The Delaware Bay Company LLC

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

HINDESight™ October 30, 2020

Fannie Mae and Freddie Mac

THE SHAMEFUL STATE OF THE FEDERAL COURTS

13 appellate judges sign on to a colorable argument since abandoned.

"May" vs. *"shall"* – two very costly words.

Ever since the first lawsuit challenging the Net Worth Sweep ("NWS") was filed in 2012, the government has taken the position that when serving as a Conservator, the **Federal Housing Finance Agency** ("FHFA") has a unique power that no other Conservator has ever possessed: the right to not conserve.

If you think that sounds a bit strange, you're not alone: in court filings, research reports, and op-ed articles, the adjectives used by normally staid legal commentators to describe the government's position have included *"preposterous"*, *"outlandish"*, *"laughable"*, *"non-starter"* (you get the point).

Complicating matters is the fact that outside of the litigation involved, FHFA has taken the opposite position, acknowledging that its role is no different from that of any other Conservator. Indeed, its own regulations state that it has a *"mandate"* to put its charges into a *"sound and solvent condition"* and to *"preserve and conserve their assets and property . . ."* (emphasis added).[1]

So how did such a 'howler' become a key component of the government's defense? Well, imagine you are a senior partner in one of the law firms given the assignment to defend it. You walk down the hall to the "bullpen" (that's where all of the young, eager-beaver, aspiring partner-wannabe "associates" are housed). You throw down a challenge: *"ok, team,"* you say. *"Come up with a colorable argument."* [2]

Here's the result:

The **Housing and Economic Recovery Act of 2008** ("HERA"), which governs FHFA, states it *"may, as conservator, take such actions as may be (i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."* (12 U.S.C. § 4617(b)(2)(D) emphasis added.) Since HERA uses the word "may" instead of "shall", the government asserts its duties are *permissive*, not *mandatory*. In other words, the Conservator doesn't really have to "*put the regulated entity in a sound and*

[1] *Conservatorship and Receivership*, 75 Fed. Reg. 39,462, 39,469 (July 9, 2010).

[2] "*A legal argument or assertion of fact that is not* (entirely) *baseless or without substance; that has at least a slim chance of success . . . even if weak, can be made in good faith . . .*" Technology and IP Law Glossary.

solvent condition" and/or *"preserve and conserve their assets and property"* if, for whatever reason, it doesn't want to. No matter that the language was copied verbatim from the statute which has governed FDIC bank conservatorships for the past 50 years. And, of course, during all that time, the FDIC – which has served as Conservator for hundreds of banks under its jurisdiction – has never taken the position that its duties were anything but mandatory.

Believe it or not, this 'colorable' argument made it past five federal district court judges (including one case in which I was a co-plaintiff). Okay, I get that district judges are the first cut at justice. They don't always get it right – which is why we have Courts of Appeal. Appellate judges are supposed to be a notch above their lower-court brethren, right? Well, how to explain that the rulings were upheld by *thirteen* appellate judges sitting in *five* separate circuits?[3] True, most piggybacked off an initial 2014 ruling, but as one legal observer commented, *"these guys are supposed to be independent thinkers. They're not there to just do a cut-and-paste job. It's really shameful."*

It took six long years, but in January 2019, the grown-ups took over. An *en banc* panel of the Fifth Circuit, re-hearing *Collins v. Mnuchin*, overruled two of their colleagues, refusing to follow them (and the other four circuits) *"through the looking glass into a world where Conservators need not conserve."*

Next stop is the **U.S. Supreme Court** on December 9. Perhaps as a result of the withering questioning with which it was confronted by the skeptical 5th circuit *en banc* panel, the government appears to have thrown in the towel on the "may" vs. "shall" defense.[4] Turns out, the **Office of the Solicitor General**, which must approve and argue all Supreme Court appeals, declined to raise it in their briefs. No doubt wary at the prospect of having to stand up in open court and make such an in-your-face argument, the SG has apparently decided not to put its reputation on the line. Thus the *"may vs. shall"* defense has hit a dead end. The issue is now moot (although the Supreme Court appeal will proceed on other grounds).

I am told that shareholder plaintiffs are already out of pocket for over $20 million litigating against the now abandoned defense. As for the government? Estimates are as high as $100 million. But, hey, the 'Conservator' has presumably recovered all its legal fees directly from Fannie and Freddie as "expenses of the Conservatorship", so what's to worry?

Shameful, indeed.

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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

[3] **Janice Rogers Brown** (D.C. Circuit) and **Don R. Willett** (5th Circuit) bravely dissented but were outvoted.

[4] Judge **Edith Jones**: *" . . . there is not a single case – goodness knows you've all been down this road six or seven times together now – and you've never come up with a* (single) *case in which a Conservator effectively took all of the net capital out of one of the lending institutions it was purporting to conserve . . . and gave it all to the government."*

The author is an owner of Fannie Mae and Freddie Mac securities. The views and opinions expressed herein are solely his, and not necessarily those of The Delaware Bay Company, LLC, Arcadia Securities, LLC and/or their principals and/or affiliates, which may, from time to time, have long or short positions in the securities of companies mentioned herein. We make no representations or warranties as to the accuracy of any of the facts contained herein and investors are warned that past performance is no guarantee of future results. Investors are also urged to consult their own legal, accounting, and other financial professionals before acting upon any of the recommendations made herein. ***Invest at your own risk.***