *See* Neil Haggerty, *Fannie and Freddie will likely exit conservatorship by 2024, Calabria says*, AMERICAN BANKER (Nov. 13, 2019), https://bit.ly/2OBA8d5. To raise the required funds, the Companies will need to make the largest public offerings of new stock in history. *See* Telis Demos, *Fannie's and Freddie's Long Road to Public Offerings*, WALL STREET JOURNAL (Nov. 19, 2019), https://on.wsj.com/34b8oTp. Equity investors obviously will not be willing to purchase new shares in Fannie and Freddie so long as Treasury is entitled to 100% of the Companies' earnings in perpetuity, so one necessary step in the contemplated reform is ending the Net Worth Sweep.

Administratively ending the Net Worth Sweep requires "valuing Treasury's existing stock in the enterprises," SG Pet. 26—i.e., deciding how much (if any) compensation Treasury should receive for ending the Net Worth Sweep and retiring its senior preferred stock. But as we have argued in this litigation, Treasury should not be compensated *at all* because the unlawful Net Worth Sweep dividends have been more than sufficient to pay down the value of Treasury's stock entirely. Therefore, if Treasury uses ending the Net Worth Sweep and retiring the senior preferred stock as a basis for awarding itself valuable compensation (e.g., nearly all the Companies' common stock), this action could later be undone by a court that rules that the Net Worth Sweep was unlawful. Thus, as Defendants recognize, so long as there is a credible threat that litigation will invalidate the Net Worth Sweep, a "cloud of uncertainty" will hang over the Companies' capital structure, SG Pet. 25, and investors will not be willing to supply the tens of billions of dollars in new capital that are essential to Treasury's reform plan.

Plaintiffs agree with Defendants about the practical effects of "[p]rolonged uncertainty concerning the validity of the Third Amendment" for Defendants' housing finance reform efforts. SG Pet. 26. Accordingly, Plaintiffs agree that the Court should grant Defendants' petition and eliminate that uncertainty by affirming the decision below that the Net Worth Sweep exceeded FHFA's powers as conservator on the facts alleged in the complaint. But if the Court were to follow Defendants' recommendation to grant the petition and *reverse* the decision below, the uncertainty concerning the validity of the Third Amendment *will not be eliminated*. Rather, to eliminate that uncertainty the Court must grant not only the first question presented in Defendants' petition but also Plaintiffs' petition.

Lawsuits challenging the Net Worth Sweep on constitutional grounds are currently pending in cases that will eventually reach three more courts of appeals. *Bhatti v. FHFA*, No. 18-2506 (8th Cir.); *Rop v. FHFA*, No. 17-497 (W.D. Mich.); *Wazee Street Opportunities Funds IV LP v. FHFA*, No. 18-3478 (E.D. Pa.). If this Court holds in *Seila Law* that independent agencies may not be headed by a single Director, the Third, Sixth, and Eighth Circuits will all be called upon to decide the same remedial issue that Plaintiffs narrowly lost on in the en banc Fifth Circuit. Defendants cannot seriously dispute that there is a substantial prospect that at least one of those appeals courts will side with the seven judges who dissented on the constitutional remedy below. If the Court denies Plaintiffs' petition, this process will take years to play out, as the Eighth Circuit and the district courts in which the cases are pending when *Seila Law* is decided undoubtedly will accept supplemental briefing on its significance and then take months more to rule. Regardless of which side prevails in the district courts, appeals will follow, and as in the Fifth Circuit panel decisions could be followed by en banc determinations. In the meantime, "uncertainty concerning the validity of the Third Amendment" will persist, SG Pet. 26, and Defendants' housing finance reform plans will be frustrated.

In sum, the practical benefits of immediately reviewing the Fifth Circuit's statutory holding may prove to be illusory if the Court does not also review the Fifth Circuit's ruling on the remedy for FHFA's unconstitutional structure. Equity investors will be willing to inject vast sums of new capital into Fannie and Freddie only after both court challenges to the validity of the Net Worth Sweep have been exhausted and at least one of them has succeeded.

B. The practical effects of pending litigation over the Net Worth Sweep justify immediate review of the first question presented in Defendants' petition notwithstanding that the issue comes to the Court in an interlocutory posture. *See Virginia Military Inst. v. United States*, 508 U.S. 946 (1993) (Scalia, J., respecting denial of certiorari) (this Court "generally await[s] final judgment in the lower courts before exercising [its] certiorari jurisdiction.").

The Fifth Circuit remanded Plaintiffs' statutory claim so that the District Court could decide in the first instance "if fact issues require trial or if summary judgment should be granted." Pet. App. 51a. To the extent that the parties' factual disputes are relevant, Plaintiffs submit that Defendants have little chance of prevailing on them given the documents Defendants have already produced in discovery. In short, the interlocutory posture of Defendants' petition is not ultimately a reason to deny certiorari on their first question presented, given the practical effects of uncertainty over the Net Worth Sweep's legal status. And again, that justification for granting Defendants' petition applies with equal force to Plaintiffs' petition.

C. This is not the place for a comprehensive discussion of the reasons why the Fifth Circuit's ruling on Section 4617(f) is correct, but a few observations about Defendants' arguments on this issue are in order.

First, Defendants devote large portions of their presentation to arguing that the Court should reverse the Fifth Circuit's denial of a motion to dismiss by making factual assertions that the complaint directly contradicts, notwithstanding the procedural posture of Plaintiffs' statutory claim. Thus, we are told that the Net Worth Sweep "helped preserve and conserve the enterprises' assets" because it "reduc[ed] the likelihood that the enterprises would prematurely exhaust Treasury's [funding] commitment" and "ensur[ed] [the Companies'] ongoing access to vital yet hard-to-come-by capital." SG Pet. 17. As documented above, Plaintiffs dispute these and many other statements of fact that appear in Defendants' petition. *See supra* 10–12. At this stage of the litigation over Plaintiffs' statutory claim, Plaintiffs' version of events must be accepted as true.

The complaint rebuts Defendants' narrative of a "vicious cycle" of dividends in multiple ways. Rather than saying that the Companies were unable to pay Treasury's dividends under the existing arrangement, the complaint alleges that Defendants knew that the Companies were about to generate income far in excess of the dividends that Treasury could have collected without the Net Worth Sweep. *See, e.g.*, Compl.

¶ 18. Moreover, even if the Court disregards the complaint's detailed allegations on this point, Defendants' "vicious cycle" explanation still makes no sense because the Companies were never required to pay Treasury's dividends in cash. Instead, the PSPAs expressly authorized the Companies to pay the dividends in kind by increasing Treasury's liquidation preference. Compl. ¶¶ 70–75. The Government's brief conveniently omits this feature of the PSPAs in its statement of the case. SG Pet. 5–6.

What is more, Defendants imposed the Net Worth Sweep at a time when the Companies were about to report tens of billions of dollars in earnings that could have otherwise been held on their balance sheets and used to cover any shortfall in future unprofitable quarters. *Id.* ¶ 128. Sweeping those earnings to Treasury *increased* rather than diminished the risk of further draws on Treasury's funding commitment. But for the Net Worth Sweep, Fannie and Freddie would have approximately $120 billion in additional capital on their balance sheets to absorb any losses they experience before looking to Treasury. Far from protecting Treasury's commitment, the Net Worth Sweep exposed it to maximum vulnerability.

Defendants' dogged insistence on their discredited factual narrative while on a motion to dismiss has only one plausible explanation: the truth is utterly indefensible. The terms of the Net Worth Sweep, the timing of its adoption, the public and private statements of those involved in developing it, and its predictable effects all demonstrate that it was designed to *foreclose* the possibility that Fannie and Freddie could be rehabilitated to a sound and solvent condition. This design "*inverts*" FHFA's mission as conservator by "abandon[ing] rehabilitation," "actively undermin[ing] pursuit of a 'sound and solvent condition,'" and failing to " 'preserve and conserve' the GSEs' assets." Pet.App. 46a-47a, 49a (emphasis added). The Net Worth Sweep simply "is patently incompatible with any definition of the conservator role." *Perry Capital*, 864 F.3d at 646 (Brown, J., dissenting).

Second, even if the Court ignores the complaint's factual allegations, Defendants are dead wrong when they claim that the Net Worth Sweep "shifted significant risk from the enterprises to Treasury" because "Treasury would receive no dividend under the new formula" "if the enterprises lost money in a given quarter." SG Pet. 19–20. There is no possible scenario whatsoever where Treasury would make a penny less under the Net Worth Sweep than under the prior version of the PSPAs. Before the Net Worth Sweep, the Companies' net dividend payments to Treasury never exceeded their net worth—to the extent the Companies' net worth fell short of Treasury's 10% dividend, Treasury made up the difference by paying itself additional dividends via circular draws on its funding commitment. So, under the regime in place prior to the Net Worth Sweep, if the Companies' net worth were less than the 10% cash dividend, for example only $2 billion of net worth, then Treasury on a net basis received a dividend of $2 billion. As that example illustrates, it is impossible for the Companies' net dividend payments to Treasury to decline as a result of a change that forces them to hand over everything in perpetuity, as the Net Worth Sweep does. For Treasury, the Net Worth Sweep had only upside and carried no additional risk.

Third, none of the courts that have heard statutory challenges to the Net Worth Sweep have agreed with Defendants' assertion that under Section 4617(f) "a court may not review whether FHFA used [its] power[s] in a legal manner." SG Pet. 18. Instead, every appellate judge to examine the question has concluded that the Net Worth Sweep may be enjoined if FHFA "exceeded the powers granted" to it by statute. Pet App. 19a; *see also* Pet. App. 108a (Haynes, J., dissenting) ("Every court to address the issue agrees that the core question is whether FHFA acted within its statutory authority."). The only cases Defendants cite to support their more sweeping interpretation of Section 4617(f) are *Gross v. Bell Sav. Bank PA SA*, 974 F.2d 403 (3d Cir. 1992), and *Ward v. Resolution Trust Corp.*, 996 F.2d 99 (5th Cir. 1993). The Third and Fifth Circuits both heard statutory challenges to the Net Worth Sweep. Although they reached different results, neither endorsed Defendants' theory that Section 4617(f) bars judicial review when the conservator unlawfully exceeds its statutory powers. *See Jacobs v. FHFA*, 908 F.3d 884, 889 (3d. Cir. 2018) (explaining that Section 4617(f) applies only when FHFA "does not exceed its statutory authority").

Fourth, the issue on which the lower courts have divided is the scope of FHFA's statutory powers as conservator, and the upshot of Defendants' position is that FHFA is free to do whatever it wants. Defendants' interpretation is contrary to the plain meaning of Section 4617(b)(2)(D), which sets out FHFA's "[p]owers as conservator": "The Agency may, as conservator, take such actions as may be—(i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." Congress in this provision spelled out what the conservator "may" do; nowhere in HERA did Congress give FHFA the authority to do the *opposite*. *See New York v. FERC*, 535 U.S. 1, 18 (2002) ("[A]n agency literally has no power to act . . . unless and until Congress confers power upon it."). Outside of this litigation, FHFA has consistently agreed with our position that these provisions are "mandate[s]" and are "required." Compl. ¶ 55. Furthermore, as the Fifth Circuit observed, treating the statutory mission articulated in Section 4617(b)(2)(D) as optional would leave FHFA without "any intelligible principle to guide its discretion as conservator" and thus render the statute unconstitutional under the nondelegation doctrine. Pet. App. 40a.

Fifth, while Defendants criticize the Fifth Circuit for interpreting the statute in light of the duties of a common law conservator, SG Pet. 20, they cannot explain why Congress used the word "conservator" if it did not intend for FHFA to conserve the Companies' assets. "[I]f a word is obviously transplanted from another legal source, whether the common law or legislation, it brings the old soil with it." Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 537 (1947).

Defendants' argument to the contrary rests entirely on 12 U.S.C. § 4617(b)(2)(J)—a provision that, if interpreted in the limitless manner Defendants propose, must be invalidated to the extent that the FHFA Director's for-cause removal protection is struck down. *See* Pls.' Pet. 34–35. In any event, Section

4617(b)(2)(J) authorizes FHFA to act in its own interests "as conservator," when taking actions otherwise "authorized" by HERA, and FHFA does not advance its conservatorship interests when it thwarts Fannie's and Freddie's return to soundness and permanently dissipates assets it is charged with preserving and conserving under Section 4617(b)(2)(D). That the statute labels the power in Section 4617(b)(2)(J) as "[i]ncidental" further reinforces this conclusion. Confronted with a similarly structured statute in *Brannan v. Stark*, 342 U.S. 451, 463 (1952), this Court rejected an interpretation of an "incidental" powers provision that would have swallowed much of the rest of the statute: "We do not think it likely that Congress, in fashioning this intricate . . . machinery, would thus hang one of the main gears on the tail pipe."

II. The Court should deny Defendants' second question presented.

Although the practical effects of the pending litigation over the Net Worth Sweep are enough to justify review of Defendants' first question presented if the Court grants Plaintiffs' petition, Defendants' second question presented does not warrant review. The Fifth Circuit definitively rejected Defendants' succession clause argument, and the issue will effectively be dead if the Court refuses to consider it now despite granting Defendants' first question presented. The Court can thus decline to review Defendants' second question presented and still provide the certainty Defendants need to move forward with housing finance reform. Defendants' second question presented is not independently cert-worthy, and the Court should decline to review it.

A. Defendants exaggerate the extent of the circuit split over whether the succession clause, 12 U.S.C. § 4617(b)(2)(A), bars statutory challenges to the Net Worth Sweep. Apart from the decision below, the only other court of appeals to reach this issue was the Seventh Circuit in *Roberts v. FHFA*, 889 F.3d 397, 408–10 (7th Cir. 2018). The Seventh Circuit addressed the succession clause in an alternative holding included in its decision only "[f]or the sake of completeness." *Id.* at 408. In briefly opining on this issue, the Seventh Circuit assumed without meaningful explanation that application of the succession clause turned on whether shareholders' statutory claims were direct or derivative under the Delaware Supreme Court's decision in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). The Seventh Circuit never grappled with the relevance of the question that the en banc Fifth Circuit thought dispositive: whether shareholders are within the zone of interests protected by the statute they claim FHFA violated, such that they may sue in their own names under the APA. Pet. App. 25a–32a. Notably, *none* of the en banc Fifth Circuit's sixteen judges argued that the Fifth Circuit's approach to this issue was wrong. So if the Court grants cert on Defendants' second question presented, it will be required to decide the issue without the benefit of a single appellate opinion criticizing the Fifth Circuit's reasoning.

Defendants say that the decision below also conflicts with the D.C. Circuit's decision in *Perry Capital*, SG Pet. 24–25, but *Perry Capital* supports the Fifth Circuit's ruling on the succession clause. In *Perry Capital*, the D.C. Circuit held that the succession clause did *not* require dismissal of breach of contract claims challenging the Net Worth Sweep. In so ruling, the D.C. Circuit found *Tooley* to be inapplicable to the contract claims at issue for much the same reason that the Fifth Circuit declined to apply it below: "*Tooley* has no application when a plaintiff asserts a claim based on the plaintiff's own right." 864 F.3d at 628 (internal quotation marks omitted). The D.C. Circuit in *Perry Capital* also heard a statutory challenge to the Net Worth Sweep, but it did not dismiss that challenge under the succession clause. Instead, its dismissal of the shareholders' statutory claims was based solely on the conclusion that FHFA did not exceed its statutory powers when it imposed the Net Worth Sweep. *See* 864 F.3d at 604–15. The only claims that the *Perry Capital* court dismissed under the succession clause were common law fiduciary duty claims against FHFA. *Id.* at 625–27. Dismissal of those fiduciary duty claims did not implicate the question on which the decision below turned—whether the APA entitles shareholders to sue in their own names over FHFA's statutory violation.

As the absence of any dissent below on the succession clause underscores, the Fifth Circuit's ruling on this issue was clearly correct. Defendants' criticisms of the Fifth Circuit's ruling mostly attack a straw man—strenuously arguing that the Fifth Circuit's decision is inconsistent with the standard the Delaware Supreme Court uses to distinguish between direct and derivative fiduciary duty claims even though the Fifth Circuit did not consider that line of precedent to be relevant. Defendants' discussion of the Fifth Circuit's actual reasoning is limited to a half paragraph in which they say that the direct or derivative nature of a lawsuit does not depend "on the statute under which the lawsuit is brought." SG Pet. 22–23. That is not even the law in Delaware. *See Citigroup Inc. v. AHW*

Inv. P'ship, 140 A.3d 1125, 1126–27 (Del. 2016) (*Tooley* is "not relevant" when "under the laws governing [the plaintiffs' claims] . . . the claims belong to the stockholder"). And whatever state law has to say on the matter, Congress plainly has authority to specify who with Article III standing may sue directly under a federal statute. *See Sierra Club v. Morton*, 405 U.S. 727, 732 n.3 (1972). In the APA, Congress said that "[a] person suffering legal wrong . . . or adversely affected or aggrieved by agency action within the meaning of a relevant statute is entitled to judicial review." 5 U.S.C. § 702. Because Plaintiffs fit within the zone of interests protected by the "relevant statute," they are personally entitled to judicial review and are not limited to suing derivatively on the Companies' behalf.

B. If the Court were to reject the Fifth Circuit's framework for deciding whether the succession clause bars Plaintiffs' statutory claim and adopt the approach Defendants propose, its next task would be to apply Delaware and Virginia caselaw on the distinction between direct and derivative claims to the facts of this case.[4] Regardless of the merits of Defendants'

[4] A federal regulation instructs Fannie and Freddie to "elect to follow the corporate governance . . . practices and procedures set forth in . . . [*inter alia*,] (i) [t]he law of the jurisdiction in which the principal office of the regulated entity is located", or "(ii) [t]he Delaware General Corporation law," unless "inconsistent" with Fannie's and Freddie's "authorizing statutes," "other Federal law, rules, and regulations," or "the safe and sound operations of the regulated entities." 12 C.F.R. § 1239.3(a), (b) (recently relocated from 12 C.F.R. § 1710(b)). Fannie and Freddie have elected to be subject to Delaware and Virginia corporate law, respectively. *See Fannie Mae Bylaws*, CORP. GOVERNANCE PRAC. &

arguments on how to apply the Delaware Supreme Court's *Tooley* test, this issue is plainly not cert-worthy. Indeed, it is difficult to imagine a subject it would be more ill-advised for the Court to wade into than this notoriously murky area of state law.

In any event, Plaintiffs' statutory claim is direct under *Tooley*. Far from merely suffering an injury that is "dependent on an injury to the corporation," *Tooley*, 845 A.2d at 1036, Plaintiffs were harmed by the transfer of their economic interest in the Companies to Treasury even if one assumes—contrary to the allegations in the complaint—that this action somehow helped the Companies. Minority shareholders were directly and uniquely injured by being eliminated from the Companies' capital structure, and an order restoring their economic rights would benefit those shareholders directly without affecting Fannie and Freddie. The mere fact that the Net Worth Sweep injured the Companies in addition to the unique harms it visited upon minority shareholders does not make Plaintiffs' statutory claim derivative. *See Gatz v. Ponsoldt*, 925 A.2d 1265, 1278 (Del. 2007); *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006); *cf. Franchise Tax Bd. of Cal. v. Alcan Aluminium Ltd.*, 493 U.S. 331, 336 (1990) ("[A] shareholder with a direct, personal interest in a cause of action [may] bring suit even if the corporation's rights are also implicated.").

C. Finally, if the Court decided to apply the *Tooley* test and determined that Plaintiffs' statutory claim is

---

PROC., Art. 1, § 1.05, https://bit.ly/2qARFdG; *Bylaws of the Federal Home Loan Mortgage Corporation*, CORP. GOVERNANCE PRAC. & PROC. & GOVERNING L., Art. 11, § 11.3, https://bit.ly/33j3nXw.

derivative under that standard, it would need to decide whether the succession clause transfers Plaintiffs' derivative claim to FHFA even though FHFA itself is the defendant. Applying a materially identical statute, the Federal and Ninth Circuits have held that, despite the general rule that a federal conservator or receiver succeeds to shareholder derivative claims, shareholders may derivatively sue a federal conservator or receiver for the agency's own misconduct. *First Hartford Corp. Pension Plan & Tr. v. United States*, 194 F.3d 1279, 1283 (Fed. Cir. 1999); *Delta Sav. Bank v. United States*, 265 F.3d 1017, 1024 (9th Cir. 2001). Those decisions find strong support in this Court's third party standing precedents, under which a plaintiff may assert the rights of someone else if he or she has a "close relationship" with that person and the person faces a "hindrance to [their] ability to protect [their] own interests." *Kowalski v. Tesmer*, 543 U.S. 125, 129–30 (2004) (internal quotation marks omitted). Nothing in the text of the succession clause suggests that Congress meant to overturn this bedrock legal principle when it said that the conservator would generally succeed to the "rights, titles, powers, and privileges" of stockholders "with respect to" Fannie and Freddie. 12 U.S.C. § 4617(b)(2)(A).

Allowing FHFA to succeed to claims against itself would also raise grave doubts about whether the succession clause is constitutional as applied to the unique facts of this case. Defendants' argument is that during conservatorship the Companies must accept FHFA as their exclusive representative in a lawsuit against FHFA. It is doubtful that FHFA could file a lawsuit against itself. *See United States v. Interstate Com. Comm'n*, 337 U.S. 426, 430 (1949) (recognizing the "general principle that no person may sue himself"); *see also SEC v. Federal Labor Relations Auth.*, 568 F.3d 990, 997 (D.C. Cir. 2009) (Kavanaugh, J., concurring). Putting aside that problem, this Court's due process precedents would not permit Congress to pass a law requiring a litigant to accept the decisions of a conflicted class representative, *Richards v. Jefferson Cty.*, 517 U.S. 793, 801 (1996), criminal defense lawyer, *Wood v. Georgia*, 450 U.S. 261, 271–72 (1981), or judge, *Ward v. Village of Monroeville*, 409 U.S. 57, 61-62 (1972). Neither may a federal statute require the Companies to accept FHFA as their exclusive representative in a lawsuit alleging that FHFA violated federal law.

* * *

Whether statutory challenges to the Net Worth Sweep are barred by the succession clause is the subject of the shallowest possible circuit split. Before ruling in Defendants' favor on this issue, the Court would need to answer numerous subsidiary questions that few if any lower court opinions address. This issue is unlikely to arise again in the future, the Fifth Circuit correctly decided it, and it does not warrant further review.

CONCLUSION

The Court should grant Defendants' first question presented, and for the same reason, it should grant Plaintiffs' petition. The Court should deny Defendants' second question presented.

Respectfully submitted,

Charles J. Cooper
Counsel of Record
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
ccooper@cooperkirk.com

Charles Flores
BECK REDDEN LLP
1221 McKinney St.
Houston, Texas 77010
(713) 951-3700

Counsel for Respondents