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"Let the people know the facts and the country will be safe." – A. Lincoln

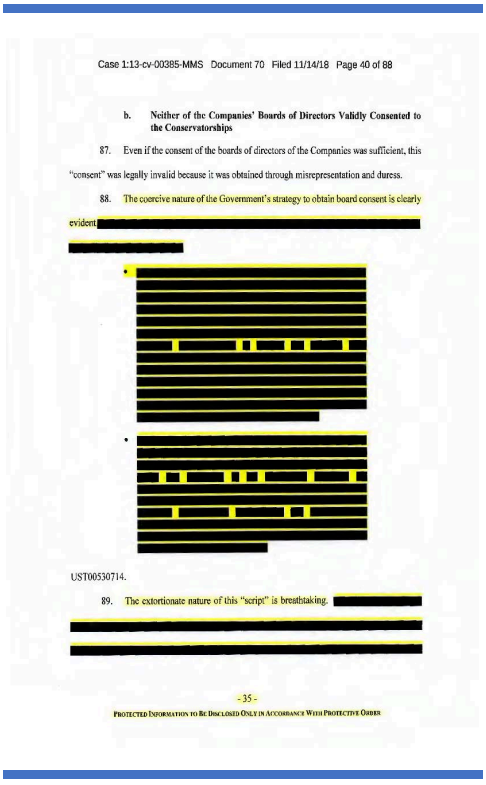
HINDESight™ December 5, 2019

MORE SHOES TO DROP.

Washington Federal could be a game-changer.

Midway through 10 hours of oral argument on the government's motion seeking dismissal of a group of lawsuits brought against it by **Fannie Mae** and **Freddie Mac** shareholders, the guy sitting to my left nudged me with his elbow. One of the attorneys was telling Judge **Margaret M. Sweeney** *". . . our complaint alleges in great detail allegations showing coercion, and I'm not going to repeat those, because they're under seal, but they are detailed and, I think, very compelling . . .".* (See *Finally, a Judge Who Gets It* – HINDESight™ Nov. 26)

Intrigued, when I got back to my office, I dug out my copy of the lawsuit in question, *Washington Federal Bank v. United States*. By way of background, recall that in 2011, the **Obama Administration** convinced Judge Sweeney to place over 11,000 documents related to the seizures of Fannie and Freddie under a Protective Order, claiming that allowing anyone to see their contents could affect 'national security' and might cause another financial crisis. Yikes!



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b. Neither of the Companies' Boards of Directors Validly Consented to the Conservatorships

87. Even if the consent of the boards of directors of the Companies was sufficient, this "consent" was legally invalid because it was obtained through misrepresentation and duress.

88. The coercive nature of the Government's strategy to obtain board consent is clearly evident [redacted]

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89. The extortionate nature of this "script" is breathtaking. [redacted]

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PROTECTED INFORMATION TO BE DISCLOSED ONLY IN ACCORDANCE WITH PROTECTIVE ORDER

Above is just one page from the *Washington Federal* complaint which, because of the Protective Order, includes material which is 'redacted' (i.e., "blacked-out" in simple English). For those of you who don't keep a magnifying glass readily at hand, paragraph 88 begins *"The coercive nature of the government's strategy to obtain board consent is clearly evident from* [redacted]

[redacted]."

There follows two bullet points which contain another 23 lines of redacted material. Paragraph 89 then seems to sum up that which we have not been allowed to see with this chilling comment: *"The extortionate nature of this 'script' is breathtaking."* (And then there are 15 more lines of redactions.)

Hmmm. One need not be a lawyer to realize that there must be some reason the government doesn't want anyone to know what's in paragraphs 88 and 89 (let alone what's behind the numerous other redactions sprinkled throughout the *Washington Federal* complaint).

Up until now, all the action in the GSE lawsuits has been concentrated on challenging the validity of the Net Worth Sweep, which happened in 2012. *Washington Federal*, on the other hand, takes issue with the events of 2008. Specifically, it is the only lawsuit which challenges the legality of the seizures and the subsequent imposition of the conservatorships.

As explained by former Fannie Mae CFO **Tim Howard** in his excellent piece "The Takeover and the Terms", the story put out by the government at the time of the seizures (and repeated as recently as three weeks ago in Judge Sweeney's courtroom) – namely, that Fannie and Freddie were in such dire financial straits that only a government rescue could save them – is completely false. (Or, as I put it in "The Case of the Concrete Life Preserver", *"it wasn't a bailout, it was a stick-up"*.) Until very recently, however, most of the media and financial punditry bought into the government's false narrative. (And just as with any other 'Big Lie', over a decade of repeating it has led a lot of people to believe it's true – when it's not.)

There are 11 conditions listed in the **Housing and Economic Recovery Act of 2008** ("HERA") which allow the government to step in and place a "regulated entity" into conservatorship. In the case of Fannie and Freddie, not one was met. But a 12th condition, quietly inserted into the legislation, allows it to do so with the "consent" or "acquiescence" of the regulated entity's board of directors.

Wow. So how exactly did the government obtain consent to seize the companies from their boards (or did they merely 'acquiesce')? It seems to me that discovering what is behind those pesky redactions might likely give us the answer. But this much is obvious: the government greased the skids by also putting into the legislation a provision which prohibits shareholders from ever bringing suit against the directors. Sweet.[1]

So why does this matter?

If Judge Sweeney allows *Washington Federal* to proceed to a full-blown trial (as many veteran court observers expect she might), the validity of the imposition of the conservatorships comes into play. What could that mean? Let's do some math.

If the Administration can recapitalize Fannie and Freddie before the courts foreclose its options, they'd be looking at the best deal for the taxpayer since the **Louisiana Purchase**: $114.7 billion in dividends already received + another $150 billion it can realize by monetizing its warrants = $264.7 billion. (By way of comparison, the **State Department**'s budget is $54 billion.)

But if Judge Sweeney finds that the 2008 seizures were illegal? That would be a game-changer. Would the government then have to return the $114.7 billion of dividends it received from the GSEs? Would it have to surrender the warrants as being the fruit of a corrupt bargain? I don't think anyone knows the answer to these questions at this point. But one thing is clear: if Judge Sweeney denies the government's motion to dismiss, the issue of whether or not the government used improper means to coerce the boards into going along with what it wanted to do will be litigated. What's behind the redactions will be revealed. And many of the key players will be forced to testify under oath (here's looking at you, **Hank Paulson**). And that means the common shareholders (**Bill Ackman** is reported to be the largest) are going to have to have a seat at the negotiating table, because absent settlement of *Washington Federal*, it will be impossible to

[1](For a retrospective on the seizures, see *Ten Years After Henry Paulson's Colossal Blunder* – HINDESight™ Sept. 4, 2018.

raise any new capital for Fannie and Freddie.

"Reasonably fast"

That's what Secretary of the Treasury-designate **Steven Mnuchin** told the press on November 30, 2016, when asked about the new administration's plans to end the conservatorships of Fannie Mae and Freddie Mac.

That was three years ago – and granted, more progress has been made in the past five months than in the past five years. But in the meantime, more evidence has been uncovered; more damning emails have come to light; more outright lies by government officials (of both parties) have been exposed. (And as pointed out herein, more shoes are likely to drop.)

As the court cases proceed to their inexorable conclusion (I say "inexorable" because the truth of what happened is utterly indefensible), the Administration risks losing a golden opportunity. Many large institutional investors – sitting on record-high piles of cash – are perched on the sidelines, ready and willing to help recapitalize Fannie and Freddie. But they will do so only if they can be assured that what happened to the previous shareholders won't happen to them; i.e., that the government's larcenous behavior will not be repeated.

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Additional resources:

HINDESight™ Nov. 26, 2019: Finally, a judge who gets it.
HINDESight™ Oct. 23, 2019: In Defense of the Hedge Funds (Part 2)
HINDESight™ Sept. 19, 2019: Best Deal Since the Louisiana Purchase
HINDESight™ Feb. 19, 2019: In Defense of the Hedge Funds (Part 1)
HINDESight™ Nov. 26, 2018: Release the Hostages
HINDESight™ Sept. 4, 2018: Ten Years After Henry Paulson's Colossal Blunder
HINDESight™ Sept. 6, 2017: "The Case of the Concrete Life Preserver"
HINDESight™ Aug. 25, 2017: Fanniegate: The Cover-up Unravels
HINDESight™ Sept. 6, 2016: The Myth of Private Gains and Public Losses
J. Timothy Howard Feb. 26, 2016: The Takeover and the Terms