Securities Regulation Daily Wrap Up, CORPORATE FINANCE—N.D. Ill.: Recovery Act precludes another suit over FHFA-Treasury bargain, (Mar. 21, 2017)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

Bolstered in part by a recent D.C. Circuit opinion, the Northern District of Illinois ruled that it cannot enjoin a deal by which Fannie Mae and Freddie Mac must hand over their net worth to the Treasury Department. The Housing and Economic Recovery Act of 2008 broadly prohibits courts from restraining FHFA's functions, as long as FHFA is acting within its statutory authority (*Roberts v. FHFA*, March 20, 2017, Chang, E.).

Conservatorship and capital infusion. Fannie and Freddie were placed into conservatorship in 2008, shortly after the Recovery Act established FHFA. To keep the companies afloat, FHFA obtained billions in emergency capital from Treasury in exchange for preferred shares of stock. Fannie and Freddie also agreed to pay Treasury a quarterly dividend of 10 percent of the total funds drawn from Treasury. In practice, the companies often had to borrow more from Treasury to pay the dividends, thus increasing the dividend payment for future quarters. In response to this debt spiral, FHFA and Treasury amended the stock purchase agreement in 2012 to replace the 10-percent dividend with a formula by which Fannie and Freddie paid roughly their quarterly net worth. This meant that the companies would never have to borrow to make their dividend payments, but also that they would not be able to accrue capital.

Stockholder lawsuits and D.C. Circuit decision. A number of Fannie and Freddie stockholders filed suit challenging the amendment. One such suit was thrown out by the D.C. Circuit last month (*Perry Capital LLC v. Mnuchin*). The appeals court took Congress at its word: Section 4617(f) of the Recovery Act provides, "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." Although an exception to the bar on judicial review has been recognized where the agency has exceeded or violated its statutory powers or functions, the court held that FHFA's actions fell within its statutory authority.

Illinois action. Although the Seventh Circuit has not interpreted Section 4617(f), the Illinois district court found *Perry Capital* persuasive. It also had the benefit of Seventh Circuit decisions interpreting a nearly identical anti-injunction provision involving the FDIC. That FIRREA provision, the Seventh Circuit wrote, "effect[s] a sweeping ouster of courts' power to grant equitable remedies" where the agency has acted within its statutory authority. Similarly, the Recovery Act provision only permits court intervention if FHFA has acted outside its statutory authority.

Indeed, the Recovery Act also required the court to dismiss the claims against Treasury. Although the statute specifically mentions FHFA, its effect is broader: courts cannot take action that would restrain or even affect "the exercise of powers or functions of" FHFA as conservator. The relief that the plaintiffs asked for, such as vacatur of the amendment and an injunction preventing Treasury from implementing its new dividend formula, would "restrain or affect" the exercise of FHFA's conservatorship authority. "It takes two to tango, and undoing one side of the Third Amendment against Treasury necessarily affects FHFA, which is, after all, the other party to the Third Amendment."

Finally, the court rejected the plaintiffs' arguments that FHFA and Treasury acted outside their statutory authority. FHFA is not supposed to be subject to the direction or supervision of any other governmental agency. But the complaint offered no facts from which to infer that FHFA ceded control over Fannie and Freddie to Treasury.

Nor was the amendment to the stock purchase agreement "inimical" to FHFA's core mandates as conservator —largely because these mandates do not exist. The court would not presume that Congress's use of the term "conservatorship" imported preexisting conservatorship principles into the Recovery Act, because the statute did not set up a typical conservatorship. Namely, the Recovery Act empowers FHFA to act in its *own* best interests. Looking to the statute's text, the court reasoned that FHFA issues no mandate to return Fannie and Freddie to solvency or preserve their assets. Even if there were such a directive, the plaintiffs conceded that the companies returned to profitability under FHFA's conservatorship, and Treasury's funding commitment ensures their continued solvency.

The case is No. 16 C 02107.

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