IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

PATRICK J. COLLINS, *et al.*, Plaintiffs, v. **FEDERAL HOUSING FINANCE AGENCY**, *et al.*, Defendants.	§ § § § § § § § § § § §	**CIVIL ACTION NO. 4:16-CV-03113**

REPLY MEMORANDUM OF FEDERAL HOUSING FINANCE AGENCY DEFENDANTS IN SUPPORT OF MOTION TO DISMISS PLAINTIFFS' FIRST AMENDED COMPLAINT

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Plaintiffs' opposition brief fails to overcome the numerous problems with their claims, all of which fail as a matter of law. The Court should dismiss this action with prejudice.

I. The Claims Seeking Elimination of the Liquidation Preferences Fail

A. Plaintiffs' New Theory is Outside the Remand

The Supreme Court remanded for one purpose alone: further litigation of claims, if any, seeking "retrospective relief" for confirmed FHFA Directors' "implementation of the third amendment" causing "compensable harm." *Collins v. Yellen*, 141 S. Ct. 1761, 1788-89 (2021). Yet Plaintiffs' new theory (a) seeks a *prospective* mandatory injunction, not retrospective relief; (b) accuses FHFA of obstructing elimination of the entire liquidation preferences Treasury accrued since 2008, rather than wrongly implementing the dividend changes effected by the Third Amendment since 2014; and (c) involves no "compensable harm." The new theory exceeds the mandate.

Despite Plaintiffs' attempts to conflate Third Amendment implementation with the liquidation preferences, the two are quite distinct. The preferred stock was issued to Treasury in 2008, and included both (1) liquidation preferences and (2) dividends—two separate "entitlements," as the Court put it. *Id*. at 1772-74. The Third Amendment changed the dividend formula, but not the liquidation preferences. By the time it was adopted, in August 2012, the liquidation preferences were already $189 billion as a result of draws the Enterprises took from Treasury during the Great Recession. *Id.* at 1773-74. That sequence belies Plaintiffs' pretense that eliminating them would redress *implementation of* the Third Amendment by Director Watt.

There is no mystery in the phrase "implementation of the third amendment." It can only mean what Plaintiffs told the Supreme Court it meant: Senate-confirmed Directors "order[ing] and approv[ing] payment of Net Worth Sweep dividends." Reply Br. 13, *Collins v. Yellen*, No. 19-422. Addressing multiple Justices' questions at argument, Plaintiffs doubled down on the position that their "implementation" challenge pertained to "dividends," specifically "overpayments" thereof. In response to Justice Thomas's question, "[H]ow [do] we read in continuing implementation of the amendment . . . when you only challenge adoption of the amendment?" for instance, counsel emphasized, "[W]e do complain about the adoption, but we also note throughout the complaint the overpayments that were being made. . . . [E]ach one of those overpayments was an implementation of the Net Worth Sweep." Tr. of Oral Arg. 67-68, *Collins v. Yellen*, No. 19-422.[1]

Plaintiffs' opposition brief tries to gloss over the mismatch between their representations to the Supreme Court and the theory actually advanced in the First Amended Complaint ("FAC"), insisting that it somehow challenges "the precise actions that the Supreme Court said could provide the basis for retrospective relief." Pl. Opp. 7. Those unequivocal representations cannot be squared with the FAC, which lacks any reference to a quarterly dividend or "overpayment" ordered by Director Watt.[2] Counts I, III, V, and VI do not even mention the Third Amendment, the "Net Worth Sweep," or quarterly dividend payments. Nor does the FAC challenge any action by Director Watt increasing the liquidation preferences, whether through Third Amendment implementation or otherwise.[3] Plaintiffs' FAC controls, not their opposition brief. *Energy Coal S.P.A. v.*

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[1] *See also id.* at 66-67 (Chief Justice Roberts: "Do you make a claim going forward about the payments even if you accept the validity of what the acting director did?" Answer: "Yes, Your Honor, we do. . . . [W]e are challenging the regulatory action of the Senate-confirmed directors in approving these dividends."); *id.* at 88-89 (Justice Gorsuch: "[Y]ou haven't complained about actions taken after 2014 in your complaint, and the only complaint has to do with the entry into the [Third Amendment], which took place during the pendency of a prior director." Answer: "[W]e do complain about the implementation. We are complaining about each and every one of the decisions under the Net Worth Sweep by the director. Every one of these dividend payments gets declared quarterly, and none of them can be paid to Treasury . . . unless the director blesses those." The transcript is available at https://bit.ly/3RhUIxW.

[2] The "Net Worth Sweep dividends" that Director Watt approved in 2017 and 2018, which totaled $36.48 billion, are *lower* than the dividends that would have been due in those years absent implementation of the Third Amendment (10% of the liquidation preferences per year, totaling $38.90 billion). FHFA, Table 2: Dividends on Enterprise Draws from Treasury, http://bit.ly/3tmDbKa, *cited in* FAC ¶ 81; *see also Roberts v. FHFA*, 889 F.3d 397, 405 (7th Cir. 2018) (noting that in some periods Third Amendment dividend was lower than it would have been under old 10%-of-liquidation-preference formula, such as when the Enterprises incurred losses in 2017 and had to draw on Treasury's commitment rather than pay dividends to Treasury).

[3] As noted, the liquidation preferences had already reached $189 billion long before Director Watt's tenure. Draws by the Enterprises on Treasury's commitment increased the liquidation preferences slightly during Director Watt's tenure, but that was by operation of a feature of the original PSPAs to which Plaintiffs do not appear to object. *See* FAC Prayer ¶ 2 (clarifying that increases in the liquidation preference are appropriate "to offset . . . draws on

CITGO Petrol. Corp., 836 F.3d 457, 462 n.4 (5th Cir. 2016) ("The complaint may not be amended by the briefs in opposition to a motion to dismiss.") (citation omitted).

B. Plaintiffs Do Not Meet Prerequisites for Agency Failure-to-Act Claims

Plaintiffs reuse the same fiction that the FAC merely targets "Director Watt's implementation of the Third Amendment" to argue that they are challenging agency action—rather than *inaction*—and therefore need not meet the prerequisites for claims challenging agency inaction set forth in *Norton v. Southern Utah Wilderness Alliance*, 542 U.S. 55 (2004). Pl. Opp. 8. That fiction deserves no more credence in this context than as a means to evade the mandate rule. Count VI is expressly brought as a failure-to-act claim. Counts I and III are substantively identical to Count VI, and although they recite the phrase "agency action," they fail to identify any agency action challenged.[4] The linchpin of all of them is not that Director Watt did anything, but 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. FAC ¶¶ 101, 121, 141, 149.

Plaintiffs alternatively contend that if *Norton* applies, they meet its requirements. But their breezy assurances that they meet the discreteness requirement because "[t]he liquidation preference is either zero or it is not" and no "day-to-day agency management" would be needed (Pl. Opp. 9) cannot be taken seriously. Because the liquidation preferences, described by the Supreme Court as the foremost of Treasury's "key entitlements" (141 S. Ct. at 1773), are integral to the PSPAs, eliminating them would essentially enjoin the entire PSPAs. Indeed, Plaintiffs admit their

Treasury's funding commitment"). The liquidation preferences went on to increase during former President Trump's appointee's tenure by over four times as much as they did under Director Watt.

[4] Plaintiffs assert that Count I, a claim purportedly brought directly under the Constitution, is exempt from this analysis because "*Norton* is a case about the meaning of the APA." Pl. Opp. 8. As FHFA's opening brief emphasized, but Plaintiffs ignore, *Norton* itself makes clear that it was applying longstanding remedial and separation-of-powers principles that predate and transcend the APA. FHFA Mot. 15-16 (citing *Norton*, 542 U.S. at 63). Plaintiffs also fail to address, and therefore concede, FHFA's argument that Count I is a *non sequitur* because it is inconsistent with *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010), the case from which it is supposedly derived. FHFA Mot. 16 n.1.

requested relief would be logical only as part of "multiple, and often sequential, steps" (Pl. Opp. 4), which would open a Pandora's box of other interlocking financial, legal, and policy issues.

To begin with, it would raise profound questions about the means of compensating Treasury for its continuing commitment of hundreds of billions of dollars to avoid the risk of Enterprise insolvency. Plaintiffs' proposal to convert Treasury's preferred stock to common stock ignores the key question of how to set the conversion ratio, which would determine how much pre-existing common stockholders' shares would be diluted. Nor can plaintiffs explain what would happen if, at the time of judgment, market conditions are not conducive to the capital-raising with which plaintiffs envision the destruction of the liquidation preferences would be coupled.

As for *Norton*'s separate "legally required" prong, Plaintiffs say the Supreme Court's decision "already explained" that if Plaintiffs prevail, they "would be entitled to a remedy." Pl. Opp. 9. The Supreme Court said no such thing, only leaving open 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 not entitlement, particularly when the Supreme Court had before it only claims challenging *agency action* and could not have foreseen the about-face Plaintiffs have made on remand. In any event, Plaintiffs' argument is circular and would render *Norton*'s second prong largely meaningless. Presuming success on the merits of the litigation is not enough to make Plaintiffs' desired agency action "legally required." Rather, Plaintiffs must show that a statute or other independent source of law "legally required" the desired action *in order to* prevail on their claim. They cannot do so.

C. Plaintiffs Fail to Overcome Section 4617(f)'s Bar

Plaintiffs concede the Supreme Court squarely held that contractual relations with Treasury relating to the preferred stock are within the Conservator's powers, which is all that is necessary to trigger § 4617(f)'s bar against judicial interference. *Compare* FHFA Mot. 17 (citing *Collins*, 141 S. Ct. at 1775-78), *with* Pl. Opp. 10 (no response). The argument that § 4617(f) "lacks the clear statement necessary to bar all remedies for a constitutional claim" (Pl. Opp. 10) is flawed on two levels. *First*, FHFA has not argued § 4617(f) bars *all* remedies for their constitutional claim. Plaintiffs have already received a substantial portion of the relief they requested, through the Fifth Circuit's and Supreme Court's invalidation of the for-cause provision. Section 4617(f) has never "den[ied]" Plaintiffs "a judicial forum" (Pl. Opp. 10), but it does bar the particular remedy they now seek, *viz.*, an extraordinarily intrusive injunction that would divest the Conservator of its role in the contracts most integral to the conservatorships. *Second*, to the extent a "clear statement" is needed in order to give § 4617(f) effect, "no court may take any action to restrain or affect the exercise of [the] powers or functions of the Agency as a conservator" could not be any clearer. That language stands in stark contrast to the statute found not to be a "clear statement" in *Webster v. Doe*, 486 U.S. 592, 594 (1988), where the statute was silent on court action and judicial review, and merely authorized the CIA Director to terminate employees in his discretion).

Plaintiffs' assertion that the Supreme Court "implicitly" rejected § 4617(f) by not mentioning it in connection with the removal-clause issue is also ill-conceived. 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. Plaintiffs' own cited cases make clear such a position would not have been tenable. *See Bartlett v. Bowen*, 816 F.2d 695, 703 (D.C. Cir. 1987) (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 regardless. 141 S. Ct. at 1787-88. Even in remanding for potential claims for "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 1788-89. That is even more so for the new claims Plaintiffs are now advancing, which the Court could not have anticipated.

D. Plaintiffs' Theory is Speculative and Implausible

Plaintiffs' opposition fails to mount any response to the key points FHFA's motion made about the FAC's sheer implausibility. Plaintiffs do not address the fact that none of the materials they cite show that the Trump Administration adopted a goal of eliminating Treasury's liquidation preferences, only that they favored ending the conservatorships and potentially raising new capital—neither of which depended on advance elimination of the entire liquidation preferences. FHFA Mot. 18-19. Plaintiffs do not confront the PSPA provision, retained in both Trump Administration amendments, presupposing the *opposite*: that the liquidation preferences would be paid down after, and through proceeds of, any stock offerings.

Plaintiffs attempt to rationalize away another blatant inconsistency in their theory—"the Trump Administration's decision" in the same PSPA amendments "to *increase* the liquidation preference"—by suggesting it was merely a step in a pre-determined (albeit unstated) plan to convert the preferred stock to common stock at a favorable ratio. Pl. Opp. 18. But that is Plaintiffs' own conjecture, not a well-pleaded allegation of the parties' actual intent. As Plaintiffs admit, the January 2021 PSPA amendments noted that the parties were still exploring possible reform options with a mix of objectives to be balanced, and "endeavor[ed]" to share a "proposal" with Congress by later that year. FAC ¶ 93. Most importantly, Plaintiffs cannot take the position on remand that the Trump Administration's increases in the liquidation preferences were conducive to their desired outcome after having insisted to the Supreme Court that the same increases "entrenched" the "nationalization of Fannie and Freddie," rendering future stock offerings "impossible." Letter in Response of Patrick J. Collins, et al., *Collins v. Yellen*, No. 19-422 (Mar. 31, 2021).

Far from being "dispositive" (Pl. Opp. 11), the unauthenticated letter purportedly from former President Trump merits no weight at all. The letter does not mention the liquidation preferences or any plan to eliminate or convert them, and speculating to infer such a plan would be manifestly inconsistent with the Trump Administration's real-world actions and contemporaneous statements discussed above. The Court need not "disbelieve the factual allegations in the complaint" or "adjudicat[e] factual disputes" (*id.* at 10) to enforce *Iqbal*'s requirement that pleadings be rooted in well-pleaded, plausible factual allegations. Counts I, III, V, and VI fail that standard.

II. The Appropriations Clause Claims Fail

1. Contrary to Plaintiffs' position, the standard verbiage in the Supreme Court's opinion remanding "for further proceedings consistent with this opinion," 141 S. Ct. at 1789, did not create an open-ended mandate authorizing injection of a totally new theory based on a distinct constitutional provision unrelated to presidential removal power. The Court affirmed dismissal of all claims in this case *except* to the limited extent Plaintiffs sought retrospective relief for acts implementing the Third Amendment that were allegedly affected by the removal restriction. The opinion's factual background section's brief reference to FHFA's funding mechanism did not open the door to a litigation sequel involving a new set of claims with different factual and legal predicates.

Not only is the new theory outside the mandate, it is also time-barred. Plaintiffs note that Rule 15(c) relation-back permits "legal theories" to be "refined" if "'the factual situation upon which the action depends remains the same.'" Pl. Opp. 20 (quoting *FDIC v. Bennett*, 898 F.2d 477, 480 (5th Cir. 1990)). But the new Appropriations Clause claims are far more than "refinement," and the "factual situation" on which they depend (*i.e.*, FHFA's funding through assessments on regulated entities) is totally different from that on which the prior claims depended (*i.e.*, for-cause protection from Presidential removal). It is not enough that the ultimate result sought under both the old and new theories is invalidation of the Third Amendment. *See*, *e.g.*, *Mayle v.*

Felix, 545 U.S. 644, 663 (2005) (amendment to habeas petition to add self-incrimination claim did not relate back to confrontation claim, despite both theories seeking to vacate same conviction).

2. On the merits, Plaintiffs' Appropriations Clause analysis is wrong at every turn. Plaintiffs pay lip service to the primacy of text in constitutional interpretation, but skip over the Appropriations Clause's own text: "No Money shall be drawn *from the Treasury*, but in Consequence of Appropriations made *by Law*[.]" U.S. Const. art. I, § 9, cl. 7 (emphasis added). Because FHFA's funding is not drawn from the Treasury, the prohibition on doing so without congressional action does not come into play. Even so, to the extent congressional action may be deemed necessary, Congress's enactment of § 4516 would manifestly qualify as "by Law." FHFA squarely made these points on pages 22-23 of its motion, and the lack of response from Plaintiffs is telling. Plaintiffs cite no case holding that a statute by Congress creating an agency self-funding mechanism violated the Appropriations Clause, because none exists. *See* Kate Stith, *Congress' Power of the Purse*, 97 Yale L.J. 1343, 1392-93 (1988) (there has been "no judicial enforcement" of Appropriations Clause striking down congressional legislation).

Plaintiffs' "history" and "tradition" analysis is equally flawed and non-responsive. Plaintiffs' proclamation that "FHFA's funding structure is wholly unprecedented" (Pl. Opp. 21) ignores the century of near-universal congressional practice for safety-and-soundness regulators cited in FHFA's opening brief (FHFA Mot. 23-24). In the Recovery Act's legislative history, a broad-based chorus of legislators and experts stressed the need to conform the Enterprises' regulator's funding to its peer safety-and-soundness regulators.[5] Far from being "highly unusual" (Pl. Opp.

[5] *See*, *e.g.*, *Reforming the Regulation of the Government-Sponsored Enterprises*, S. Hrg. 110-957, 194 (2008) (Sen. Carper: emphasizing importance of "having a regulator that is independent of the appropriations process, *much as the other regulators are*"); *Review of the Office of Federal Housing Enterprise Oversight and Federal Housing Finance Board*, Serial No. 108-100 (House Hearing), 29 (2004) (OFHEO, one of FHFA's predecessor agencies: "[T]he fact that [OFHEO], *unlike every other safety and soundness regulator*, has to go through the appropriations process has hindered the agency in the past from fully fulfilling its mission."); *H.R. 3703 - The Housing Finance Regulatory Improvement Act—Part 2*, Serial No. 106-52 (House Hearing), 133 (2000) (Financial Services Roundtable: "OFHEO

21-22), § 4516(f)(2)'s proviso that assessments "shall not be construed to be Government or public funds or appropriated money" is a recurring staple of financial regulatory legislation.[6]

Plaintiffs attempt to contrast FHFA with "the FDIC, and many of Defendants' other examples" of financial regulatory agencies on the ground that FHFA's Director is "exceptional" for being, per the Supreme Court's decision in this case, removable at will. Pl. Opp. 22. That is wrong: "the heads of a number of self-funded agencies," including the FDIC, FCA, and NCUA, "do not enjoy statutory for-cause removal protection." Charles Kruly, *Self-Funding and Agency Independence*, 81 Geo. Wash. L. Rev. 1733, 1751 (2013). Even Plaintiffs admit (Pl. Opp. 22 n.4) the most apposite historical analogue—the OCC, established in 1864—is under Presidential control.[7] Not only is FHFA's funding structure thus deeply rooted in history and tradition, Plaintiffs' assertion that it gives the President himself a "blank check to tax and spend as he pleases" (Pl. Opp. 22) is unfounded hyperbole. The Section 4516 assessments process functions without Presidential involvement, and the funds can be used only for "expenses of the Director and the Agency." 12 U.S.C. § 4516(f)(4).

Contrary to Plaintiffs' assertion, a non-precedential concurring opinion that two-thirds of the Fifth Circuit declined to join does not merit more weight than the unanimous rulings of all other courts on Appropriations Clause challenges to the CFPB. *See* FHFA Mot. 24 n.12 (collecting cases). Rather than those decisions being "repudiated" by *Seila Law v. CFPB*, 140 S. Ct. 2183

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is *the only Federal financial safety and soundness regulator[] that is currently subject to the appropriations process*. That should be changed immediately by the Congress and as quickly as you can."); *H.R. 2575 - The Secondary Mortgage Market Enterprises Regulatory Improvement Act*, Serial No. 108-54 (House Hearing), 86 (2003) (Consumer Federation of America: "[R]emoving funding for [regulator's] activities from the annual appropriations process would go an extremely long way in addressing many of the concerns that have been cited.") (all emphases added).

[6] *See*, *e.g.*, 12 U.S.C. §§ 16, 244 (OCC), 2250(b)(2) (Farm Credit Administration).

[7] Plaintiffs note that the OCC is housed within Treasury but fail to explain why that organizational configuration, or the fact that *Treasury* is "made accountable for its [*i.e.*, Treasury's] spending through the normal appropriations process," are meaningful distinctions. OCC does not depend on Treasury for its funds, and Treasury may not "delay or prevent the issuance of any [OCC] rule" or "intervene in any [OCC] matter or proceeding." 12 U.S.C. § 1(b)(1).

(2020) (Pl. Opp. 23), several of them postdate and apply *Seila Law*.[8] As they explain, *Seila Law*, if anything, refutes the notion of an appropriations problem: while fully cognizant of the CFPB's funding mechanism, 140 S. Ct. at 2194, 2204, the Court found "[t]he *only* constitutional defect we have identified in the CFPB's structure is the Director's insulation from removal. If the Director were removable at will by the President, the constitutional violation would *disappear*." *Id.* at 2209 (emphases added). Moreover, even if the concurring opinion were the law—which it is not—Plaintiffs have no answer to the fact that the opinion itself disclaimed applicability to safety-and-soundness regulators like FHFA. FHFA Mot. 24-25 (citing *Check Cashing* concurrence).[9]

3. Finally, Plaintiffs fail to establish that invalidation of the Third Amendment or entire PSPAs would be an appropriate remedy for their new Appropriations Clause claims. As noted, no court has ever invalidated *any* agency action on the ground that the statute providing for the agency's funding transgressed the Appropriations Clause. It would be particularly incongruous to grant such a remedy for the first time as to transactions not even funded through the allegedly unconstitutional funding mechanism—a point to which Plaintiffs offer no response. The Court should accordingly dismiss Counts II and IV for failing to plausibly state grounds that would entitle Plaintiffs to the extraordinary relief they seek.

CONCLUSION

For the foregoing reasons, the Court should dismiss this action with prejudice.

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[8] *CFPB v. Citizens Bank, N.A.*, 504 F. Supp. 3d 39, 57 & n.13 (D.R.I. 2020); *CFPB v. Fair Collections & Outsourcing, Inc.*, 2020 WL 7043847, at *7-9 (D. Md. Nov. 30, 2020); Hr'g Tr., *CFPB v. Law Offices of Crystal Moroney, P.C.*, No. 7:20-cv-3240, ECF No. 34-5 at 55 (S.D.N.Y. Aug 19, 2020), *on appeal*, No. 20-3471 (2d Cir.).

[9] Plaintiffs' argument that FHFA's funding is "more problematic" than CFPB's due to lack of a specific dollar cap ignores that FHFA's assessments are limited to "an amount not exceeding the amount sufficient to provide for reasonable costs (including administrative costs) and expenses of the Agency" after crediting any surplus from the previous year. 12 U.S.C. § 4516(a), (d). That amount has been less than 0.00005 of the "$8 trillion of assets" Plaintiffs misleadingly imply are available to FHFA. *See Collins*, 141 S. Ct. at 1772 (FHFA budget of $311 million in 2020). To be clear, FHFA believes the *Check Cashing* concurrence is erroneous and has no bearing on the issues herein.

Respectfully submitted,

Dated: September 9, 2022

/s/ Robert J. Katerberg

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CERTIFICATE OF SERVICE

I hereby certify that, on September 9, 2022, a copy of the foregoing was electronically filed with the Clerk of Court of the United States District Court for the Southern District of Texas, using the CM/ECF system, which will send a Notice of Electronic filing to all parties of record.

/s/ Robert J. Katerberg

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