Nos. 19-422 & 19-563

In the Supreme Court of the United States

PATRICK J. COLLINS, ET AL.,

Petitioners,

v.

STEVEN T. MNUCHIN,
SECRETARY OF THE TREASURY, ET AL.

STEVEN T. MNUCHIN,
SECRETARY OF THE TREASURY, ET AL.,

Petitioners,

v.

PATRICK J. COLLINS, ET AL.

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF PATRICK J. COLLINS, ET AL.

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QUESTIONS PRESENTED

The Federal Housing Finance Agency (FHFA) is an "independent" agency headed by a single Director who is removable by the President only for cause. 12 U.S.C. § 4511(a); *id.* § 4512(b)(2). In 2012, FHFA, purporting to act as the conservator for Fannie Mae and Freddie Mac, agreed with the Treasury Department to nationalize these two privately owned, for-profit corporations, removing Plaintiffs and other private shareholders from the Companies' capital structures. The questions presented are:

1. Whether 12 U.S.C. § 4617(b)(2)(A)—which says that during conservatorship FHFA "succeed[s]" to shareholders' "rights . . . with respect to the [Companies] and the[ir] assets"—defeats Plaintiffs' statutory challenge to the nationalization of Fannie Mae and Freddie Mac;

2. Whether 12 U.S.C. § 4617(f)—which prohibits courts from taking any action that would "restrain or affect the exercise of powers or functions of the Agency as a conservator"—precludes courts from enjoining the nationalization of Fannie Mae and Freddie Mac on statutory grounds;

3. Whether FHFA's structure violates the separation of powers; and

4. Whether the courts must strike down the statutory provisions that make FHFA independent and set aside a final agency action that FHFA took when it was unconstitutionally structured.

PARTIES TO THE PROCEEDING

Petitioners and Cross-Respondents Patrick J. Collins, Marcus J. Liotta, and William M. Hitchcock were the plaintiffs in the District Court and the plaintiffs-appellants in the Court of Appeals.

Respondents and Cross-Petitioners Steven T. Mnuchin, Secretary, U.S. Department of Treasury, Department of the Treasury, Federal Housing Finance Agency ("FHFA"), and Mark A. Calabria, Director of the Federal Housing Finance Agency, were defendants-appellees in the Court of Appeals. The Department of the Treasury and the FHFA were defendants in the District Court. Jacob J. Lew, the previous Secretary of the Treasury, was initially a defendant in the District Court but later replaced as a defendant by the current Secretary of the Treasury, Steven T. Mnuchin. Melvin L. Watt, the previous Director of the FHFA, was a defendant in the District Court and initially a defendant-appellee in the Court of Appeals but later replaced as a defendant-appellee in the Court of Appeals by FHFA Acting Director Joseph M. Otting. Joseph M. Otting was subsequently replaced as a defendant-appellee in the Court of Appeals by FHFA's current Director, Mark A. Calabria.

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INTRODUCTION

One would be hard pressed to find a more egregious example of administrative overreach than the events that gave rise to this lawsuit. In August 2012—just after the housing market turned around and FHFA and Treasury learned that Fannie and Freddie were about to report the largest earnings in their history—Defendants nationalized these two private, for-profit Companies, removing Plaintiffs and other private shareholders from the Companies' capital structures. Defendants claim to have had statutory authority to take this step under a law that stressed "[t]he need to maintain" Fannie and Freddie as "private shareholder-owned compan[ies]," 12 U.S.C. § 1455(*l*)(1)(C)(v), and several Courts of Appeals agreed with Defendants' facially implausible argument that FHFA as the Companies' "conservator" is not required to conserve the Companies' assets.

Apparently recognizing that the argument that succeeded in several lower courts is unlikely to carry the day here, Defendants shifted their focus to a different defense; namely, that during conservatorship only *the conservator* may sue *the conservator* for wiping out Plaintiffs' investments. This argument rests on a fundamental misconception about who is entitled to sue under the APA, misapplies long-settled principles for distinguishing between direct and derivative shareholder claims, and if credited as a matter of statutory construction would lead to a patent violation of procedural due process.

Both the decision to nationalize Fannie and Freddie and Defendants' aggressive arguments for unlimited agency power are symptoms of a serious constitutional disease. In FHFA, Congress established an independent agency headed by a single, unelected Director answerable to no one. This Court held last term that the CFPB's identical structure violates the separation of powers. Like any other litigants injured by a federal official acting without constitutional authority, Plaintiffs are entitled to a meaningful remedy for this constitutional violation—in this case, a remedy that restores Plaintiffs to their rightful place in the Companies' capital structures.

By the time this suit was filed, the nationalization of Fannie and Freddie had netted the federal government an astonishing windfall of $124 billion. For both statutory and constitutional reasons, Defendants' action cannot stand.

STATEMENT

A. 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"). The Companies do not themselves originate mortgages but instead purchase, guaranty, and securitize them, thus providing liquidity to the residential mortgage market. In essence, the Companies insure these mortgages and allow Americans access to mortgages on attractive terms.

Fannie and Freddie were well-positioned to weather the decline in home prices and financial turmoil of 2007 and 2008. JA45. While 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 paper 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). Like the Consumer Financial Protection Bureau (CFPB), FHFA is an "independent" agency headed by a single Director who can only be removed by the President for cause. 12 U.S.C. § 4511(a); *id.* § 4512(b)(2).

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. JA52.

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 that authority by entering into agreements with FHFA to purchase equity in the Companies ("Preferred Stock Purchase Agreements" or "PSPAs"). JA53. 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. JA55–56, 62–63.

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. JA56; *see* JA133; JA187.[1] The original PSPAs also specified quarterly dividends on the Government Stock's liquidation preference. These dividends 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%. JA57; *see* JA132; JA180. Paying the dividends in kind would not have reduced the amount available under Treasury's funding commitment. JA60; *see* JA128–29.

Second, FHFA agreed that the Companies would issue warrants entitling Treasury to acquire 79.9% of their common stock at a nominal price. JA56; *see* JA128; JA132. As Treasury noted at the time, the warrants were designed to "provide potential future upside to the taxpayers," JA56, 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. JA60–61; *see* JA132. Prior to the Third Amendment to the PSPAs, Treasury consistently waived this fee, and the PSPAs provided 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, JA86—a modest sum for a com-

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[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.

pany 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." JA30.

B. 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] JA63–66. Tens of billions of dollars of these accounting adjustments were based on wildly pessimistic and unrealistic assumptions about the Companies' future financial prospects. JA63. 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. JA66. The Companies drew $26 billion more to pay

[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. *See* JA64.

cash dividends to Treasury. *Id.* Notwithstanding an option to pay dividends in kind by simply increasing the liquidation preference, FHFA forced the Companies to draw funds from Treasury to cover the unnecessarily large paper losses. And because the PSPAs tied the Companies' dividend payments to the size of the outstanding liquidation preference, Treasury's dividends 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' private shares still had significant value. JA67–76. 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. JA67–68. 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, JA70–71, 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. JA73–74.

FHFA and Treasury also knew that the Companies were about to reverse many of the unjustified paper losses previously imposed upon them. JA75–76. 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 for Fannie alone—a prediction that proved to be accurate. JA75. 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, JA72–73, and a key item on Treasury's agenda for the August 9 meeting was how quickly Fannie forecasted releasing its reserves, JA69–70.

C. FHFA and Treasury impose the Net Worth Sweep, thwarting Fannie's and Freddie's rehabilitation and enriching the federal government at the expense of private shareholders.

By August 2012, FHFA and Treasury knew that the Companies were on the verge 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 Defendants' plans to keep Fannie and Freddie in perpetual conservatorship and to prevent their private shareholders from seeing any return on their investments. JA35. 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 amended the PSPAs to impose the Net Worth Sweep and ensure, as Treasury put it, that "every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers." JA97. 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 buffer.[3] JA83. FHFA and Treasury thus nationalized Fannie and Freddie, thereby ensuring that they could not be rehabilitated or operate in a sound condition. JA81.

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. JA38–39. 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

[3] This Third Amendment to the PSPAs also suspended operation of the periodic commitment fee, but the fee had consistently been waived and was projected to be a relatively modest amount. JA86.

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. JA69. 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. JA66; JA106–07. Under the Net Worth Sweep, however, the dividend floats from zero to infinity—reaching $130 billion in 2013 alone. JA90. Thus, Treasury assumed precisely zero risk when it agreed to the Net Worth Sweep.

The Net Worth Sweep also exposed the line of commitment to maximum vulnerability. JA99–100. With only a minimal buffer, the Companies would have to draw on the commitment in any quarter where they suffered more than minimal losses. In the absence of the Net Worth Sweep, the Companies would have over $124 billion in capital to absorb any such losses before the commitment would have to be tapped. *See* JA93.

D. Proceedings Below

Plaintiffs are Fannie and Freddie shareholders who sued 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 dismissed the complaint, ruling that all of Plaintiffs' claims fail as a matter of law. Pet. App. 261a–267a.[4] 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. Pet. App. 167a. In dissent, Judge Willett argued that, contrary to the decisions of some other courts, "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 then-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 the 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

[4] "Pet. App." citations refer to materials appended to Defendants' petition.

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), only FHFA may sue FHFA for exceeding its statutory powers as conservator. Pet. App. 25a–33a. Judge Haynes dissented and argued that the Net Worth Sweep did not exceed FHFA's statutory authority. Pet. App. 108a–113a.

By a vote of twelve to four, the en banc Fifth Circuit concluded that FHFA is unconstitutionally structured. Pet. App. 56a-58a, 65a n.1 & 2. By a vote of nine to seven, however, a different majority refused to set aside the Net Worth Sweep. App.73–81. Judge Willett dissented from the court's ruling on the remedy, arguing that analysis of that issue should be guided by this Court's decision in *Bowsher v. Synar*, 478 U.S. 714, 736 (1986). Judge Willett also observed that this Court has repeatedly set aside agency actions rendered in violation of the Appointments Clause and reasoned that it is anomalous to withhold the same remedy for violations of the President's removal power. App.155–56. In a separate dissent on the remedy issue, Judge Oldham argued that the court exceeded its authority under Article III by rewriting HERA to strip FHFA of its independence while withholding relief that would fully redress Petitioners' injuries from the Net Worth Sweep. App.111–17.

SUMMARY OF ARGUMENT

I. Plaintiffs' statutory claim is not barred by HERA's Succession Clause, 12 U.S.C. § 4617(b)(2)(A). Defendants concede that this provision does not foreclose direct shareholder claims, and it is undisputed that Plaintiffs are "aggrieved . . . within the meaning of a relevant statute" because they fall within the zone of interests arguably protected by HERA. 5 U.S.C. § 702. Under this Court's precedents, no more is required for Plaintiffs to maintain a direct statutory claim. *See American Power & Light Company v. SEC*, 325 U.S. 385 (1945).

Plaintiffs' statutory claim is also direct under the standard traditionally applied to distinguish direct from derivative shareholder claims. Injured shareholders can sue directly when an action increases the value of a favored class of a corporation's stock to the detriment of all others. The Net Worth Sweep removed Plaintiffs from the Companies' capital structures, and this action visited a direct injury on Plaintiffs without regard to its effect on Fannie and Freddie. A single fact pattern sometimes gives rise to *both* direct and derivative claims, and Defendants err when they assume that the Net Worth Sweep could not have injured Plaintiffs directly merely because it *also* injured the Companies.

Furthermore, even if the Court concludes that Plaintiffs' statutory claim is derivative, the Succession Clause is best read as permitting shareholder derivative claims against the conservator. Defendants' contrary position—that only *the conservator* can sue *the conservator* for exceeding its statutory powers by imposing the Net Worth Sweep—would render the statute unconstitutional as a matter of procedural due process.

II. FHFA exceeded its statutory authority when it imposed the Net Worth Sweep. As conservator, FHFA's statutory mission is to seek to preserve and conserve the Companies' assets and to restore them to a sound condition. *See* 12 U.S.C. § 4617(b)(2)(D). The Net Worth Sweep dissipated assets that FHFA is required to preserve, and it guaranteed that the Companies could never rebuild capital and return to a sound condition. Whatever the scope of FHFA's discretion as conservator, it exceeds its authority when it takes steps that are antithetical to its conservatorship mission.

Defendants' claims that the Net Worth Sweep somehow preserved Fannie's and Freddie's assets misconceive the terms of the original PSPAs. The Companies were never under any obligation to pay cash dividends on Treasury's senior preferred stock, and it is impossible for the Companies' net dividend payments to go down as a result of the Net Worth Sweep. Defendants' arguments also directly contradict the allegations in the Complaint, which alleges—based upon Defendants' own documents—that the Net Worth Sweep is designed to prevent the Companies from rebuilding capital and delivering value for their private shareholders.

III. As an independent agency headed by a single Director, FHFA's structure is identical to that of the CFPB. That FHFA's structure violates the separation of powers follows *a fortiori* from the Court's decision last term in *Seila Law LLC v. CFPB*, 140 S. Ct. 2183 (2020).

IV. The appropriate remedy for Plaintiffs' constitutional claim is to set aside the Third Amendment. This Court has often vacated the actions of federal officials who acted without constitutional authority, and any lesser remedy would leave litigants with little incentive to bring separation of powers claims.

The Fifth Circuit treated FHFA's constitutional violation as harmless error, but this Court has never applied the harmless error rule in a separation of powers case. Separation of powers violations are structural errors not subject to the harmless error rule, and in any event the error in this case was not harmless.

ARGUMENT

I. THE SUCCESSION CLAUSE DOES NOT BAR PLAINTIFFS' CHALLENGE TO THE NET WORTH SWEEP

Every Court of Appeals to address the issue has concluded and Defendants concede that the Succession Clause—12 U.S.C. § 4617(b)(2)(A)—does not bar direct shareholder claims during conservatorship. *See* Pet. App. 26a–27a; *Roberts v. FHFA*, 889 F.3d 397, 408 (7th Cir. 2018); *Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 624 (D.C. Cir. 2017). The en banc Fifth Circuit correctly held without any dissent that Plaintiffs' statutory claim is direct rather than derivative, Pet. App. 27a–32a, and this claim therefore is not subject to dismissal under the Succession Clause. Moreover, even if Plaintiffs' statutory claim were derivative, it could still proceed due to the conservator's conflict of interest in deciding whether Fannie and Freddie should sue the conservator for exceeding its statutory authority.

A. Plaintiffs' Statutory Claim is Direct Under the APA.

1. A direct suit rests upon the shareholder's "direct, personal interest in a cause of action," *Franchise Tax Bd. v. Alcan Aluminum Ltd.*, 493 U.S. 331, 336 (1990), and is not "founded on a right of action existing in the corporation itself," *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 528 (1984). A derivative action, in contrast, is one in which a shareholder "seek[s] in [the corporation's] right the restitution he could not demand in his own." *Id.* (internal quotation marks omitted). Although Defendants devote much of their argument to the standard the Delaware Supreme Court uses to distinguish direct from derivative fiduciary duty claims, the correct question is whether Plaintiffs themselves fall within the category of individuals who are authorized to seek judicial review of FHFA's actions under the APA. If Plaintiffs are personally "aggrieved . . . within the meaning of a relevant statute," 5 U.S.C. § 702, they have a "direct, personal interest in a cause of action" and are therefore entitled to sue directly in their own names and without resort to a derivative action on behalf of Fannie and Freddie, *Alcan*, 493 U.S. at 336.

As a gloss on the phrase "within the meaning of a relevant statute," 5 U.S.C. § 702, this Court has held that one who seeks judicial review under the APA must show that the suit aims to vindicate interests that are " 'arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question.' " *Clarke v. Sec. Indus. Ass'n*, 479 U.S. 388, 395–96 (1987) (quoting *Ass'n of Data Processing Serv. Orgs., Inc. v. Camp*, 397 U.S. 150, 153

(1970)). The zone-of-interests test is the "appropriate tool for determining who may invoke" the APA's generous judicial review provisions, *Lexmark International, Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 130 (2014), and this Court has repeatedly used this test to decide who is "a proper litigant" in APA cases, *Clarke*, 479 U.S. at 390. Thus, for a claim brought under the APA, the zone-of-interests test is the correct rule for determining whether a plaintiff has personal rights under the statute and thus may sue directly.

When applied in APA cases, the zone-of-interests test "is not meant to be especially demanding," *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Patchak*, 567 U.S. 209, 225 (2012) (internal quotation marks omitted), and it is easily satisfied here. As the Court of Appeals held and Defendants do not dispute, Plaintiffs fall within the zone of interests protected by HERA because they are "the residual claimants of [the Companies'] value." Pet. App. 29a. The statute empowers FHFA to act as a "conservator," thus drawing upon a long tradition of conservators acting to rehabilitate distressed financial institutions and to protect the interests of their shareholders. *See infra* 40–41. The statute expressly commands the conservator to "preserve and conserve" the Companies' assets and restore them to a "sound and solvent condition," 12 U.S.C. § 4617(b)(2)(D), recognizes that conservatorship does not terminate shareholders' claims against the Companies' assets, *id.* § 4617(b)(2)(K)(i), and maintains a place for shareholders in the order of priorities for payments to claimants if the Companies are liquidated in receivership, *id.* § 4617(c)(1). Plaintiffs' interests thus comfortably fit within the zone of interests. It follows that Plaintiffs can maintain a direct claim under the APA and need not sue on behalf of Fannie and Freddie.

2. Using the zone-of-interests test to determine whether Plaintiffs can maintain a direct statutory claim finds strong support in *American Power & Light Company v. SEC*, 325 U.S. 385 (1945)—a case this Court decided one year before Congress enacted the APA. In that case, the SEC ordered a corporation to make accounting entries on its books to increase capital reserves, thereby reducing the funds that would have otherwise been available to pay dividends to the corporation's sole and controlling common shareholder. *Id.* at 386–87. The shareholder brought a direct challenge to the Commission's order, claiming it was entitled to do so under a statute that provided that "any person or party aggrieved by an order issued by the Commission" could obtain judicial review. *Id.* at 386 (quoting 15 U.S.C. § 79x(a)). Reversing the First Circuit's ruling that the shareholder was required to proceed derivatively, this Court declined to apply "the usual criteria of standing to sue" and instead asked only whether the shareholder was a "person . . . aggrieved" within the meaning of the statute. *Id.* at 390. "In awarding a review of an administrative proceeding," this Court explained, "Congress has power to formulate the conditions under which resort to the courts may be had." *Id.* at 389. The shareholder was "aggrieved" under the statute—and thus entitled to sue directly—because the Commission's order did not affect the corporation "in the manner it affect[ed]

the [shareholder].” *Id.*; *see also id.* at 392 (“[W]e do not deem it essential that the proceeding have the character of a derivative suit.”).

Congress consciously drew upon the caselaw concerning who is an “aggrieved” person within the meaning of existing judicial review statutes when it enacted the APA, *see* ATTORNEY GENERAL’S MANUAL ON THE APA at 96 (1947), *available at* https://bit.ly/33bfjfW, and *American Power* bears directly upon the issues in this case in several respects. First, the only injury that the plaintiff shareholder suffered in *American Power* was that a regulatory action directed at the corporation made it more difficult for the corporation to pay dividends. Plaintiffs in this case similarly challenge an action that injured Plaintiffs, *inter alia*, by making it impossible for Fannie and Freddie to pay dividends on Plaintiffs’ stock. If the shareholder in *American Power* could maintain a direct claim under a statute that closely parallels the operative language in the APA, it follows *a fortiori* that the same is true here.

Second, the locus of this Court’s analysis in *American Power* was whether the shareholder plaintiff was itself “aggrieved” within the meaning of the applicable statute. Likewise in this case, the only question is whether Plaintiffs may personally invoke judicial review under 5 U.S.C. § 702. The standards state courts typically use to distinguish between direct and derivative claims in other contexts—i.e., “the usual criteria of standing to sue” when a shareholder files a lawsuit, *American Power*, 325 U.S. at 390—are irrelevant.

Third, in lamenting the "untenable consequences" that Defendants say would follow from allowing any person "aggrieved by agency action within the meaning of a relevant statute" to sue directly under the APA, SG Br. 30, Defendants echo the dissent in *American Power*, which argued that under the majority's decision there would be "no limit to which minority stockholders may harass the Commission and their respective corporations by challenging orders of the Commission directed to the corporations." 325 U.S. at 396 (Murphy, J., dissenting). Three quarters of a century later, Plaintiffs submit that experience under statutes like the one before the Court in *American Power* has not borne out Justice Murphy's prediction.

Nor is there reason to fear that a straightforward application of the zone-of-interests test here would lead to an avalanche of direct shareholder suits under the APA. *See* SG Br. 28–29. Although the zone-of-interests test is forgiving in APA cases, it is not satisfied when a plaintiff's interests are "so marginally related to . . . the purposes implicit in the statute that it cannot reasonably be assumed that Congress intended to permit the suit." *Patchak*, 567 U.S. at 225 (internal quotation marks omitted). Despite Defendants' suggestions to the contrary, a shareholder advancing a direct claim under the APA will not automatically meet this standard whenever it is satisfied by the corporation itself. To maintain a direct suit under the APA, a shareholder must show that "*his* aggrievement, or the adverse effect *upon him*" arguably falls within the zone of interests protected or regulated by the relevant statute. *Lujan v. Nat'l Wildlife Fed'n*, 497 U.S.

871, 883 (1990). That requirement is easily and undisputedly satisfied by the shareholder-focused statutory provisions in HERA, but Defendants are wrong when they contend that the same will be true any time a statute authorizes an agency to levy fees or deny subsidies to a corporation without making any reference to how the corporation should be managed or to the rights of shareholders. *Cf. Air Courier Conf. v. Am. Postal Workers Union AFL-CIO*, 498 U.S. 517, 523–25 (1991).

3. Despite Defendants' argument to the contrary, SG Br. 26–27, resort to state corporation law to determine whether Plaintiffs' statutory claim is direct or derivative is not justified by the last sentence of 5 U.S.C. § 702: "Nothing herein . . . affects other limitations on judicial review or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable ground." That sentence was enacted in 1976 as part of a broad abrogation of sovereign immunity, and Congress added it "simply to make clear that all other than the law of sovereign immunity remain unchanged." *Darby v. Cisneros*, 509 U.S. 137, 153 (1993) (cleaned up). In *Darby*, the Solicitor General made essentially the same argument that Defendants advance here, and this Court concluded that the 1976 "postenactment legislative history" provides no insight into the nature and scope of the equitable defenses the government may invoke in APA cases. *Id.* at 152–53.

Furthermore, even if Defendants' argument about the last sentence of 5 U.S.C. § 702 had not already been rejected in *Darby*, it would fail because it fundamentally misunderstands the shareholder standing rule. That rule was previously categorized among the "prudential requirements of the standing doctrine." *Franchise Tax Bd. v. Alcan Aluminum Ltd.*, 493 U.S. 331, 336 (1990). This Court's decision in *Lexmark* calls into question whether the "prudential" label is apt, 572 U.S. at 127 n.3, but the point remains that the shareholder standing rule is part of a broader body of non-Article III default rules concerning who may sue over an alleged injury. Then-Judge Scalia, who had more than passing familiarity with the 1976 amendments, *see Darby*, 509 U.S. at 152 n.15, observed in 1985 that the APA "pare[s] back traditional prudential limitations" on who may sue in favor of the more lenient zone-of-interests test, *FAIC Sec., Inc. v. United States*, 768 F.2d 352, 357 (D.C. Cir. 1985) (Scalia, J.). This Court's decisions cannot be understood in any other way. *Compare, e.g.*, *Nat'l Credit Union Admin. v. First Nat'l Bank & Tr. Co.*, 522 U.S. 479, 488 (1998) (concluding competitor had standing to challenge agency action under zone-of-interests test), *with Ala. Power Co. v. Ickes*, 302 U.S. 464, 479–81 (1938) (explaining why competitors generally lacked standing under legal regime that prevailed prior to the APA). Thus, while Defendants remain free to invoke "*other* limitations on judicial review" and "*other* appropriate legal or equitable ground[s]" for dismissal, 5 U.S.C. § 702 (emphases added), the 1976 amendments to the APA do not negate the ability of anyone "aggrieved by agency action within the meaning of a relevant statute" to bring a direct suit seeking judicial review, *id.*

4. In resisting application of the zone-of-interests test to determine whether Plaintiffs may maintain a

direct statutory claim, Defendants also point to two examples of what they say are "other statutes that grant a similar right of review" but that have been interpreted "not to alter the operation of background restrictions on shareholder suits." SG Br. 27–28. Both examples are inapposite.

Defendants' first example is 42 U.S.C. § 1981—a statute that does not even expressly create a private right of action, much less address which private litigants may invoke it in court. This Court recognized an implied private right of action under Section 1981 in *Johnson v. Railway Express Agency, Inc.*, 421 U.S. 454, 459–60 (1975), and it is hardly surprising that the Court subsequently drew upon general principles of corporation and agency law when deciding who could assert a cause of action that it had created, *see Domino's Pizza, Inc. v. McDonald*, 546 U.S. 470, 477 (2006); *see also Franklin v. Gwinnett Cty. Pub. Sch.*, 503 U.S. 60, 76–78 (1992) (Scalia, J., concurring in the judgment) (recognizing heightened judicial responsibility to supply limits on implied rights of action).

Even less help to Defendants is their second example, the Racketeer Influenced and Corrupt Organizations Act (RICO), which gives a private right of action to "[a]ny person *injured in his business or property* by reason of" a pattern of racketeering activity. 18 U.S.C. § 1964(c) (emphasis added). "[T]he breadth of the zone of interests varies according to the provisions of law at issue," and this Court has described the emphasized text as "more restrictive" in its specification of who may sue—a sharp contrast to the APA's "generous review provisions." *Bennett v. Spear*, 520 U.S.

154, 163, 165 (1997). Furthermore, the text of the private right of action under RICO was borrowed from Section 4 of the Clayton Act, which this Court has refused to give a literal construction for various practical and historical reasons that have nothing to do with the APA. *See Assoc. Gen. Contractors v. Cal. State Council of Carpenter*, 459 U.S. 519, 529–36 (1983). RICO is thus very far afield.

"[W]here a dispute is otherwise justiciable, the question whether the litigant is a proper party to request an adjudication of a particular issue is one within the power of Congress to determine." *Sierra Club v. Morton*, 405 U.S. 727, 732 n.3 (1972); *accord American Power*, 325 U.S. at 389. The other statutes Defendants identify contain no language comparable to 5 U.S.C. § 702.

B. Plaintiffs' Statutory Claim Is Direct Under Background Principles of Corporation Law.

1. Conspicuously absent from Defendants' discussion of how courts generally distinguish between direct and derivative claims is any citation to a case in which the terms of a corporation's stock were amended to advantage a favored shareholder and disadvantage all of its other investors. In a portion of a dissent with which the majority did not disagree, Justice Frankfurter stated the settled rule for such cases: "[I]f a corporation rearranges the relationship of different classes of security holders to the detriment of one class, a stockholder in the disadvantaged class may proceed against the corporation as a defendant to protect his own legal interest." *Swanson v. Traer*, 354

U.S. 91, 99 (1957) (Frankfurter, J., dissenting). Such cases of "reorganization . . . deal with the interests of investors" and thus are proper subjects for direct suits. *Pittsburgh & W.V. Ry. Co. v. United States*, 281 U.S. 479, 487 (1930); *see* 12B FLETCHER CYCLOPEDIA OF THE LAW OF CORP. § 5908 (Sept. 2020) (listing among examples of direct claims shareholder challenges to "recapitalization[s]" that unfairly disadvantage minority shareholders).

This Court's decision in *Alleghany Corporation v. Breswick & Company*, 353 U.S. 151, 160 (1957), is illustrative. In that case, two controlling shareholders caused their corporation to exchange existing preferred stock (worth $33 million) for new preferred stock (worth $48 million), a transaction that benefited the controlling shareholders while simultaneously reducing the proportionate ownership interests of common shareholders. After regulators approved the transaction, minority shareholders sued, arguing that the transaction violated shareholder-rights provisions of the Investment Company Act. *Alleghany*, 353 U.S. at 158–59. In holding that the suit could go forward, the Court explained that the transaction did not involve simply "the indirect harm which may result to every stockholder from harm to the corporation." 353 U.S. at 160 (quoting *Pittsburgh & W. Va. Ry. Co.*, 281 U.S. at 487). Rather, the conduct of the controlling shareholders imposed distinct harms on the "minority common stockholders," *id.* at 158, who could therefore maintain a direct action. *Alleghany* is consistent with many other cases involving similar transfers of value from one class of shareholders to another. *See, e.g.*, *Jones v. H.F. Ahmanson & Co.*, 460 P.2d 464, 466–72

(Cal. 1969) (Traynor, C.J.); *Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.*, 2005 WL 1713067, at *8 (Del. Ch. July 13, 2005); *Acker v. Transurgical, Inc.*, 2004 WL 1230945, at *1 (Del. Ch. Apr. 22, 2004).

Under *Alleghany* and similar cases, Plaintiffs can maintain a direct claim. The Net Worth Sweep radically changed the terms of Treasury's preferred stock, transferring Plaintiffs' entire economic interest in the Companies to Treasury, and thus effectively removing Plaintiffs from the Companies' capital structure. That effect of the Net Worth Sweep harms Plaintiffs, not Fannie and Freddie.

2. There is no tension between the rule just described and the standard the Delaware Supreme Court uses to distinguish between direct and derivative fiduciary duty claims. *See Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). As an initial matter, before applying the *Tooley* standard, the Delaware courts first look to "the laws governing" the claim in question and ask whether the substantive law that gives rise to the claim provides that it "belong[s] to the stockholder." *See Citigroup, Inc. v. AHW Inv. P'ship*, 140 A.3d 1125, 1126–27 (Del. 2016). Because Plaintiffs' claims belong to them under the APA's zone-of-interests test, not even the Delaware courts would apply *Tooley* in this case.

In any event, Plaintiffs' statutory claim is direct under the *Tooley* test. Under *Tooley*, the Delaware courts ask two questions: "who suffered the alleged harm (the corporation or the suing stockholders, individually)"; and "who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" 845 A.2d at 1033. Where, as in this case, the corporation's capital structure is rearranged to help some shareholders and disadvantage others, the harmed shareholders suffer a direct injury that does not depend on how (or whether) the corporation was also injured. Similarly, unwinding such a transaction benefits the disadvantaged shareholders without regard to the remedy's effect on the corporation.

Most of Defendants' argument to the contrary proceeds from the mistaken premise that if a transaction harms the corporation in any way, it necessarily follows that shareholders did not also suffer a distinct, direct injury. But a claim can be direct "even if the corporation's rights are also implicated." *Alcan*, 493 U.S. at 336. The requirement under *Tooley* is that the shareholder sustain a "direct injury" that is "independent of any alleged injury to the corporation," *Tooley*, 845 A.2d at 1039—not that the corporation escaped the challenged transaction unharmed. "Courts have long recognized that the same set of facts can give rise both to a direct claim and a derivative claim." *Grimes v. Donald*, 673 A.2d 1207, 1212 (Del. 1996); *accord Pareto v. FDIC*, 139 F.3d 696, 699 (9th Cir. 1998) (observing that "an action may lie both derivatively and individually based on the same conduct"). It would be impossible for a single transaction to lead to both direct and derivative claims if Defendants were correct in assuming that direct shareholder claims can be defeated simply by showing that the corporation was also injured.

Moreover, to assess whether an injury is direct or derivative, one useful metric is to ask whether the plaintiff suffered "some individualized harm not suffered by all of the stockholders at large." *Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008). Minority shareholders are injured directly, for example, when denied "the right to a pro rata share of the common property," *Southern Pac. Co. v. Bogert*, 250 U.S. 483, 487 (1919), and when controlling shareholders opt to "pay dividends only to themselves," 12B FLETCHER § 5922. Such scenarios differ from cases involving nothing more than waste of corporate assets—a type of harm that typically has the same effect on all the corporation's outstanding shares, thus giving rise to derivative claims. *See El Paso Pipeline GP Co. v. Brinckerhoff*, 152 A.3d 1248, 1260 (Del. 2016).

Notwithstanding the ways in which the Net Worth Sweep *also* injured Fannie and Freddie, its change to the terms of Treasury's stock visited a distinct and direct injury upon Plaintiffs. As the complaint observes, in the first quarter of 2013, Fannie paid Treasury a $59.4 billion dividend thanks to the Net Worth Sweep. JA102. Had Fannie declared $59.4 billion in dividends under the prior arrangement, it would have paid the first $2.9 billion to Treasury based upon its senior preferred stock, and the remaining $56.5 billion would have been shared among the Companies' other shareholders, including Plaintiffs, with the lion's share going to Treasury had it exercised its common stock warrants. But Treasury was not content with 80% of Fannie's and Freddie's common equity, it wanted it all. The fact that Treasury as the senior shareholder now receives dividends that would have previously been paid to Plaintiffs harms Plaintiffs, not the Companies. *See* JA81 (explaining that the Net Worth Sweep "effectively nationalized the Companies and confiscated the existing and potential value of all privately held equity interests").

It follows from what has already been said that Plaintiffs would directly "receive the benefit" of the remedy they request—that the Net Worth Sweep be unwound so that Plaintiffs are restored to their rightful place in the Companies' capital structure. *Tooley*, 845 A.2d at 1033. When a plaintiff seeks injunctive or declaratory relief rather than damages, the only way to determine to whom the relief flows is to consider whose injury it remedies. Accordingly, "courts have been more prepared to permit the plaintiff to characterize the action as direct when the plaintiff is seeking only injunctive or prospective relief," as is the case here. *Grimes v. Donald*, 673 A.2d 1207, 1213 (Del. 1996). For example, *Gatz v. Ponsoldt* held that a shareholder's claim was direct where the plaintiff asked the court to unwind a transaction entered into by the corporation to the advantage of certain shareholders at the expense of others. 2004 WL 3029868, at *7–8 (Del. Ch. Nov. 5, 2004). Under *Tooley*, there is no doubt that Plaintiffs' statutory claim is direct.

* * *

Plaintiffs challenge a transaction that transferred their shares' economic interest in Fannie and Freddie to Treasury, thereby effectively eliminating Plaintiffs from the Companies' capital structures. Regardless of the effect this transaction had on Fannie and Freddie, it visited a direct injury on Plaintiffs, and Plaintiffs will directly benefit if the transaction is set aside.

C. Plaintiffs Can Maintain a Derivative Suit Because the Conservator Has a Conflict of Interest.

1. Even if Plaintiffs' claims were derivative, they would still not be barred by 12 U.S.C. § 4617(b)(2)(A) because the right to sue FHFA for exceeding its statutory powers is not among the "rights, titles, powers, and privileges . . . with respect to" Fannie and Freddie to which the agency "succeed[s]" during conservatorship.

The Succession Clause speaks of the conservator as the "Successor" to the Companies and certain shareholder rights—a word that is used when someone "comes into the enjoyment of . . . one or more of the rights . . . of another person." *Succession,* WEBSTER'S NEW INTERNATIONAL DICTIONARY 2517 (2d ed. 1944). *See also Successor in Interest,* BLACK'S LAW DICTIONARY (11th ed. 2019) ("A successor in interest retains the same rights as the original owner, with no change in substance."). Yet even under Defendants' interpretation, FHFA cannot exercise the "right" it claims to have received from shareholders, for the conservator cannot sue 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"). Under the word's plain meaning, FHFA cannot be said to have "succeeded" to a right to sue it is powerless to exercise.

Defendants' real argument is not that the conservator *succeeds* to the right to bring shareholder derivative actions against the conservator but that the Succession Clause *terminates* the ability of shareholders to bring such actions themselves. Yet elsewhere the statute says that "the appointment of the Agency as receiver"—but not conservator—"shall terminate all rights and claims that the stockholders . . . may have against the assets . . . of the regulated entity." 12 U.S.C. § 4617(b)(2)(K)(i). It necessarily follows that when the conservator "succeed[s] to" shareholder rights "with respect to the regulated entity and the assets of the regulated entity," this succession does not *terminate* shareholder rights. *Id.* § 4617(b)(2)(A).

Reading the Succession Clause to foreclose all shareholder derivative suits against the conservator would also be contrary to Section 4617(a)(5)(A), which says that "[i]f [FHFA] is appointed conservator or receiver under this section, the regulated entity may, within 30 days of such appointment, bring an action" challenging the appointment. As Defendants acknowledge, this provision contemplates a shareholder derivative suit against FHFA during conservatorship even though the agency "immediately succeed[s]" to shareholder "rights, titles, powers, and privileges" upon being appointed conservator. 12 U.S.C. § 4617(b)(2)(A). Defendants cast Section 4617(a)(5)(A) as an "express exception" to the Succession Clause's general rule, SG Br. 30, but nothing in the statutory text indicates that the drafters perceived any conflict between the two provisions. Elsewhere in Section 4617, when Congress created exceptions to a general rule, it specified that the exception should prevail "notwithstanding" the general rule, 12

U.S.C. §§ 4617(b)(18)(A), (8)(G)(i), (i)(2)(B), or that the general rule was "subject to" the exception, *e.g.*, *id.* §§ 4617(b)(4), (b)(5)(F)(ii), (i)(6)(A). The absence of such language in Section 4617(a)(5)(A) and the Succession Clause shows that Congress understood a shareholder derivative suit against the conservator to be consistent with the Succession Clause's transfer of shareholder rights.

Particularly in a statute that elsewhere *does* place express but circumscribed limits on judicial review of FHFA's actions during conservatorship, *see* 12 U.S.C. § 4617(f), there is no basis for discovering another, more sweeping limitation in Section 4617(b)(2)(A). *See* A. SCALIA & B. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXT 107–08 (2012) (discussing negative implication canon). Defendants thus draw exactly the wrong conclusion from provisions of the statute that permit injunctive relief "at the request of the Director," 12 U.S.C. § 4617(f), and contemplate the conservator acting "in the best interests of . . . the Agency," *id.* § 4617(b)(2)(J)(ii). *See* SG Br. 30. Defendants misread these provisions. *See infra* 43–44. But in any case, when other parts of the statute specifically delineate the conservator's powers and specify when its actions are subject to judicial review, that is hardly the occasion to craft a further shield for the conservator out of statutory text that does not expressly address judicial review.

That Congress did not intend through the Succession Clause to terminate all derivative actions is also apparent from the fact that this provision lists "stockholder[s]" but not creditors as among the individuals whose rights FHFA may exercise during conservatorship. 12 U.S.C. § 4617(b)(2)(A). Section 4617 concerns, among other things, FHFA's rights and duties when Fannie and Freddie are insolvent, and it is well established that "the creditors of an *insolvent* corporation have standing to maintain derivative claims against directors on behalf of the corporation." *N. Am. Cath. Educ. Programming Found. v. Gheewalla*, 930 A.2d 92, 101–02 (Del. 2007). It is difficult to understand why Congress would bar shareholder derivative claims during conservatorship or receivership while permitting similar claims by creditors during insolvency to go forward. The better reading of the statute is that the Succession Clause does not categorically bar either sort of derivative suit.

None of the foregoing is to say, however, that the conservator's succession to rights of the corporation and its shareholders, officers, and directors is irrelevant to when shareholders may maintain a derivative action. Even before the words of the Succession Clause first appeared in the United States Code, it was commonplace to describe a federal conservator or receiver as the "successor" or as having "succeeded" to the financial institution under its care. *E.g.*, *FDIC v. Palmero*, 815 F.2d 1329, 1334 (10th Cir. 1987); *FDIC v. Grella*, 553 F.2d 258, 262 (2d Cir. 1977); *Hardee v. Wash. Loan & Tr. Co.*, 91 F.2d 314, 317 (D.C. Cir. 1937). Ordinarily a shareholder who pursues a derivative action is required first to make a demand on the corporation's directors, *see Daily Income Fund*, 464 U.S. at 532–34; 13 FLETCHER CYCLOPEDIA OF THE LAW OF CORP. § 5963 (Sept. 2020), but during conservatorship or receivership the demand must instead be addressed to the conservator or receiver that "stands in the place" of the corporation, *O'Connor v. Rhodes*, 79 F.2d 146, 148 (D.C. Cir. 1935); *accord* 13 FLETCHER § 5966. Conservatorship or receivership is fatal to most derivative lawsuits because the conservator or receiver, upon succession to the rights of the corporation and its management, has broad discretion to refuse the demand. *See Landy v. FDIC*, 486 F.2d 139, 147–48 (3d Cir. 1973); *Lucking v. Delano*, 117 F.2d 159 (6th Cir. 1941). But where it would be "a vain thing to make demand" because the conservator or receiver itself is accused of wrongdoing and thus faces a conflict of interest, demand is excused and a derivative suit may proceed. *O'Connor*, 79 F.2d at 149; *see also, e.g.*, *Brinckerhoff v. Bostwick*, 88 N.Y. (43 Sickels) 52, 60 (1882). The Succession Clause reinforces and does not alter these well-established principles of equity.

2. Plaintiffs' understanding of the Succession Clause and the principles that govern shareholder derivative suits during conservatorship is confirmed by two Court of Appeals decisions that interpreted 12 U.S.C. § 1821(d)(2)(A)(i)—the statutory provision on which the Succession Clause was modeled—as permitting shareholders to maintain a derivative suit when the conservator or receiver faces a manifest conflict of interest. *See 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). There was no contrary authority when Congress enacted HERA in 2008. When Congress reenacted substantially the same language, it should be presumed to have adopted the consistent

judicial construction reflected in those decisions. *See Bragdon v. Abbott*, 524 U.S. 624, 645 (1998).

Defendants contend that two intermediate appellate court decisions cannot establish the meaning of statutory language for purposes of the prior construction canon, SG Br. 31–32, but they fail to appreciate the path-making nature of the Federal Circuit's decision in *First Hartford*. After this Court decided *United States v. Winstar Corp.*, 518 U.S. 839 (1996), shareholders in dozens of banks that failed due to federal regulators' handling of the savings and loan crisis sued the United States in the Court of Federal Claims, ultimately recovering billions of dollars in damages. Many of those cases involved derivative claims that could not have gone forward under the interpretation that Defendants propose and that the Federal Circuit rejected in *First Hartford*. *See, e.g.*, *AmBase Corp. v. United States*, 142 Fed. Cl. 105 (2011). When Congress enacted HERA in 2008, the *Winstar* cases were by far the most significant litigation that had occurred under the statutory provisions of FIRREA that Congress used as its model. Given this context, the Office of Legal Counsel was entirely justified when, in a memo that sought to reassure markets of the enforceability of the original PSPAs, it pointed to *First Hartford* as the only authority that needed to be cited to show that "[i]t is established that the Court of Federal Claims has jurisdiction . . . to hear a breach of contract claim brought by a properly authorized party for payment of damages owed to a corporation." 32 O.L.C. Op. 127, 128 (Sept. 26, 2008), *available at* https://bit.ly/2GNTsDQ. Congress's manifest intent was to reassure investors by including in HERA provisions modeled on FIRREA. *See Perry Capital*, 864 F.3d at 647 (Brown, J., dissenting). The Federal Circuit's prominent decision in *First Hartford* deserves great weight, especially since all substantial claims for money damages against the United States are heard by that circuit.

3. Defendants' interpretation of the Succession Clause also runs counter to a basic tenet of our system of government. The upshot of Defendants' argument is that the nationalization of Fannie and Freddie devastated shareholders only derivatively and that, as the successor to shareholder derivative claims, *FHFA itself* is the only entity that may question FHFA's statutory authority to take this momentous action. But as Madison explained in Federalist 10, "[n]o man is allowed to be a judge in his own cause, because his interest would certainly bias his judgment, and, not improbably, corrupt his integrity." Consistent with that principle, this Court has long applied a "strong presumption" favoring judicial review of administrative action. *Bowen v. Michigan Academy of Family Physicians*, 476 U.S. 667, 670 (1986) (quoting *Abbott Labs. v. Gardner*, 387 U.S. 137, 140 (1967)). Congress legislates against the backdrop of that well-settled presumption, which imposes "a heavy burden" on those who argue that a statute "prohibit[s] all judicial review of [an] agency's compliance with a legislative mandate." *Mach Mining, LLC v. EEOC*, 135 S. Ct. 1645, 1651 (2015). The presumption "can only be overcome by clear and convincing evidence of congressional intent to preclude judicial review." *Guerrero-*

Lasprilla v. Barr, 140 S. Ct. 1062, 1069 (2020) (internal quotation marks omitted).

Without acknowledging the presumption or that their interpretation of the Succession Clause would effectively render many of FHFA's actions unreviewable, Defendants argue that Congress vested FHFA with the exclusive power to challenge the lawfulness of its *own decision* to impose the Net Worth Sweep. But the Succession Clause does not even speak in terms of the reviewability of FHFA's actions. When Congress chooses to limit judicial review of agency action, it must do so clearly. *See Stark v. Wickard*, 321 U.S. 288,309 (1944) (refusing to treat statute's "silence . . . as to judicial review" as precluding review). Particularly given that HERA elsewhere addresses the reviewability of FHFA's actions as conservator, *see* 12 U.S.C. § 4617(f), the Succession Clause's silence as to judicial review cannot be read to foreclose Plaintiffs' statutory claim.

4. Finally, if the Court concludes that the Succession Clause bars Plaintiffs' claims, it should rule that the statute is unconstitutional as applied in this case because due process does not permit a federal statute to require that *the conservator* represent Fannie and Freddie in a lawsuit challenging the actions of *the conservator*. In *Hansberry v. Lee*, 311 U.S. 32, 37 (1940), this Court held that the Due Process Clause does not allow unnamed members of a class to be bound by the outcome of a class action unless they are adequately represented. There was no constitutionally adequate representation in *Hansberry* because the class representatives in the prior action defended a racially re-

strictive covenant that the plaintiffs in the subsequent suit sought to challenge. After emphasizing the "potentially conflicting interests" at stake, the *Hansberry* Court concluded that the representation did not satisfy the requirements of due process. 311 U.S. at 44–45.

This Court's cases leave no doubt that the Due Process Clause would not permit Congress to pass a law requiring that Fannie and Freddie be represented by a conflicted representative or lawyer. *See Richards v. Jefferson Cty.*, 517 U.S. 793, 801 (1996); *Wood v. Georgia*, 450 U.S. 261, 271–72 (1981). For the same reason, the Succession Clause cannot constitutionally assign to FHFA the sole responsibility for representing Fannie's and Freddie's interests in a lawsuit against FHFA. The statute can be easily construed to avoid this due process problem, and the canon of constitutional avoidance thus provides yet another reason to reject Defendants' interpretation. *See Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988). But if the Court concludes it cannot avoid the constitutional issue, it should rule that the Succession Clause violates due process as applied to the facts presented in this case.

II. THE ANTI-INJUNCTION CLAUSE DOES NOT BAR PLAINTIFFS' STATUTORY CHALLENGE TO THE NET WORTH SWEEP

Every court to examine the issue has agreed that 12 U.S.C. § 4617(f) does not prohibit injunctive relief when FHFA exceeds its statutory powers as conservator, *see* Pet. App. 21a–23a, and that is how this Court interpreted materially indistinguishable statutory language in *Coit Independent Joint Venture v. Federal Savings and Loan Insurance Corporation*, 489 U.S. 561, 574–75 (1989). The question under Section 4617(f) in this case thus boils down to whether HERA authorized the conservator to impose the Net Worth Sweep, thereby making it impossible for the Companies to rebuild capital, at a time when the conservator knew the Companies were about to report their most profitable quarters ever. Because this thwarting of FHFA's conservatorship objectives violated HERA, Section 4617(f) does not bar Plaintiffs' statutory claim.

A. The Net Worth Sweep is Antithetical to FHFA's Conservatorship Mission.

1. FHFA's conservatorship mission is to preserve and conserve assets and restore the Companies to soundness and solvency.

a. In announcing the creation of the conservatorships in 2008, FHFA unequivocally assured the public that the purpose of the conservatorship was to "preserve the assets of Fannie Mae and Freddie Mac over the conservatorship period." JA50. Yet in defending the Net Worth Sweep against statutory challenges over seven years and across six circuits, Defendants' lawyers consistently argued that FHFA is under no statutory obligation as conservator to seek to "preserve and conserve the assets and property of the [Companies]" or to restore them to a "sound and solvent condition." 12 U.S.C. § 4617(b)(2)(D). Indeed, that was the principal ground on which Defendants prevailed in most of the lower courts. *See, e.g.*, *Roberts*, 889 F.3d at 403; *Perry Capital*, 864 F.3d at 606–08. But in their opening merits brief to this Court, Defendants appear to abandon that position, even going so far as to describe preserving and conserving the Companies' assets as FHFA's conservatorship "mission." SG Br. 4. We do not begrudge Defendants their tactical retreat, but a proper analysis of the merits of Plaintiffs' statutory claim must begin with an understanding of why, like any conservator, FHFA's core function is to conserve assets and operate the institutions under its care with the objective of restoring them to a sound financial condition.

In setting forth FHFA's "[p]owers as conservator," HERA provides that FHFA "may, as conservator, 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). When FHFA acts as conservator, Section 4617(b)(2)(D) "mark[s] the bounds of FHFA's conservator . . . powers," and actions by FHFA that go beyond or conflict with those powers can therefore be enjoined. *Perry Capital*, 864 F.3d at 638 (Brown, J., dissenting).

Section 4617(b)(11)(E) confirms this understanding of FHFA's conservatorship role. In exercising "any right, power, privilege, or authority as conservator," that provision says that FHFA "shall conduct its operations in a manner which . . . maximizes the net present value return from the sale or disposition of such assets." 12 U.S.C. § 4617(b)(11)(E). It follows that when FHFA "effectively sold Treasury one of the enterprises' 'asset[s],' (namely, its potential net worth in future quarters)," SG Br. 40, it was required to seek the best possible return with an eye to restoring the Companies to soundness and solvency.

This straightforward reading of HERA is further reinforced by Congress's use of the word "conservator," for when Congress enacts a statute using "a well-established term," courts presume that it "intended the term to be construed in accordance with pre-existing . . . interpretations." *Bragdon v. Abbott*, 524 U.S. 624, 631 (1998). Courts have long recognized that a conservator "has limited powers and must conserve the ward's property," Pet. App. 43a; *see, e.g.*, *Deputy v. du Pont*, 308 U.S. 488, 496 (1940), and the word "conservator" is ordinarily used to refer to a "guardian, protector, or preserver," *Conservator,* BLACK'S LAW DICTIONARY (11th ed. 2019). *See also* 12 U.S.C. § 1717(c)(1) (authorizing Fannie to "create, accept, execute, and otherwise administer . . . receiverships, conservatorships . . . or other *fiduciary and representative* undertakings" (emphasis added)). Defendants criticize the en banc Fifth Circuit for interpreting HERA in light of this traditional understanding of conservatorship, but in doing so they attack a straw man. The Fifth Circuit's point was not that as conservator FHFA must prioritize "making profits for . . . shareholders," SG Br. 45–46, but that like any conservator FHFA is charged with a broadly rehabilitative mission.

Outside of litigation, FHFA has repeatedly emphasized that Section 4617(b)(2)(D) specifies the mission it is required to pursue as conservator. FHFA's regulations acknowledge "the Conservator's mandate to put the regulated entity in a sound and solvent condition and to preserve and conserve the assets and property of the regulated entity." Conservatorship and Receivership, 75 Fed. Reg. 39,462, 39,469 (July 9, 2010). FHFA Acting Director DeMarco described preserving and conserving assets as one of FHFA's "principal mandates set forth in law." Edward J. DeMarco, FHFA Acting Director, The Conservatorships of Fannie Mae and Freddie Mac: Current and Future Operations (Sept. 19, 2011), https://bit.ly/2RaLEhi. Former FHFA Director Watt told Congress that FHFA's "statutory mandates obligate" it to seek to preserve and conserve assets during conservatorship. Statement of Melvin L. Watt, Director, FHFA, Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (May 11, 2017), https://bit.ly/33fQcZn. And FHFA's current Director has said that under HERA he is "tasked with getting [Fannie and Freddie] to a safe and sound condition." Interview by Vonnie Quinn, Bloomberg News, with Mark Calabria, FHFA Director, at 3:20–30 (Sept. 16, 2019), https://bit.ly/2FmEnIA.

Despite these public statements, several Courts of Appeals rejected Plaintiffs' interpretation, reasoning that Section 4617(b)(2)(D)'s use of the word "may" renders the provision permissive rather than mandatory. But the assumption that the word "may" necessarily "implies some degree of discretion" can be "defeated by . . . obvious inferences from the structure and purpose of the statute." *United States v. Rodgers*, 461 U.S. 677, 706 (1983). In our constitutional system, "an agency literally has no power to act . . . unless and until Congress confers power upon it," *New York v. FERC*, 535 U.S. 1, 18 (2002), so when Congress specifies what an agency "may" do, it defines the bounds of the agency's authority. *See Halverson v. Slater*, 129 F.3d 180, 184–87 (D.C. Cir. 1997) (language that "Secretary may delegate" authority to specific entity prohibits delegation to another entity).

Moreover, as the en banc Fifth Circuit observed, concluding that FHFA's pursuit of the objectives set forth in Section 4617(b)(2)(D) is optional would leave FHFA without "any intelligible principle to guide its discretion as conservator," Pet. App. 40a, thus raising grave doubts about whether HERA violates the nondelegation doctrine, *see Whitman v. Am. Trucking Ass'n*, 531 U.S. 457, 474 (2001); *Fahey v. Mallonee*, 332 U.S. 245, 250–53 (1947) (reading background principles of law that govern conservatorships into statute to avoid nondelegation problem).

b. Defendants emphasize features of HERA that give FHFA discretion and a range of tools for carrying out its conservatorship responsibilities, *see* SG Br. 34–37, but none of these provisions authorize FHFA to forsake its conservatorship mission by affirmatively sabotaging the Companies' recovery through a self-dealing transaction with Treasury. As Defendants note, FHFA is empowered to "[o]perate" the Companies, "transfer" their assets, and "carry on" and "conduct" their business. 12 U.S.C. §§ 4617(b)(2)(B), (b)(2)(G), (b)(2)(J). But those statutory powers are given to FHFA "as conservator" and therefore must be exercised in a manner consistent with the basic conservatorship function specified in Section 4617(b)(2)(D).

Defendants likewise miss the mark when they invoke FHFA's "[i]ncidental power[ ] . . . as conservator" to "take any action authorized by this section, which the Agency determines is in the best interests of the regulated entity or the Agency." 12 U.S.C. § 4617(b)(2)(J). This provision concerns FHFA's interests only "as conservator," and FHFA's interests as conservator are not synonymous with the interests of the Treasury Department. FHFA does not advance its conservatorship interests when it permanently dissipates assets it is charged with preserving and conserving. Moreover, Section 4617(b)(2)(J) applies only to actions that are elsewhere "authorized by this section," meaning that when FHFA exercises powers conferred elsewhere in Section 4617 it is subject to the *additional requirement* that it use its powers to advance "the best interests of the regulated entity or the Agency." Any other interpretation of the general incidental powers provision would nullify the specific rehabilitative mission assigned to the conservator in Section 4617(b)(2)(D). *See RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) ("It is a commonplace of statutory construction that the specific governs the general."). That the power in Section 4617(b)(2)(J) is labeled "[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."[5]

Nor can FHFA forsake its conservatorship mission based upon the Companies' statutory duties to promote liquidity in the mortgage markets and affordable housing. *See* 12 U.S.C. § 4501; SG Br. 35–36. Congress thought that establishing and enforcing capital standards for the Companies was important to promoting their public missions before conservatorship, 12 U.S.C. § 4501(6), and the conservator promotes them by safeguarding the Companies' assets and property and rehabilitating them to soundness and solvency, *id.* § 4617(b)(2)(D).

Finally, the requirement that *Treasury* seek to "protect the taxpayer" when investing in the Companies does nothing to nullify *FHFA*'s conservatorship duty to preserve and conserve the Companies' assets. *See* 12 U.S.C. § 1455(*l*)(1)(B); SG Br. 37. Before making an investment, Treasury is also required to consider "[t]he need to maintain [each] Corporation's status as a private shareholder-owned company," 12 U.S.C. § 1455(*l*)(1)(C)(v), and Congress plainly did not envision that during conservatorship FHFA would extinguish the interests of private shareholders by

[5] Legislative history also makes clear that when Congress first authorized federal receivers to take their own "best interests" into account, it anticipated that they would "give due consideration to the interest of all the claimants upon the assets of the association, including general creditors, uninsured depositors, *and association stockholders*." H.R. Rep. No. 1263, at 10 (1968) (emphasis added).

transferring the entire value of the Companies' net assets to Treasury in exchange for no meaningful consideration.

2. FHFA abandoned its conservatorship mission when it imposed the Net Worth Sweep.

Rather than "conserving and preserving" the Companies' assets, the Net Worth Sweep has caused the Companies to turn over the entire net value of those assets to a single shareholder—Treasury—every quarter. And rather than placing the Companies in a "sound and solvent condition," the Net Worth Sweep has needlessly forced the Companies to operate on the brink of insolvency by stripping them of capital. Despite Defendants' assertions to the contrary, *see* SG Br. 46–49, these flaws in the Net Worth Sweep are more fundamental than mere objections to the wisdom or motivation of FHFA's decision. Rather, the Net Worth Sweep constitutes a wholesale *abandonment* of FHFA's core conservatorship mission, for it puts the Companies in a permanently unsound condition—the opposite of conservatorship's statutory objective.

It is beyond dispute that the Net Worth Sweep depletes the Companies' capital, a consequence that FHFA's regulations rightly declare to be "inconsistent with [its] statutory goals." Conservatorship and Receivership, 76 Fed. Reg. 35,724-01, 35,727 (June 20, 2011). Rather than allow the Companies to retain and build up their capital, the Net Worth Sweep siphons off every dollar belonging to the Companies in excess of the buffer into Treasury's coffers. Indeed, Treasury made clear in publicly announcing the Net Worth Sweep that its effect was to prevent the Companies from "retain[ing] profits" or "rebuild[ing] capital." JA97. The Net Worth Sweep is thus antithetical to FHFA's mission to "preserve and conserve the assets and property" of the Companies. 12 U.S.C. § 4617(b)(2)(D)(ii).

This permanent dissipation of capital also violates FHFA's obligation to seek to "put the [Companies] in a sound and solvent condition." *Id.* § 4617(b)(2)(D)(i). As FHFA has acknowledged, capital reserves are a critical aspect of soundness and solvency. JA94; *see* 12 U.S.C. § 4513(a)(1)(B) (recognizing that "maintenance of adequate capital" is one element of Companies operating in a "safe and sound manner"). Capital is the standard by which "soundness" is measured by federal regulators of all financial institutions. Such reserves serve as a buffer against the inevitable vicissitudes of the economic cycle. Institutions with sufficient capital are deemed safe, and those without are deemed unsound.

Defendants argue that the Net Worth Sweep preserved the Treasury funds that are available to the Companies under the PSPAs, but the opposite is true. Defendants imposed the Net Worth Sweep at a time when they knew 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. JA93–94. 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, when the operative complaint was filed Fannie and Freddie would have had approximately $124 billion in additional capital on their balance sheets to absorb any losses they experience before looking to Treasury. JA93. Far from protecting Treasury's commitment, the Net Worth Sweep exposed it to maximum vulnerability since it robbed the Companies of a buffer to absorb losses that might occur in future quarters.

Plaintiffs are not the only parties in this case who recognize that the Net Worth Sweep is antithetical to FHFA's statutory charge as conservator. As a senior staffer to the Chairman of the Senate Banking Committee, Director Calabria was "intimately involved in the policy discussions and legislative drafting that led to the creation of HERA." Michael Krimminger & Mark A. Calabria, *The Conservatorships of Fannie Mae and Freddie Mac: Actions Violate HERA and Established Insolvency Principles*, CATO INSTITUTE at 5 (Feb. 9, 2015), https://bit.ly/3bO8bdg. Before his appointment as FHFA's Director, Mr. Calabria coauthored a paper in which he endorsed Plaintiffs' theory of the case:

> The conservator's duty is to rehabilitate the Companies to a "sound and solvent condition" by restoring their compliance with regulatory capital and other prudential requirements since the whole goal is to return the Companies to normal, operating businesses. Contrary to this fundamental requirement for conservators, the effect of the Net Worth Sweep is that the Companies will never be able to build capital, as both Treasury and FHFA have stated publicly. This necessarily

> means that the Companies are being prevented from returning to a "sound and solvent condition" by Treasury and the FHFA. On its face, this violates HERA.

Krimminger & Calabria, *supra*, at 50. Notably, when asked about this paper during an interview after becoming FHFA's Director, Mr. Calabria reiterated his view that the Net Worth Sweep was "of questionable legality." Interview with Mark Calabria, *supra* at 6:10–56. Whether the Net Worth Sweep is consistent with FHFA's conservatorship mission is ultimately a question for the courts. But this Court should give significant weight to the considered view of FHFA's Director that his agency exceeded its statutory powers when it imposed the Net Worth Sweep.

3. *The Net Worth Sweep is an impermissible end-run around the statute's receivership provisions.*

In HERA, Congress authorized FHFA to act "as conservator *or* receiver," 12 U.S.C. § 4617(a) (emphasis added), and whichever choice FHFA made had corresponding statutory limits and obligations. While the conservator's mission is to preserve and conserve assets with the aim of restoring the Companies to soundness and solvency, 12 U.S.C. § 4617(b)(2)(D), as receiver FHFA is required to "place [the Companies] in liquidation" and follow a rigid set of procedures for distributing the proceeds to stakeholders, *id.* § 4617(b)(2)(E), (b)(3)–(9), (c). Defendants acknowledged when they announced the Net Worth Sweep that this action would "expedite the wind down of Fannie Mae and Freddie Mac" and ensure that these two companies "will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." JA97. As the Fifth Circuit explained, taking this decisive step towards the Companies' ultimate liquidation without first placing them into receivership exceeded FHFA's authority. Pet. App. 46a–48a.

The difference between conservatorship and receivership is important because as receiver FHFA is required to follow a specific order of priorities when distributing proceeds from the Companies' liquidation—an order of priorities that makes Plaintiffs and the Companies' other shareholders the residual claimants. 12 U.S.C. § 4617(c). Allowing FHFA to wind down the Companies and distribute their assets to a favored stakeholder during conservatorship would enable the agency to evade this order of priorities and the other procedures HERA requires it to follow during receivership. *See id.* § 4617(b)(3)–(9). This Court has rejected similar attempts to evade the statutory order of priorities in the bankruptcy context. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 984 (2017). It should do the same when interpreting HERA.

To be sure, Section 4617(a)(2) states that FHFA may "be appointed conservator *or* receiver for the purpose of *reorganizing*, *rehabilitating*, or *winding up* the affairs of a regulated entity." Despite Defendants' argument to the contrary, this provision cannot be read to suggest that all the powers it articulates belong to both conservators and receivers. If FHFA as conservator has all three powers listed in Section 4617(a)(2)—"reorganizing, rehabilitating, [and] winding up"—it follows that FHFA as receiver must have them all as well. But that cannot be, as even FHFA explains that as receiver it "shall place the [Companies] in liquidation," leaving no room to rehabilitate them. 12 C.F.R. § 1237.3(b) (quoting 12 U.S.C. § 4617(b)(2)(E)).

Section 4617(a)(2) is thus best read as a general, introductory provision that summarizes the authorities collectively granted to FHFA as conservator and receiver, while the following provisions of the statute specify which authorities FHFA may exercise in each particular capacity. HERA's structure further supports this interpretation. *See* 12 U.S.C. § 4617(b) ("Powers and duties of the Agency as conservator or receiver"); *id.* § 4617(b)(2)(D) ("Powers as conservator"); *id.* § 4617(b)(2)(E) ("Additional powers as receiver"). Properly interpreted, therefore, Section 4617(a)(2) reinforces that FHFA's mission as conservator is rehabilitative.

Defendants are also wrong when they argue that, because the Companies continue to operate, it necessarily follows that the Net Worth Sweep was not a step towards the Companies' wind up and ultimate liquidation. *See* SG Br. 43–44. Conservatorship can only end in one of two ways: with the Companies' rehabilitation and return to soundness or with their ultimate receivership and liquidation. The Third Amendment definitively closed off the former possibility, as Defendants acknowledged at the time. *See* JA97. This amendment to the PSPAs has no built-in end date and thus was no "temporary" measure, SG Br. 44, and the possibility that Defendants might someday reverse their unlawful action cannot defeat Plaintiffs' statutory claim.

B. Defendants' "Vicious Cycle" Argument Fails on its Own Terms and Proceeds from a Disputed Factual Premise.

1. Having abandoned the argument that as conservator FHFA is under no statutory obligation to seek to preserve and conserve the Companies' assets and restore them to a sound condition, Defendants' final redoubt is to argue that the Net Worth Sweep actually furthered FHFA's rehabilitative mission by rescuing the Companies from a "vicious cycle" in which they drew on Treasury's limited funding commitment to pay dividends on Treasury's senior preferred stock. SG Br. 38. To assess this argument, Defendants say "it is important to consider the factual background concerning the enterprises' financial situation at the time FHFA acted," SG Br. 37—by which Defendants apparently mean the terms of the PSPAs and the sums the Companies had borrowed from Treasury as of mid-2012 but not the Companies' financial outlook or FHFA's actual reasons for acting as it did. But even were the Court to disregard the rules of civil procedure and accept Defendants' invitation to ignore the factual allegations in the Complaint, Defendants' "vicious cycle" argument fails because it misunderstands the terms of the original PSPAs.

Start with the erroneous notion that Treasury "took on a new risk" with the Net Worth Sweep since it "would receive smaller dividends when either enterprise earned less than its quarterly share of $19 billion." SG Br. 41. This claim misunderstands the dividend arrangement that existed prior to the Net Worth Sweep. There is *no possible scenario* in which Treasury would make a penny less due to the Net Worth

Sweep. Before the Net Worth Sweep, the Companies' net 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 the funding commitment. To see this, consider Defendants' example of 2015, a year in which the Companies' dividend payments under the Net Worth Sweep totaled $15.8 billion—less than the amount of the 10% dividend. *See* SG Br. 39.[6] Under the prior arrangement, if the Companies had a net worth of $15.8 billion over the course of a year, their total net dividend payments to Treasury would have been at most $15.8 billion, with any additional "dividends" being financed through circular draws on Treasury's funding commitment. Thus, under the Net Worth Sweep, Treasury gets more when the Companies' net worth exceeds the prior 10% dividend and no less on a net basis when the Companies earn less than the prior 10% dividend. From Treasury's standpoint, the Net Worth Sweep carried no risk and had only upside.

But what of Defendants' claim that circular dividends threatened to exhaust the limited sums that were available under Treasury's funding commitment? Here again Defendants' argument founders on the terms of the agreements that preceded the Net

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[6] Defendants emphasize that in 2015 the Companies' earnings fell short of the roughly $18.9 billion that would have been needed to pay Treasury's 10% dividend in cash under the prior arrangement. But they fail to mention that without the Net Worth Sweep the Companies would have started 2015 with a combined net worth of at least $132 billion. *See* JA90.

Worth Sweep. The concern is entirely pretextual because the Companies never had to pay a penny in cash dividends—they were free at all times to pay in kind with increases to the liquidation preference. Also, those agreements entitled Treasury to dividends "when, as and if declared by the Board of Directors," JA178, and placed no affirmative obligation on the Companies' Boards to declare cash dividends in unprofitable quarters. Indeed, it is generally illegal for a corporation to declare cash dividends if doing so "would render the corporation insolvent or the corporation's assets would be less than its liabilities." 11 FLETCHER CYCLOPEDIA OF THE LAW OF CORP. § 5329 (Sept. 2020). Under the original PSPAs, the Companies were likewise free to decline to pay the periodic commitment fee in cash. JA133. If FHFA thought it was unwise for the Companies to finance cash dividends and commitment fees by making draws on Treasury's funding commitment, the original PSPAs allowed FHFA to simply decline to order the Companies to make these payments. Doing so would not have reduced the total amount available under Treasury's funding commitment. *See* JA60.

Under the original PSPAs, declining to declare cash dividends on Treasury's senior preferred stock would have had two additional consequences that Defendants emphasized in the lower courts. First, any dividends not paid in cash on Treasury's senior preferred stock would have been added to Treasury's liquidation preference, thus increasing Treasury's claims on the Companies' assets if they are ever liquidated. JA187. Echoing an argument made by Defendants, the Seventh Circuit said that the Net Worth

Sweep was a permissible alternative to adding to the liquidation preference since increasing the liquidation preference "would eventually shift assets to Treasury." *Roberts*, 889 F.3d at 405. But this reasoning overlooks the fact that the Third Amendment *also* adds to Treasury's liquidation preference, entitling Treasury during liquidation to a payment equal to the liquidation preference *plus* a final Net Worth Sweep dividend payment. *See* JA186; JA239–40. The upshot is that, thanks to the Third Amendment, if the Companies are liquidated Treasury is entitled to *everything that is left* after the Companies' debtholders are paid—the largest liquidation preference possible for an equity investor. Faced with a choice between marginally increasing the liquidation preference under the existing agreements or amending them to increase Treasury's liquidation preference even further, FHFA's conservatorship mission required it to prefer the former and reject the Net Worth Sweep.[7]

A second consequence of avoiding draws on Treasury's funding commitment by declining to declare dividends would have been that, until all dividends in ar-

[7] In *Roberts*, the Seventh Circuit also said that FHFA could reasonably opt for the Net Worth Sweep rather than declining to declare dividends under the existing terms of the PSPAs so that Fannie and Freddie could "potentially redeem Treasury's preferred shares by paying down the liquidation preference." 889 F.3d at 405. But as FHFA's Director has written, the Net Worth Sweep guarantees that "there can be no repayment" of Treasury's investment since all positive net worth, less a buffer, is swept to Treasury every quarter as a dividend that does not reduce the liquidation preference. *See* Krimminger & Calabria, *supra*, at 17.

rears were paid in cash, the interest rate on Treasury's senior preferred stock would have increased from 10% to 12%. JA180. But as demonstrated above, the Companies' net dividend payments to Treasury never exceeded (and never could exceed) their net worth; the Net Worth Sweep only affects the Companies' net dividend payments if their net worth is greater than the cash dividends that could have been paid to Treasury under the original deal. Whether 12% or 1,000%, there is no numerical interest rate that would result in Fannie and Freddie paying Treasury more in dividends than they have been forced to pay under the Net Worth Sweep, for the Net Worth Sweep entitles Treasury to every penny the Companies make. As with the liquidation preference, when FHFA was given the choice between a small increase in Treasury's dividend rate and a large one, FHFA's conservatorship mission required it to prefer the smaller increase and reject the Net Worth Sweep.

Defendants' "vicious cycle" argument also fails for another reason: FHFA's statutory charge is to "preserve and conserve the *assets and property*" of Fannie and Freddie, 12 U.S.C. § 4617(b)(2)(D)(ii) (emphasis added), and the PSPAs say that Treasury's funding commitment must *not* be counted among "the total assets" of the Companies. JA124 (defining "Deficiency Amount"). FHFA's current and former Directors agree. Director Calabria has written that "adequate capital reserves" under the statute "is defined as common equity, not government support," Krimminger & Calabria, *supra*, at 45, and Director Watt told the House Financial Services Committee that he "do[es] not deem [the remaining amount of Treasury's commitment] as operating capital," Statement of Melvin L. Watt, Director, FHFA (Oct. 3, 2017), https://bit.ly/35oWoRn.

In sum, Treasury gave up nothing in exchange for agreeing to the Net Worth Sweep, the "problem" Defendants were allegedly solving with the Third Amendment was wholly illusory because the Companies never had to pay dividends in cash, and Treasury's funding commitment is not one of the "assets" the statute requires the conservator to preserve and conserve. For these reasons, even if the Court accepts Defendants' version of events and disregards the contrary allegations in the Complaint, FHFA still exceeded its conservatorship authority by agreeing to the Net Worth Sweep.

2. Plaintiffs' statutory claim comes to the Court on a motion to dismiss, and at this stage of the litigation the Complaint's factual allegations must be accepted as true. Despite grudgingly acknowledging this most basic rule of civil procedure, *see* SG Br. 2, 46, Defendants contradict the complaint on nearly every page of their brief that discusses application of Section 4617(f) to the facts of this case. Defendants repeatedly assert that when the Net Worth Sweep was imposed the Companies were exposed to a "risk that cash-dividend payments would consume the financial lifeline provided by Treasury," SG Br. 38, and claim that a change to the prior dividend arrangement was necessary to relieve the Companies from "crushing dividend payments and commitment fees" they could not otherwise afford, SG Br. 42. Defendants know that these statements contradict the Complaint, *see* Pls.' Resp. to

SG Pet. 10–12, yet they persist in making them because the "risk" of unaffordable 10% cash dividends that the Companies supposedly faced in mid-2012 is the starting point and necessary factual premise for Defendants' entire argument that the Net Worth Sweep preserved and conserved the Companies' assets. The Court cannot credit this claim given the Complaint's contrary factual allegations.

The Complaint specifically alleges that Defendants' vicious cycle narrative is "false," JA35, and that Defendants knew that Fannie and Freddie "would generate earnings well in excess of the Companies' dividend obligations to Treasury," JA69. Those allegations are not based on idle speculation. Senior officials at Fannie privately *told* FHFA in the runup to the announcement of the Net Worth Sweep that their company had embarked on its "golden years" of profitability, JA70–71, and, in response to government questioning, that the improved outlook would soon necessitate accounting writeups that would immediately increase Fannie's net worth by approximately $50 billion, JA72; JA75. The day before the Third Amendment was signed, an internal Treasury document listed 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. JA78. The Complaint also quotes Fannie's CFO at the time, who testified that Defendants acted as they did out of "a desire not to allow capital to build up within the enterprises and not to allow the enterprises to recapitalize themselves." JA81.

Defendants say that courts should not question the conservator's "predictive judgments" and criticize

Plaintiffs for assessing the Net Worth Sweep "with the benefit of hindsight." SG Br. 48. But the Complaint alleges that Defendants imposed the Net Worth Sweep with *foresight* about the Companies' improved financial performance: Defendants' "expectation" was that without a change to the PSPAs "Fannie and Freddie would recognize extraordinary profits that would allow them to begin rebuilding their capital levels and position themselves to exit conservatorship and deliver value to their private shareholders." JA77–78. Defendants acted when they did because they realized that otherwise 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." JA35.

Defendants also argue that the Court should disregard FHFA's "subjective motives" when deciding whether it exceeded its conservatorship powers. SG Br. 47. FHFA may be appointed "conservator or receiver *for the purpose* of reorganizing, rehabilitating, or winding up" the Companies, 12 U.S.C. § 4617(a)(2) (emphasis added), and nothing in the statute prevents the Court from considering *the purpose* of the Net Worth Sweep when deciding whether this action was consistent with FHFA's conservatorship mission. Regardless, it is not Plaintiffs but Defendants who would have the Court decide this case on the basis of subjective intent—a pretextual subjective intent to avoid the supposed "risk" that the Companies would exhaust Treasury's funding commitment to pay Treasury 10% cash dividends. If FHFA can cloak itself in immunity from judicial review under Section 4617(f) simply by invoking its “predictive judgments,” SG Br. 48, surely the Court can consider what FHFA actually predicted.[8]

III. FHFA’S STRUCTURE VIOLATES THE SEPARATION OF POWERS

This Court’s decision in *Humphrey’s Executor v. United States*, 295 U.S. 602 (1935), is incompatible with the text, structure, and history of the Constitution, and nothing is left of its reasoning after *Seila Law, LLC v. CFPB*, 140 S. Ct. 2183 (2020). For the reasons Justice Thomas articulated in his partial concurrence in *Seila Law*, the Court should overrule *Humphrey’s Executor* and end its eighty-five-year experiment with an unaccountable fourth branch of government. *Id.* at 2211–19 (Thomas, J., concurring in part).

But the Court need not revisit *Humphrey’s Executor* to conclude that FHFA is unconstitutionally structured. FHFA “is essentially a companion of the CFPB,” *Seila Law*, 140 S. Ct. at 2202, and its single-Director leadership structure “raises the same question” this Court decided in *Seila Law*, *PHH Corp. v. CFPB*, 881 F.3d 75, 175 (D.C. Cir. 2018) (en banc) (Kavanaugh, J., dissenting). Like the CFPB, FHFA is an “independent” agency, 12 U.S.C. § 4511(a); 44 U.S.C. § 3502(5), and it is headed by a single Director who is

[8] Defendants also contradict the Complaint when they refer to the “crushing” size of periodic commitment fees. *See* SG Br. 42. These fees were always waived and could only be charged at a “market rate” with agreement from Fannie and Freddie. JA86–87; JA132–33. The Complaint alleges that Freddie projected its annual fee to be $400 million and that given market conditions the only appropriate fee would have been zero. JA86–87.

only removable for cause, 12 U.S.C. § 4512(b)(2). Also like the CFPB, FHFA regulates "a major segment of the U.S. economy," *see Seila Law*, 140 S. Ct. at 2200, for it "plays a crucial role in overseeing the mortgage market, on which millions of Americans annually rely," *id*. at 2241 (Kagan, J., dissenting); *see* JA48. As with the CFPB, FHFA has statutory authority to issue subpoenas, bring enforcement actions, and impose civil penalties to give effect to its decisions. *See* 12 U.S.C. §§ 4581, 4585, 4588. FHFA is also like the CFPB in that it is exempted from the normal appropriations process, funding itself by levying fees on the Companies and the other entities it regulates. *See* 12 U.S.C. § 4516.

If anything, from a separation of powers standpoint FHFA is *worse* than the CFPB. While many of the CFPB's decisions "occur[ ] in the twilight of judicially unreviewable discretion," *PHH Corp. v. CFPB*, 839 F.3d 1, 35 (D.C. Cir. 2016) (Kavanaugh, J.), *vacated*, Order, No. 15-1177 (D.C. Cir. Feb. 16, 2017), Defendants contend that most of FHFA's actions are altogether unreviewable. The Court need not accept Defendants' sweeping view of FHFA's powers to recognize that this agency is even less accountable than the CFPB—not subject to oversight by the President, unconstrained by Congress's power of the purse, and immune from judicial review during conservatorship except when it exceeds its statutory authorities. Congress "created a monster" when it established FHFA, *Saxton v. FHFA*, 901 F.3d 954, 963 (8th Cir. 2018) (Stras, J., concurring), and there is no doubt after *Seila Law* that this agency is unconstitutionally structured.

IV. THE THIRD AMENDMENT MUST BE SET ASIDE BECAUSE IT WAS IMPOSED BY AN UNCONSTITUTIONAL AGENCY

A. When a Federal Official Acts Without Constitutional Authority, Vacatur of the Official's Actions Is the Appropriate Remedy.

In a long line of cases, this Court has repeatedly set aside the past actions of federal officials who were unconstitutionally insulated from oversight by the President or who otherwise served in violation of the Constitution's structural provisions. The Fifth Circuit's refusal to set aside the Third Amendment is badly out of step with these important precedents.

In *Bowsher v. Synar*, 478 U.S. 714, 736 (1986), the Court affirmed a judgment that set aside a presidential sequestration order that the President was unconstitutionally compelled to sign based upon findings by the Comptroller General—a congressional officer whom the President could not remove. The President signed the first such mandated sequestration order on February 1, 1986, RONALD REAGAN, ORDER ON EMERGENCY DEFICIT CONTROL MEASURES FOR FISCAL YEAR 1986, *available at* https://goo.gl/96DX3T, and six days later a three-judge district court that included then-Judge Scalia set aside the order, *Synar v. United States*, 626 F. Supp. 1374, 1404 (D.D.C. 1986). In affirming that judgment, this Court left no doubt that vacatur of past actions is an appropriate remedy in cases that involve violations of the President's removal power.

This understanding of the remedies for violations of the President's removal power is confirmed by *Seila*

Law. In that case, the petitioner raised the CFPB's unconstitutional structure as a defense to an effort by the agency to enforce a civil investigative demand. After ruling that the petitioner had suffered a redressable injury and that the CFPB was unconstitutionally structured, the Chief Justice went on to address the remedy in a portion of his opinion joined by Justices Alito and Kavanaugh. *See* 140 S. Ct. at 2207–08. The plurality ultimately decided to remand the case because the Government argued that the civil investigative demand had been "ratified by an Acting Director accountable to the President," and a remand was necessary to address in the first instance "whether this alleged ratification in fact occurred and whether, if so, it is legally sufficient to cure the constitutional defect in the original demand." *Id.* at 2208. The clear implication of this language is that absent a "legally sufficient cure," the civil investigative demand issued by the unconstitutionally insulated CFPB Director would have to be vacated. Although the Chief Justice only wrote for a plurality on this issue, all nine members of the Court appear to have taken it as a given that a violation of the President's removal power could justify setting aside an unconstitutionally structured agency's investigative demand. *See id.* at 2219 (Thomas, J., dissenting in part); *id.* at 2245 (Kagan, J., concurring in the judgment with respect to severability).

Many other cases concerning various structural features of the Constitution support the same approach. After finding violations of the Appointments Clause, this Court has repeatedly set aside the actions of officials who were held to be serving in violation of the Constitution. *Lucia v. SEC*, 138 S. Ct. 2044, 2055 (2018); *NLRB v. Noel Canning*, 134 S. Ct. 2550 (2014). The Court also awarded backward-looking relief to successful litigants in many of its seminal separation of powers cases. *See, e.g.*, *Clinton v. New York*, 524 U.S. 417, 425 & n.9 (1998) (past cancellation of particular funds under Line Item Veto was invalid); *INS v. Chadha*, 462 U.S. 919, 936 (1983) (plaintiff had standing because "[i]f the [legislative] veto provision violates the Constitution, and is severable, the deportation order against Chadha will be cancelled"); *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 589 (1952) (President required to return steel mills he had already seized). The Fifth Circuit majority thought these cases distinguishable because they concerned officials "vested with authority that was never properly theirs to exercise." Pet. App. 69a. But no less than in any other separation of powers case, when FHFA's single Director exercises Executive Power without meaningful oversight from the President, he exercises authority that was never properly his.

Two of the judges who voted to deny Plaintiffs a meaningful remedy in the proceedings below concluded that the *only* remedy for violations of the President's constitutional removal authority is a declaratory judgment and an order prospectively striking down the offending statutory provision. *See* Pet. App. 73a–75a (Duncan, J., concurring). Those judges principally relied on this Court's discussion of severability in *Free Enterprise Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 490 (2010), but that case does not support such a cramped view of the available remedies in presidential removal cases. In *Free Enterprise*

Fund, an accounting firm under investigation by the PCAOB sued the agency for being unconstitutionally insulated from presidential oversight, and the principal remedy it sought was an order prospectively shutting down the agency. By the time the case reached this Court, the PCAOB's investigation of the firm had concluded and "produced no sanction," thus leaving nothing to vacate. 561 U.S. at 490. Accordingly, the Court in *Free Enterprise Fund* had no occasion to decide what should happen to the PCAOB's past actions; the only remedial question before the Court was whether and how the PCAOB should operate going forward.

This Court's cases identify two key rationales for why a federal official's actions must be set aside if the official acts without constitutional authority. First, under our Constitution, such actions are "void." *Seila Law*, 140 S. Ct. at 2196; *accord Noel Canning v. NLRB*, 705 F.3d 490, 493 (D.C. Cir. 2013), *aff'd*, 134 S. Ct. 2550 (2014) (observing that the acts of an official who serves in violation of the Appointments Clause are "void *ab initio*"). The Constitution mandates certain structural and procedural requirements that must be followed for a federal official to act. Among those requirements are that senior executive officials be appointed in the manner specified by the Appointments Clause and subject to oversight by the President. When these requirements are not observed, the official's actions are *ultra vires* and must be set aside.

Second, it is essential that courts deploy remedies that "create incentives" for litigants to vindicate the Constitution's structural constraints, which protect everyone's liberty. *Lucia*, 138 S. Ct. at 2055 & n.5

(cleaned up). The cost of litigating a major separation of powers case is substantial, and the practical reality is that plaintiffs would not bring these cases if there were no prospect of winning vacatur of a harmful past agency action or some other form of backward-looking relief. The Framers' vision was that the Constitution's various structural provisions would work together to protect the individual and ensure democratic accountability, and as a practical matter vacatur of past unconstitutional actions is necessary if courts are to police violations of the separation of powers.

B. The Harmless Error Rule Does Not Provide a Basis for Denying Plaintiffs a Meaningful Remedy.

Without endorsing Judge Duncan's conclusion that vacatur of past agency actions is never an available remedy in presidential removal cases, the Fifth Circuit majority concluded that no such remedy is appropriate here because it was not convinced that the President's inability to supervise FHFA's Director affected FHFA's decision to sign the Third Amendment. Pet. App. 69a–71a. The Fifth Circuit erred. This Court has never applied the harmless error rule in a separation of powers case, and in any event Defendants cannot show that the constitutional violation was harmless on the facts presented here.

1. The harmless error rule does not apply in separation of powers cases.

a. "[T]he doctrine of separation of powers is a *structural safeguard* rather than a remedy to be applied only when specific harm, or risk of specific harm, can be identified." *Plaut v. Spendthrift Farm, Inc.*, 514

U.S. 211, 239 (1995). In part because of the structural, prophylactic nature of the separation of powers, successful plaintiffs in such cases are entitled to meaningful remedies even if they cannot "prove that the Government's course of conduct would have been different in a 'counterfactual world' in which the Government had acted with constitutional authority." *Seila Law*, 140 S. Ct. at 2196 (quoting *Free Enterprise Fund*, 561 U.S. at 512 n.12).

Consistent with this understanding, this Court has repeatedly awarded meaningful, backward-looking remedies in cases in which it was highly unlikely that the separation of powers violation affected the substance of the challenged government action. In *Seila Law*, for example, there was no plausible argument that greater presidential oversight of the CFPB would have changed the agency's decision to investigate a small California law firm for consumer fraud. *See Seila Law*, 140 S. Ct. at 2196. Likewise, in *Stern v. Marshall*, 564 U.S. 462, 503 (2011), the Court held that a bankruptcy judge "lacked the constitutional authority to enter a final judgment on a state law counterclaim" and refused to give effect to such a judgment without asking whether the bankruptcy judge would have reached the same conclusion had he enjoyed lifetime tenure under Article III. *See also, e.g.*, *Glidden Co. v. Zdanok*, 370 U.S. 530, 533 (1962) (plurality); *cf. Nguyen v. United States*, 539 U.S. 69, 77 (2003) (reversing unanimous Ninth Circuit decision because one of panel's three members was not an Article III judge).

Perhaps the clearest illustration of this Court's longstanding refusal to apply the harmless error rule in separation of powers cases is *Lucia v. SEC*, 138 S. Ct. at 2055. There, the Court ruled that an administrative law judge (ALJ) held his position in violation of the Appointments Clause when he rendered a challenged decision. The Court set aside the ALJ's decision. Observing that on remand the same ALJ could not "be expected to consider the matter as though he had not adjudicated it before," the Court further ordered that the case be reassigned to a different ALJ. *Id.* Thus, far from withholding meaningful relief from the petitioners because the Court thought it probable that the constitutional violation had no effect on the outcome of the administrative decision, the Court in *Lucia* treated that possibility as a reason to award a *more expansive* remedy.

b. The leading case in the lower courts on application of the harmless error rule in the separation of powers context is *Landry v. FDIC*, in which the D.C. Circuit concluded that violations of the Appointments Clause are " 'structural,' and thus subject to automatic reversal" without regard to whether the violation caused any prejudice. 204 F.3d 1125, 1131 (D.C. Cir. 2000) (quoting *Neder v. United States*, 527 U.S. 1, 8 (1999)). A review of the circumstances under which this Court has deemed certain constitutional violations to be "structural"—and thus not subject to the harmless error rule—further shows why that rule does not apply here.

First, this Court treats constitutional violations as structural "if the effects of the error are simply too hard to measure." *Weaver v. Massachusetts*, 137 S. Ct. 1899, 1908 (2017); *see Laccetti v. SEC*, 885 F.3d 724, 725 (D.C. Cir. 2018) (Kavanaugh, J.) (observing that harmless error rule applies only "if the effect of such an error can be meaningfully assessed"). As Judge Williams explained in *Landry*, in separation of powers cases "it will often be difficult or impossible for someone subject to a wrongly designed scheme to show that the design—the structure—played a causal role in his loss." *Landry*, 204 F.3d at 1131. This case illustrates the problem. Applying the harmless error rule here would require determining which individual (or individuals) the President would have selected to head a non-independent FHFA from its inception in 2008, what policies those individuals would have pursued from the time of their appointments, and whether those policies would have given rise to the same economic and political dynamics that produced the Net Worth Sweep. Courts are ill-equipped to undertake such a "speculative inquiry into what might have occurred in an alternate universe." *United States v. Gonzalez-Lopez*, 548 U.S. 140, 150 (2006).

Second, this Court will not apply the harmless error rule when a constitutional protection is not merely a safeguard against erroneous decisions but instead "protects some other interest." *Weaver*, 137 S. Ct. at 1908. Although the Framers undoubtedly believed that the separation of powers would prompt federal agencies to make decisions that would be more protective of liberty, *see PHH Corp.*, 881 F.3d at 183–88 (Kavanaugh, J., dissenting), the Take Care Clause and Article II's Vesting Clause also preserve clear lines of political accountability for exercises of Executive Power, *see Free Enterprise Fund*, 561 U.S. at 497. The critical constitutional interest in maintaining democratic accountability for uses of Executive Power would be served by setting aside the Third Amendment irrespective of whether the substance of the action in question was affected by the constitutional violation.

Third, a constitutional violation is structural if it "always results in fundamental unfairness." *Weaver*, 137 S. Ct. at 1908. By vesting all Executive Power in one elected President, the Framers made "a profound judgment" about the way in which such power should be exercised. *Cf. Sullivan v. Louisiana*, 508 U.S. 275, 281 (1993). The separation of powers "affect[s] the framework within which" the federal government exercises its limited powers and therefore "def[ies] analysis by 'harmless-error' standards." *Arizona v. Fulminante*, 499 U.S. 279, 309–10 (1991).

2. FHFA's violation of the separation of powers was not harmless.

a. In the proceedings below, the Fifth Circuit treated FHFA's violation of the separation of powers as harmless error without clearly articulating the legal standard it was applying or identifying which party it thought should bear the burden of persuasion. *See* Pet. App. 69a–71a. This Court has never applied the harmless error rule in a separation of powers case, and other lower court decisions are no help on the applicable standard because they treat violations of the separation of powers as "structural error" subject to automatic reversal. *See, e.g.*, *Bandimere v. SEC*, 844 F.3d 1168, 1181 n.31 (10th Cir. 2016) (following *Landry*). While the question is novel, Plaintiffs submit that, assuming separation of powers violations are subject to harmless error review, the appropriate standard is the one that the D.C. Circuit uses when an agency completely fails to comply with the APA's notice and comment requirements; a failure to comply with the Constitution's separation of powers should not be considered harmless "if there is any uncertainty at all as to the effect of that failure." *Sugar Cane Growers Co-op. v. Veneman*, 289 F.3d 89, 96 (D.C. Cir. 2002).

Like APA notice and comment, the separation of powers requires those who exercise government power to follow a set of procedures that are intended to promote better, less arbitrary, and more liberty-protective decisionmaking. *See PHH Corp.*, 881 F.3d at 183 (Kavanaugh, J., dissenting). Also like notice and comment, separation of powers doctrine places no limits on what substantive actions the government can take so long as the mandated procedures are followed. The harmless error rule could be readily abused under these circumstances: an agency can always claim that it would have made the same decision had it followed the required procedures. "To avoid gutting the APA's procedural requirements," the lower courts impose an extraordinarily heavy burden on the government to demonstrate harmless error when the government utterly fails to follow the APA's notice and comment requirements. *Riverbend Farms, Inc. v. Madigan*, 958 F.2d 1479, 1487 (9th Cir. 1992) (Kozinski, J.). The rationale for that approach applies with at least as much force in the separation of powers context.

b. Defendants cannot meet their heavy burden to demonstrate harmless error. To start, it is impossible to say who would have headed FHFA over the years had the agency not been independent or what policies

FHFA's hypothetical Directors would have pursued. Had FHFA not been unconstitutionally structured, President Obama would have been able to select a FHFA Director of his choice in 2009 rather than spending years contending with Republican-appointee James Lockhart and, later, Acting Director DeMarco, who was eligible for the post only because he was one of Mr. Lockhart's handpicked deputies. *See* 12 U.S.C. § 4512(c)–(f). Without any way to know who would have been at the helm of the agency over these years, there is no way to assess whether the financial, policy, and political circumstances that led to the Third Amendment would have occurred.

It also bears noting that in the summer of 2012 FHFA Acting Director DeMarco publicly sparred with the Obama Administration over housing finance policy issues. Mr. DeMarco had a particularly heated public exchange with the Secretary of the Treasury. *See* Letter from Timothy F. Geithner to Edward DeMarco (July 31, 2012), *available at* http://goo.gl/BGbWJR. Relations between the two sides were so bad that two weeks before the Third Amendment was consummated a reporter asked an Administration official about the possibility of firing Mr. DeMarco, to which the official responded: "That is not authority that the president has." Rob Blackwell, *Donovan: Obama Can't 'Fire' FHFA's DeMarco*, AM. BANKER (Aug. 2, 2012), https://bit.ly/3hxceMc.

The likelihood that a non-independent FHFA would have had a different Director in August 2012 is important to the harmless error analysis in this case. It is FHFA's Director—not the Treasury Secretary—who is assigned the statutory duty "to ensure that . . .

[Fannie and Freddie] operate[ ] in a safe and sound manner, including maintenance of adequate capital." 12 U.S.C. § 4513(a)(1)(B). Whether a non-independent FHFA Director would have thought the Net Worth Sweep consistent with that and FHFA's other statutory duties—and whether the President would have agreed—is simply unknowable.

To assess the prospects of the Net Worth Sweep in an alternate universe in which FHFA lacked independence, it is also necessary to consider the broader political context. In August 2012, the White House was occupied by a Democrat and the House of Representatives majority was Republican. In that political environment, if the President had controlled FHFA he might have preferred to avoid the appropriations process by keeping money at the Companies that could have been used to fund the Administration's housing policies—policies with which Mr. DeMarco vehemently disagreed. Moreover, the Net Worth Sweep was imposed on the eve of a presidential election, and the Administration might not have been willing to run the political risks inherent in nationalizing Fannie and Freddie without public support from an independent financial regulator. In that way, "FHFA's status as an 'independent' counterparty could actually have boosted the Third Amendment's political salability." Pet. App. 54a. Putting all this together, it is highly uncertain what would have happened had FHFA not been an independent agency. That is more than enough to prevent Defendants from demonstrating harmless error. *Cf. Sugar Cane Growers Co-op*, 289 F.3d at 96.

The Fifth Circuit majority thought it significant that Defendants have continued to defend the Net Worth Sweep in court across two presidential administrations and several changes of leadership at FHFA. Pet. App. 70a. The same was true for the civil investigative demand in *Seila Law*. *See* 140 S. Ct. at 2220–21 (Thomas, J., dissenting in part). Although Presidents have appointed new FHFA Directors in the years since the Third Amendment was signed, the agency has been headed by a single Director not subject to the President's oversight throughout. Moreover, the political and policy dynamics that determine whether an agency takes a particular action are obviously quite different than the dynamics that bear upon an agency's decision to defend against lawsuits challenging actions already taken. To see that this is so, the Court need look no further than Director Calabria, under whose leadership FHFA has continued to defend the Third Amendment despite the Director's past acknowledgements that imposing the Third Amendment was both unwise and illegal. *See* Kriminger & Calabria, *supra*.

C. Defendants' Equitable Defenses Do Not Provide a Basis for Denying Plaintiffs a Meaningful Remedy.

Plaintiffs' constitutional claim is cognizable under the APA, which says that "[t]he reviewing court *shall . . . hold unlawful and set aside* agency action . . . found to be . . . contrary to constitutional right, power, privilege, or immunity." 5 U.S.C. § 706 (emphasis added). Thus, "[i]n *all* cases agency action *must* be set aside . . . if the action failed to meet . . . constitutional requirements." *Citizens to Pres. Overton Park, Inc. v.*

Volpe, 401 U.S. 402, 413–14 (1971) (emphases added); *accord SAS Inst., Inc. v. Iancu*, 138 S. Ct. 1348, 1359 (2018) (observing that the APA "*directs* courts to set aside agency action 'not in accordance with law' " (emphasis added)). Although courts have a measure of discretion when deciding how to carry out this statutory charge, the text leaves no room for a court to decide as a matter of equity and fairness that unconstitutional agency action ought not be set aside. "Courts of equity cannot, in their discretion, reject the balance that Congress has struck in a statute." *United States v. Oakland Cannabis Buyers' Co-op.*, 532 U.S. 483, 497–98 (2001).

Defendants nevertheless urged the Fifth Circuit to exercise its equitable discretion to decline to set aside the Net Worth Sweep. The APA's unambiguous text forecloses such arguments, and in any event there is no equitable basis for withholding a meaningful remedy in this case.

1. Before the Fifth Circuit, Defendants asserted the equitable defense of laches. But it is undisputed that Plaintiffs sued within the six-year statute of limitations that applies to APA claims, *see* 28 U.S.C. § 2401(a), and this Court has "never applied laches to bar in their entirety claims for discrete wrongs occurring within a federally prescribed limitations period." *Petrella v. Metro-Goldwyn-Mayer, Inc.*, 572 U.S. 664, 680 (2014). Because "applying laches within a limitations period specified by Congress would give judges a 'legislation-overriding' role that is beyond the Judiciary's power," laches does not apply here. *SCA Hygiene Prods. Aktiebolag v. First Quality Baby Prods., LLC*, 137 S. Ct. 954, 960 (2017).

Moreover, even if laches were an available defense in APA cases, the defense could not succeed on the facts of this case. "Where there has been no inexcusable delay in seeking a remedy and where no prejudice to the defendant has ensued from the mere passage of time, there should be no bar to relief." *Gardner v. Panama R.R. Co.*, 342 U.S. 29, 30–31 (1951). Plaintiffs acted reasonably in suing within the applicable statute of limitations, and Defendants cannot plausibly claim to have been prejudiced by the fact that Plaintiffs did not sue sooner. Furthermore, the Net Worth Sweep has been the subject of active litigation since shortly after it went into effect, and where a defendant's actions inflict similar injuries on multiple individuals, "it is not essential that each such person should intervene in the suit brought in order that he be deemed thereafter free from the laches which bars those who sleep on their rights." *Southern Pac. Co. v. Bogert*, 250 U.S. 483, 490 (1919).

2. At Defendants' urging, the Fifth Circuit majority refused to grant Plaintiffs a meaningful remedy in part because Plaintiffs' constitutional theory applies with equal force not only to the Net Worth Sweep but to every provision of the PSPAs, saying that Plaintiffs should not be permitted to "pick and choose" which provisions of the agreements are held invalid. Pet. App. 66a–67a. Defendants raised this argument for the first time on appeal, and Plaintiffs responded by unequivocally saying that the PSPAs should be invalidated *in toto* if the courts determine that to be the most fitting remedy: "To the extent the Court deems it appropriate, Plaintiffs have no objection to vacatur of the PSPAs in their entirety." Reply Br. of Plaintiffs-

Appellants at 8, *Collins, et al. v. Mnuchin, et al.,* No. 17-20364, (5th Cir. Sept. 22, 2017). Thus, the Fifth Circuit majority was simply wrong when it said that Plaintiffs "never requested a declaratory judgment about the PSPAs as a whole." Pet. App. 67a.

Regardless, Judge Willett's dissent correctly applied the governing principles of law in concluding that "[t]he Third Amendment is the smallest independent agreement that caused the Shareholders' injury, so that is what to rescind." Pet. App. 146a (Willett, J., dissenting) (citing RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 17 (AM. LAW INST. 2011)). But even if this Court disagrees, that is at most a reason to set aside the PSPAs in their entirety, not a reason to deny Plaintiffs all meaningful relief.

D. HERA's "Best Interests" Provision Cannot be Severed from the Director's For-Cause Removal Protection.

If the Court concludes that the FHFA Director's for-cause removal protection is unconstitutional, it will need to decide not only what that ruling means for the Third Amendment but also whether to sever the unconstitutional provisions of HERA from the rest of the statute. On remedies, Plaintiffs agree with Justice Thomas's partial dissent in *Seila Law*. *See* 140 S. Ct. at 2220–24 (Thomas, J., dissenting in part). Recognizing that a recent dissent is unlikely to be adopted by a majority of the Court, however, Plaintiffs respectfully submit in the alternative that if Defendants' reading of 12 U.S.C. § 4617(b)(2)(J)(ii) is correct, that provision is not severable from the unconstitutional provisions of HERA and therefore should not be considered when the Court rules on Plaintiffs' statutory claim.

Unlike the statute before the Court in *Seila Law*, HERA contains no severability clause. This Court's task is therefore to determine whether it is "evident that [Congress] would not have enacted those provisions which are within its power, independently of [those] which [are] not." *Murphy v. NCAA*, 138 S. Ct. 1461, 1482 (2018). The severability inquiry operates on a provision-by-provision basis, *id.*, and the Court should be reluctant to find provisions severable from each other if doing so would "alter[ ] the balance of powers between the Legislative and Executive Branches." *Alaska Airlines, Inc. v. Brock*, 480 U.S. 678, 685 (1987); *see also Bowsher*, 478 U.S. at 734–36.

To the extent that Defendants are correct that Section 4617(b)(2)(J)(ii) gives FHFA nearly limitless discretion to operate the Companies in furtherance of whatever goals it deems to be in its own "best interests," Congress intended for that discretion to be exercised by an agency free from "political domination or control" and "separate and apart from any existing department of the government—not subject to the orders of the President." *Humphrey's Ex'r*, 295 U.S. at 625; 12 U.S.C. § 4511(a) ("There is established the Federal Housing Finance Agency, which shall be an independent agency of the Federal Government."). Justice Kavanaugh has recognized the close relationship between agency independence and very broad delegations of administrative discretion, observing that if Congress were to repeal the for-cause removal provisions that appear in various statutes it might also enact "more tightly drawn substantive statutes so as to prevent excessive delegations of power to the Executive Branch or perceived concentration of power in the President." *In re Aiken Cty.*, 645 F.3d 428, 447–48 (D.C. Cir. 2011) (Kavanaugh, J., concurring). Plaintiffs do not believe that Section 4617(b)(2)(J)(ii) gives FHFA unfettered discretion to define its own best interests however it pleases and pursue those interests with the Companies' resources. But if the Court disagrees, Plaintiffs submit that it is highly unlikely that Congress would have given such sweeping discretion to an agency subject to control by the President.

CONCLUSION

The Court should affirm the Fifth Circuit's statutory ruling and its ruling that FHFA is unconstitutionally structured. It should reverse the Fifth Circuit's ruling on the appropriate remedy for Plaintiffs' constitutional claim and order that the Third Amendment be set aside.

Respectfully submitted,

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