Banking and Finance Law Daily Wrap Up, TOP STORY—U.S.: Shareholders win partial victory over treatment of GSEs' conservatorships, (Jun. 23, 2021)

Banking and Finance Law Daily Wrap Up

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By John M. Pachkowski, J.D.

The shareholders of the Government-Sponsored Enterprises—Fannie Mae and Freddie Mac—have scored a partial victory in their lawsuit against the FHFA and Treasury Department over the treatment of Fannie Mae's and Freddie Mac's conservatorships.

The U.S. Supreme Court has ruled that certain shareholders of Fannie Mae and Freddie Mac were barred from seeking damages by the provisions of the Housing and Economic Recovery Act of 2008 (*Collins v. Yellen*, June 23, 2021, Alito, J.).

The case stems from a lawsuit filed by a number of Fannie Mae's and Freddie Mac's shareholders seeking damages due to a 2012 amendment to the agreements (Fannie Mae Agreement and Freddie Mac Agreement) between the Federal Housing Finance Agency and the Treasury Department under which the Treasury Department provided Fannie Mae and Freddie Mac needed capital in exchange for preferred shares in the GSEs, liquidation preferences, dividends, and related rights. The agreements, which are part of Fannie Mae's and Freddie Mac's FHFA conservatorships, are commonly referred to as the Senior Preferred Stock Purchase Agreements, which are intended to ensure that Fannie Mae and Freddie Mac, respectively provide stability to the financial markets; prevent disruptions in the availability of mortgage finance; and protect the taxpayer. The 2012 amendment is known as the "third amendment."

The shareholders' lawsuit claimed that the third amendment exceeded the FHFA's statutory authority under the Housing and Economic Recovery Act of 2008 (Recovery Act) and constitutional grounds in that the FHFA's structure violates the separation of powers because the FHFA is led by a single director, removable by the President only for cause.

Statutory grounds. The Court ruled that the FHFA did not exceed its authority under the Recovery Act and that claim must be dismissed due to the Recovery Act's "anti-injunction clause." The anti-injunction clause provides that unless review is specifically authorized by one of its provisions or is requested by the director, "no court may take any action to restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver." The Court found that the FHFA's expansive authority in its role as a conservator permits the agency to act in what it determines is "in the best interests of the regulated entity *or the Agency*." The Court noted that the when the FHFA acts as a conservator, "it may aim to rehabilitate the regulated entity in a way that, while not in the best interests of the regulated entity, is beneficial to the Agency and, by extension, the public it serves." The Court added that this feature of the FHFA conservatorship was "fatal to the shareholders' statutory claim." Finally, the Court concluded, "It is not necessary for us to decide—and we do not decide—whether the FHFA made the best, or even a particularly good, business decision when it adopted the third amendment."

Constitutional grounds. Turning its attention to the shareholders' constitutional claim, the Court found that the Recovery Act's restriction on the President's power to remove the FHFA Director was a violation of the U.S. Constitution's Separation of Powers Provision.

On a preliminary matter, the Court noted that the shareholders had standing under Article III of the Constitution. The shareholders' "pocketbook injury" was a prototypical form of injury in fact. Furthermore, the shareholders' injury was traceable to the FHFA's adoption and implementation of the third amendment. In addition, a decision in the shareholders' favor could easily lead to the award of at least some of the relief that the shareholders seek.

Finally, the Court noted that although the shareholders no longer have any ground for prospective relief, they retain an interest in the retrospective relief which saves their constitutional claim from mootness.

In finding that the Recovery Act's for-cause restriction on the President's removal authority violated the Separation of Powers Provision, the Court cited its 2020 decision in *Seila Law LLC v. Consumer Financial Protection Bureau*. In that decision, the Court ruled that Congress could not limit the President's power to remove the Director of the Consumer Financial Protection Bureau to instances of "inefficiency, neglect, or malfeasance." In so holding, the Court observed that the CFPB, an independent agency led by a single Director, "lacks a foundation in historical practice and clashes with constitutional structure by concentrating power in a unilateral actor insulated from Presidential control." In the instant case, the Court said, "A straightforward application of *Seila Law*'s reasoning dictates the result here. The FHFA (like the CFPB) is an agency led by a single Director, and the Recovery Act (like the Dodd-Frank Act) restricts the President's removal power."

Addressing the majority's Separations of Powers holding, Justice Elena Kagan noted, in a concurring opinion, "*Stare decisis* compels the conclusion that the FHFA's for-cause removal provision violates the Constitution. But the majority's opinion rests on faulty theoretical premises and goes further than it needs to." She added, "In thus departing from *Seila Law*, the majority strays from its own obligation to respect precedent."

In a dissenting opinion, Justice Sonia Sotomayor stated. "The Court has proved far too eager in recent years to insert itself into questions of agency structure best left to Congress. In striking down the independence of the FHFA Director, the Court reaches further than ever before, refusing tenure protections to an Agency head who neither wields significant executive power nor regulates private individuals."

Retrospective relief. Finding that the shareholders no longer "have a live claim for prospective relief," the Court addressed the issue of whether the shareholders have any retrospective relief. The Court rejected the shareholders' argument that the third amendment was void *ab initio* since it was adopted and implemented by officers who lacked constitutional authority since the argument was "neither logical nor supported by precedent."

As for retrospective relief, the Court observed that that type of relief is possible since "it is still possible for an unconstitutional provision to inflict compensable harm." The Court added, "The possibility that the unconstitutional restriction on the President's power to remove a Director of the FHFA could have such an effect cannot be ruled out. The Court concluded, "The parties' arguments should be resolved in the first instance by the lower courts."

In a concurring opinion, Justice Clarence Thomas stated, "I seriously doubt that the shareholders can demonstrate that any relevant action by an FHFA Director violated the Constitution. And, absent an unlawful act, the shareholders are not entitled to a remedy."

Fixing remaining flaws. Reacting to the Court's decision, FHFA Director Mark Calabria said, "I respect the Supreme Court's decision and the authority of the President to remove the Federal Housing Finance Agency Director." He added, "I wish my successor all the best in fixing the remaining flaws of the housing finance system in order to preserve homeownership opportunities for all Americans."

The case is No. 19-422.

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Companies: Fannie Mae; Freddie Mac

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