UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

ATIF F. BHATTI, *et al.*, Plaintiffs, v. THE FEDERAL HOUSING FINANCE AGENCY, *et al.*, Defendants.	Case No. 0:17-cv-2185 (PJS/HB)

REPLY MEMORANDUM OF LAW IN SUPPORT OF FHFA DEFENDANTS' MOTION TO DISMISS SECOND AMENDED COMPLAINT

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Plaintiffs' opposition fails to salvage their irredeemably flawed claims. Contrary to plaintiffs' sole response on § 4617(f), applying that provision according to its terms does not cut off judicial review or deny them a forum; it simply disallows the extraordinary injunction they seek here. Plaintiffs do not meaningfully grapple with *Norton v. S. Utah Wilderness Alliance*, 542 U.S. 55 (2004), and related limitations on failure-to-act claims, instead contending implausibly that maintaining the decade-long status quo of the Conservator's economic deal with Treasury was a *new* action. And they do not plug the many holes in their spurious narrative, which is grounded not in well-pleaded factual allegations but in self-serving *post hoc* speculation totally out of step with the Trump Administration's real-world actions.

I. Multiple Threshold Legal Bars Preclude Plaintiffs' Claims

A. HERA's Anti-Injunction Provision

Plaintiffs do not deny that setting terms for the Conservator's contracts with the Enterprises' largest investor is part of the core "powers and functions" of the Conservator, nor that a court order overhauling those terms would be an archetype of the litigative interference the statute was intended to prevent. They resist § 4617(f) solely on the ground that it lacks the "clear statement" needed to "bar all remedies for a constitutional violation," "bar Plaintiffs' constitutional claims," or "deny a forum for constitutional claims." Opp. 18 (cleaned up).[1] That argument fails because FHFA has not sought and does not seek to use § 4617(f) to do any of those things.

[1] "Opp." as used herein means plaintiffs' opposition brief (ECF No. 103); "FHFA Mem." means FHFA's opening brief (ECF No. 100).

Section 4617(f) precludes *certain relief*, not judicial review of constitutional issues. That the available relief does not include everything on plaintiffs' wish list does not equate to shutting the courthouse doors. Plaintiffs cannot credibly complain of being denied any forum for a constitutional challenge that has occupied numerous courts' attention. The Supreme Court granted a significant part of the relief the shareholders sought in both *Collins v. Yellen*, 141 S. Ct. 1761 (2021), and this case: a declaration "that FHFA's structure violates the separation of powers."[2]

The cases plaintiffs cite for their "clear statement" argument are very different. They involve attempts to shut off courts entirely from hearing substantial constitutional claims, rather than exclusion of particular remedies.[3] To the extent statutes merely limiting available remedies must include a clear statement, "Congress could not have been clearer about leaving" matters such as "[r]enegotiating dividend agreements" and "ensuring ongoing access to vital yet hard-to-come-by capital" to "FHFA's managerial judgment." *Perry Capital v. Mnuchin*, 864 F.3d 591, 607 (D.C. Cir. 2017).

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[2] Compl. ¶ 190(a)1, ECF No. 1, *Collins v. FHFA*, Civ. A. No. 4:16-cv-3113 (S.D. Tex.), *see* Plaintiffs-Appellants' Reply Br. at 10-11, *Bhatti v. FHFA*, No. 18-2506 (8th Cir.) ("even if the Court declines to vacate the Net Worth Sweep," merely "subjecting FHFA to oversight by the President" prospectively would "partially redress [plaintiffs'] injuries").

[3] *See, e.g.*, *Webster v. Doe*, 486 U.S. 592 (1988) (statute giving CIA Director wide discretion over personnel terminations implicitly precluded judicial review of such terminations under the APA, but did not categorically bar litigation of related constitutional claims); *Bartlett v. Bowen*, 816 F.2d 695, 707 (D.C. Cir. 1987) (Congress cannot "foreclose all judicial review on the constitutionality of a congressional enactment").

Further, Plaintiffs' current claims are properly treated as APA arbitrary-and-capricious or failure-to-act claims, not constitutional claims. *See Collins*, 141 S. Ct. at 1794 n.7 (Thomas, J., concurring).[4] Regardless, plaintiffs cite no authority that characterizing their claims as "constitutional" renders § 4617(f) inoperative. While § 4617(f) might not preclude relief stopping a conservator from *exceeding* its "constitutionally permitted" powers, *Nat'l Tr. for Historic Pres. v. FDIC*, 995 F.2d 238, 240 (D.C. Cir. 1993), plaintiffs do not dispute that "the unconstitutional removal provision never diminished FHFA's constitutional or statutory authority to act." FHFA Mem. 19-20; *see* Opp. 18-21 (no response).

The fact that *Collins* discussed § 4617(f) in its statutory analysis, but not its constitutional analysis, does not "implicitly" mean the provision is inapplicable here. Opp. 18, 19. There is a simple explanation why § 4617(f) did not come up in the Court's constitutional discussion: no one argued it prevented the Court from ruling on the constitutionality of the removal provision. Nor would such a position have been tenable, as plaintiffs' own cited cases indicate. *Bartlett*, 816 F.2d at 703 (Congress cannot "enact legislation and preclude the judiciary from hearing challenges to the constitutionality of that legislation"). The Court did not need to consider whether the primary remedy discussed—vacating the Third Amendment—would restrain or affect the Conservator's exercise of its powers or functions because it found that relief unavailable anyway. 141

[4] Plaintiffs partially embrace Justice Thomas's APA "arbitrary and capricious" discussion, modeling Count III on his concurrence's footnote 7. SAC ¶ 110. Yet they ignore the main points of that discussion: that such a claim would be the *only* path for plaintiffs, and that it would squarely implicate § 4617(f).

S. Ct. at 1787-88. With respect to possible "retrospective relief" for Third Amendment implementation, the Court made clear that any and all remedial limitations would be fair game for further litigation. *Id.* at 1789.

B. Requirements for Failure-to-Act Claims Not Met

1. Plaintiffs' contention (Opp. 11-14) that they actually challenge affirmative agency actions, rather than a failure to act, cannot be squared with the complaint. The cornerstone of the complaint is the notion that *changes to the status quo* that allegedly "would have occurred … if President Trump had installed his own FHFA director at the start" did *not*, in fact, occur. SAC ¶¶ 97, 103, 109, 118; *see also id.* ¶ 86 ("If President Trump had fired Director Watt and installed his own FHFA director in January 2017, the administration would have been able to start pursuing its policy objectives for Fannie and Freddie two years earlier.").

There is no allegation that any *action* by former Director Watt prevented those changes. In fact, plaintiffs insist that it is irrelevant that Director Watt was never asked to make those changes and never refused. Opp. 26. Plaintiffs' theory depends on former Director Watt's mere passive presence in office, not on his doing anything.

Plaintiffs do not "challenge the same agency action" (Opp. 12) as in *Collins*. In *Collins*, "the relevant action … [was] the third amendment." 141 S. Ct. at 1779. While the SAC recounts the Third Amendment as historical background, *e.g.*, SAC ¶¶ 34, 36, it identifies no Third Amendment-implementing action for which plaintiffs seek retrospective relief. The four counts and prayer for relief do not include the words "Third Amendment," "Net Worth Sweep," or "dividends." SAC ¶¶ 93-120 & Prayer for Relief.

The liquidation preferences they now target for annihilation accrued mostly *before* the Third Amendment. SAC ¶ 31 (liquidation preferences totaled $189 billion in summer 2012). This case, as now pleaded, is far afield from "actions that confirmed Directors have taken to *implement* the third amendment." *Bhatti v. FHFA*, 15 F.4th 848, 853-854 (8th Cir. 2021) (quoting *Collins*, 141 S. Ct. at 1787).[5]

Plaintiffs cannot elide the distinction between agency action and failure-to-act by recasting failure to eliminate the liquidation preferences as "agency action maintaining Treasury's liquidation preference." Opp. 15 (quote marks omitted). That approach would hollow out *Norton*. As a matter of semantics, any failure to change the status quo could be superficially recast as "action" maintaining the status quo. Yet *Norton*, the APA, and pre-APA remedial jurisprudence contrast affirmative agency actions and lack of action for a reason, and teach that claims seeking to force agencies to undertake new actions are subject to important restraints that must be given effect here.

2. Plaintiffs go through these contortions to try to avoid *Norton* because they have no meaningful response to *Norton* on the merits. Plaintiffs make light of *Norton*, highlighting Justice Scalia's examples of offbeat failure-to-act claims that would not lie,

[5] The opposition characterizes plaintiffs' claims as challenging Director Watt's "implementation of the PSPA provisions that swept the Companies' dividends to Treasury and increased Treasury's liquidation preference while the Trump administration was in office." Opp. 14. The SAC contains no trace of such a challenge, perhaps because *less than 4%* of the liquidation preferences accrued while Director Watt headed FHFA in 2017-18, and the total "Net Worth Sweep" dividends paid in that period were *less than* those that would have been payable under the pre-Third Amendment formula. In any event, "it is axiomatic that [a] complaint may not be amended by the briefs in opposition to a motion to dismiss." *Fischer v. Minneapolis Pub. Schs.*, 792 F.3d 985, 990 n.4 (8th Cir. 2015) (cleaned up).

e.g., "broad statutory mandate[s] to manage wild burros [for] ecological balance." Opp. 17. It goes without saying, however, that the legal principles in *Norton* transcend those particular examples.

In Justice Scalia's examples, moreover, at least there was a "statutory mandate," satisfying *Norton*'s requirement that the agency have been legally "required to take" the action the plaintiffs seek to compel. *Norton*, 542 U.S. at 64. Here, in contrast, plaintiffs concede a "statutory prohibition" *forbade* the actions they seek to compel for half the time that Director Watt supposedly blocked the way. Opp. 37 n.4; FHFA Mem. 23 (citing statute); *cf. Org. of Comp. Markets v. USDA*, 912 F.3d 455, 463 (8th Cir. 2018) (rejecting failure-to-act claim where "appropriations riders … preclud[ed] USDA from finalizing its proposed regulation").

Plaintiffs appear to contend they have the equivalent of a statutory mandate because "*Collins* explained that Plaintiffs would be entitled to a remedy" and FHFA "do[es] not have *discretion*" to withhold a remedy for which plaintiffs claim entitlement. Opp. 17. That faulty reasoning makes a hash out of both *Collins* and *Norton*.

Collins did not say plaintiffs were "entitled" to anything, only that its holdings did "not *necessarily* mean … the shareholders have *no* entitlement to retrospective relief." 141 S. Ct. at 1788 (emphasis added). Leaving open a sliver of a possibility of relief is hardly entitlement.

Norton's prohibition against "judicial direction" of "agency action that is not demanded by law" only makes sense as referring to a legal obligation that existed independently from and predated the litigation, *e.g.*, a statute. Plaintiffs' position that the

"demanded by law" requirement should be deemed satisfied because if they ultimately prevail in litigation, they would be entitled to *judicial* relief, is circular and would render *Norton* meaningless. What matters is that, as plaintiffs concede, FHFA was never under any independent, pre-existing legal obligation to take the extraordinary steps they ask this Court to order.

3. With respect to *Norton*'s "discreteness" requirement, wiping out quarter-trillion dollar liquidation preferences or converting Treasury's preferred stock to common stock would hardly be "straightforward," "binary," or a "single simple act" (Opp. 17, 42). Either action would upend the Enterprises' relationships with Treasury as they have existed for the last 14 years—relationships on which the stability of the U.S. housing finance system has rested. The opening sentence of plaintiffs' opposition makes clear they seek nothing less than judicially supervised reversal of what they characterize as a "nationalization" of Fannie Mae and Freddie Mac. Opp. 1.

While the specific changes plaintiffs seek are themselves transformative in nature, they would open a Pandora's box of other interlocking financial, legal, and policy issues. Plaintiffs admit their requested relief would be logical only as part of "multiple, and often sequential steps" implicating numerous policy issues and other stakeholders. Opp. 5. For starters, erasing what the Supreme Court ranked the foremost of Treasury's "key entitlements" (141 S. Ct. at 1773) would raise profound questions about how Treasury would be compensated prospectively for its continuing commitment of hundreds of billions to avoid risk of Enterprise insolvency. Plaintiffs' proposal to convert Treasury's preferred stock to common stock begs the question of how to set the conversion ratio,

which would determine how much pre-existing common stockholders' rights would be diluted. Nor can plaintiffs explain what would happen if, at the time of judgment, market conditions are not optimal for the public stock offerings with which plaintiffs envision the proposed elimination or diminution of Treasury's economic rights would be coupled.

These are just a few of the complex, non-"binary" issues into which the parties and the Court would be plunged, belying plaintiffs' empty assurance of "no day-to-day management" (Opp. 17). Such multifaceted, programmatic policy matters belong in "the offices of the [agency] or the halls of Congress," not the courts. *Norton*, 542 U.S. at 64 (quote marks omitted).

4. Plaintiffs' claim of entitlement to a mandatory "injunction placing them in the position they would be in absent the unconstitutional removal restriction" (Opp. 1; *see also id.* at 41-44) cannot be reconciled with *Norton*. Nor is any such sweeping new entitlement supported by anything in *Collins*, which simply allowed further litigation regarding the narrow possibility of limited retrospective relief.

The idea of "reparative injunctions" ordering the Executive Branch to carry out a major change in discretionary economic policy is alien to separation-of-powers jurisprudence, FHFA Mem. 25, and plaintiffs fail to come forward with any apposite case. Rather, their lead "reparative injunction" case involved specific performance of a property seller's contractual obligation to remove an unwanted swim dock. *Forster v. Boss*, 97 F.3d 1127 (8th Cir. 1996). Plaintiffs' other cited cases, involving remedial decrees addressing school desegregation, voting rights, and prison conditions, were against state and local governments, so the limitations embodied in *Norton* were not in

play. That courts have sometimes ordered prescriptive relief against local school boards to root out decades of unconstitutional segregation is no precedent for compelling the Conservator and Treasury to overhaul their financial relationship in a radical way that is not and has never been required by the Constitution or any statute, and that neither agency has ever adopted as its policy.

II. Plaintiffs' Narrative is Farfetched and Contradicted by the Trump Administration's Actual Actions

Plaintiffs' opposition brief fails to rehabilitate their complaint's implausible and wildly speculative narrative. This is not a matter of "doubting the facts alleged." Opp. 40. The key links in plaintiffs' narrative are not historical facts at all, but rather self-serving conjecture about what policies *would have* been pursued and what outcomes *would have* been achieved in a hypothetical world. Those "unreasonable inferences" and "unrealistic assertions" warrant no credence whatsoever, *Brown v. Medtronic, Inc.*, 628 F.3d 451, 461 (8th Cir. 2010), and they fail to establish a plausible entitlement to relief.

1. While plaintiffs still implausibly attribute to the Trump Administration a goal of "return[ing]" value held by Treasury "to the shareholders," Opp. 1, they offer a slightly more nuanced variation: that Treasury supposedly concluded the best way to maximize *its* value was to surrender its first-preference position with the hope of reaping a return through common stock instead. Opp. 37-38. However, there is not a single allegation in the complaint from which it could plausibly be inferred that Treasury analyzed the economics that way or formed such a view, much less was prepared to act on it. On the contrary, Treasury's housing finance reform plan in September 2019 and

the PSPA amendments that month and in January 2021 all reaffirmed the importance of maintaining Treasury's preferred stock position for the foreseeable future.

2. Plaintiffs do not dispute that, among the numerous FHFA or Treasury documents and public statements marshaled in their complaint, the only place their hypothesized actions are mentioned is in bullets in a wide-ranging preliminary list of options in Treasury's September 2019 report. FHFA Mem. 30. As FHFA pointed out, the potential options as articulated there are "[e]liminating all *or a portion of* the liquidation preference" or "exchanging all *or a portion of* that interest." *Id.* Plaintiffs admit the phrase "or a portion of" is part of the bullet, Opp. 34, yet make no effort to reconcile that phrase with their theory that 100% elimination was the sole path.

Moreover, even those options were listed alongside many others, including receivership, and all subject to much more analysis and study. Plaintiffs take the position that other options, particularly receivership, must have been a feint because they were supposedly "irreconcilable" with "all the public statements" by Administration officials. Opp. 39-40. But in the same contemporaneous testimony plaintiffs quote in the complaint, both Director Calabria and Secretary Mnuchin repeatedly impressed upon Congress that receivership was very much on the table. *The End of Affordable Housing? A Review of the Trump Administration's Plans to Change Housing Finance in America*, 116th Cong., at 31-32 (Oct. 22, 2019) (cited in SAC ¶ 53) (Mnuchin: "We have made no decision as to whether they would exit by conservatorship or receivership."); *id.* at 43 (Calabria: "I very much share Secretary Mnuchin's earlier point that no decision has been made on going forward"); *id.* (Mnuchin: objecting to suggestion that

Administration was predisposed towards "recapping and releasing" and reiterating "we have the option to go through receivership. We have not had any discussion . . ."); *id.* at 60 (Calabria: "[As] Secretary Mnuchin has said, we haven't gotten to the point of deciding what the next route is . . . ."); *id.* at 61 (Mnuchin: "[A]gain, we have not predetermined whether they go through conservatorship [or] receivership."). The "presumption of regularity" that plaintiffs invoke elsewhere counsels against assuming that such contemporaneous "official statements of public officials" are disingenuous, as plaintiffs' theory would require. Opp. 23.

3. Plaintiffs' narrative further unravels in view of the September 2019 and January 2021 PSPA amendments adopted by President Trump's chosen leadership at both agencies. Those amendments implemented one of the *other* options set forth in the Treasury September 2019 report—"[a]djusting the variable dividend on Treasury's senior preferred shares so as to allow the GSE to retain earnings" (Treasury Mot. Ex. A at 27)—while going in the opposite direction from eliminating the liquidation preferences. Specifically, the amendments not only (a) reaffirmed that proceeds of any future stock offering must be used to pay down the liquidation preferences, but (b) doubled down on the liquidation preferences by providing for major *increases*. FHFA Mem. 31-32.

The shareholders complained to the Supreme Court in *Collins* that these amendments *compounded* the alleged violations of their rights. Plaintiffs' opposition likewise reiterates: "each dollar added to the liquidation preference harmed Plaintiffs by lengthening the road back to positive value for their shares." Opp. 11. With striking inconsistency, plaintiffs nevertheless posit elsewhere in their opposition that each dollar

added to the liquidation preferences actually was part of an alleged grand plan to *eliminate* the liquidation preferences, *shortening* the road to junior preferred enrichment. Opp. 39 (suggesting purpose of raising liquidation preferences was to enable Treasury to "receive more common stock if it chose to convert its senior preferred shares"). Plaintiffs offer no factual basis for their internally inconsistent and self-serving speculation. And they do not even attempt to explain why the agreements would continue to require that future offering proceeds be used to pay down the liquidation preferences if the decision-makers envisioned the preferred stock would have ceased to exist by that point.

4. The *post hoc* purported President Trump letter merits no weight at all, let alone a presumption of regularity. Plaintiffs cite no case applying such a presumption to alleged after-the-fact reminiscences by former officials for the stated purpose of influencing pending litigation. The statements in that purported letter bear no resemblance to what the former President's Treasury Secretary actually did and said for all four years of the Administration, and what FHFA did and said under the former President's chosen leadership. At bottom, the alleged letter is just rank speculation unworthy of any evidentiary value, much less deference. Notwithstanding plaintiffs' rhetoric, Presidents have no more power than do courts to "ensure[] that [the Enterprises'] common stock increased in value" (Opp. 1), and the document provides no basis for ordering the current Administration to execute a quarter-trillion dollar economic policy transformation that the former Administration did not itself pursue.

CONCLUSION

The Court should dismiss the Second Amended Complaint with prejudice.

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Respectfully submitted,

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