No. 17-580

IN THE

Supreme Court of the United States

PERRY CAPITAL LLC, for and on behalf of investment funds for which it acts as investment manager, ARROWOOD INDEMNITY COMPANY, ARROWOOD SURPLUS LINES INSURANCE COMPANY, AND FINANCIAL STRUCTURES LIMITED,

Petitioners,

v.

STEVEN T. MNUCHIN, in his official capacity as the Secretary of the Department of the Treasury, MELVIN L. WATT, in his official capacity as Director of the Federal Housing Finance Agency, UNITED STATES DEPARTMENT OF THE TREASURY, and FEDERAL HOUSING FINANCE AGENCY,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

REPLY BRIEF OF PETITIONERS

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PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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REPLY BRIEF FOR PETITIONERS

The brief of the federal respondents confirms the urgent need for this Court's review.

The federal respondents do not dispute that the D.C. Circuit's interpretation of HERA as authorizing the Net Worth Sweep already has allowed Treasury to take from two privately-owned companies ***$129 billion*** more in "dividends" than Treasury otherwise could have received under its securities. Nor does the government dispute that the D.C. Circuit's statutory interpretation empowers the FDIC—whose conservatorship authority provided the template for FHFA's—to "[]negotiate" away the perpetual net worth of any bank that it might come to operate as conservator. In fact, the government does not *anywhere* acknowledge *any* limitation on what FHFA or the FDIC might do while operating an institution as conservator. Nor does the government dispute that the D.C. Circuit's interpretation of Section 4617(f) as barring judicial review of *Treasury's* actions renders utterly ineffectual Congress's carefully prescribed limitations on Treasury's authority to act in this area.

These are the staggering—indeed, surreal—consequences of the decision below, and they mark this case as one of exceptional importance warranting this Court's review. To say, as the government does, that this case arises from "singular circumstances," BIO 35, does not diminish its importance. Every financial crisis has its own "singular circumstances," but under the D.C. Circuit's decision, the power of a government conservator to strip assets from its wards for the government's benefit will be unbridled whatever the circumstances. And this case well illustrates how such unbridled power might be abused.

On the merits, the government suggests no reason whatsoever to think that Congress granted FHFA the power, as *conservator*, to enter into a transaction explicitly intended to "[e]xpedite [w]ind [d]own" of its wards by precluding them from "retain[ing] profits" or "rebuild[ing] capital." Pet. 9. The government says that the "unique circumstances surrounding the housing crisis" allowed for a response beyond a "typical conservatorship scenario." BIO 35. But, by 2012, the housing crisis had passed. And, in any event, HERA's conservatorship powers undisputedly were copied from the FDIC's and, before this litigation, no one (least of all, the FDIC) believed the FDIC enjoyed anything other than "typical conservatorship" powers. Indeed, the government cannot identify even one example—from either the decades of FDIC practice, or the centuries of common law that preceded it—of a conservator acceding to anything even remotely resembling the Net Worth Sweep (never mind one resulting from a purported "renegotiat[ion]," BIO 17, between one federal respondent and another). That "lack of historical precedent" is itself a "telling indication" of a "severe … problem." *Free Enterprise Fund* v. *PCAOB*, 561 U.S. 477, 505 (2010). And the "indication" is much amplified here where the claimed power—to expedite a wind down by depleting capital—is flatly contrary to FHFA's own notice-and-comment interpretation of its conservatorship authority, Pet. 23, and antithetical to the common-law understanding of the job of a conservator.

The government's merits defense of the dismissal of claims against Treasury is even less persuasive. Even if HERA permitted FHFA as conservator to "renegotiate" into a Net Worth Sweep—and it does not—HERA did not permit Treasury, in 2012, to "renegotiate" the securities it had purchased in 2008. And

there is nothing in Section 4617(f) that even faintly suggests—much less provides the requisite clear and convincing evidence—that Congress intended to preclude judicial review of actions by Treasury in excess of its statutory authority.

I. The D.C. Circuit's Decision Warrants This Court's Review.

A. The Government's Confiscation Of The Companies' Capital Is Enormous, Unprecedented, And Intentionally Destructive.

When "enormous" sums "turn[] on a question of federal statutory interpretation," it "is a strong factor in deciding whether to grant certiorari." *Fid. Fed. Bank & Tr.* v. *Kehoe*, 547 U.S. 1051 (2006) (Scalia, J., concurring in the denial of certiorari). In *Fidelity Federal Bank & Trust*, Justice Scalia was concerned that an erroneous interpretation of federal law could result in class-action liabilities that "may reach $40 billion." *Ibid.*

Under the Net Worth Sweep, the Companies thus far have transferred to Treasury $278 billion—$91 billion more than their draws from Treasury and $129 billion in excess of what Treasury could have received under its fixed-rate dividend securities—and yet remain saddled with Treasury's $189 billion liquidation claim. In 2017 alone, the Companies transferred to Treasury more than the $40 billion Justice Scalia found to be both "enormous" and an "important" certiorari consideration. BIO 10 n.11. The scale of the Net Worth Sweep's expropriation is nearly impossible to comprehend. In this nation's history, it possibly could be matched only by Executive Order 10,340's seizure of the property of 87 steel companies, which quite unlike the Net Worth Sweep, was a temporary wartime

measure to last only until "effective future operation is assured." Exec. Order 10,340 ¶ 6; *see also Youngstown Sheet & Tube Co.* v. *Sawyer*, 343 U.S. 579 (1952).

The government contends that its massive expropriation is counterbalanced by "the $258 billion ongoing commitment from Treasury that is keeping the [Companies] afloat." BIO 20. That is wrong on two counts: First, the size of Treasury's commitment was agreed to in 2009—so it could not be the *quid* to the Net Worth Sweep's *quo*. Second, it is simply untrue that Treasury's funding commitment now sustains the Companies' operations. Since the federal respondents imposed the Net Worth Sweep, neither Company has looked to Treasury's commitment; instead each has sent tens of billions in excess dividends to Treasury that could have been retained as capital to protect against future losses. Indeed, in the 2013 debt ceiling crisis, it was the Companies' enormous excess dividends of $110 billion that were keeping Treasury afloat—not the reverse.

B. The Government's Unbounded Conception Of FHFA's Powers As Conservator Sharpens The Circuit Split.

The decision below enlarges FHFA's power as conservator far beyond anything known in federal legislation or the common law, and the government's efforts to rationalize the decision only sharpen the division between the D.C. Circuit and the Ninth and Eleventh Circuits over the availability of judicial review of conservatorship transactions.

According to the D.C. Circuit, FHFA may do whatever it likes so long as FHFA can characterize its actions as falling within one of HERA's general grants of authority such as the power to "operate" the Companies. Pet.App. 21a-38a. FHFA, the D.C. Circuit

concluded, need not abide by the common-law fiduciary limits on conservators observed faithfully for decades by the FDIC. If FHFA's action is taken in connection with "operat[ing]" the Companies—whatever its intent or effect on the Companies—the government says a court "may not second guess" that action. BIO 18, 20. But, as Judge Brown recognized, this expansive statutory construction means, in effect, that FHFA can "take any action it wishes, apart from formal liquidation, without judicial oversight." Pet.App. 88a.

The government offers no principled limitation on this unreviewable authority. Indeed, it seems to adopt a position even more extreme than the D.C. Circuit, only "***assuming*** that Section 4617(f) allows judicial review … where FHFA acts beyond its statutory or constitutional authorities," and thus questioning the availability of any judicial review at all. BIO 18 (emphasis added).

This is hardly "substantially equivalent to the standard articulated by the Ninth and Eleventh Circuits." BIO 30. Both Circuits expressly recognize the availability of judicial review where FHFA acts in excess of its conservatorship authority. *See County of Sonoma* v. *FHFA*, 710 F.3d 987, 992 (9th Cir. 2013); *Leon County* v. *FHFA*, 700 F.3d 1273, 1278 (11th Cir. 2012). Neither of those Circuits suggests, as the government does, that Section 4617(f) might bar review in all cases. And while the D.C. Circuit did say that a court could enjoin FHFA's activities that exceed its statutory conservatorship authority, by interpreting that authority so capaciously as to allow FHFA to "take any action it wishes, apart from formal liquidation," Pet.App. 88a, whatever judicial review the D.C. Circuit might permit is a hollow promise. In reality,

under the D.C. Circuit's statutory interpretation, all that bounds FHFA's powers as conservator is its own sense of propriety. FHFA may exempt its actions from judicial review simply by tagging its actions with its "conservator stamp." *See Leon County*, 700 F.3d at 1278.

C. The Government's Unprecedented View Of FHFA's Conservatorship Powers Imperils The Broader Financial Regulatory System.

A sound insolvency regime based on the rule of law requires "uniform and predictable" "rules set out *ex ante*" that cannot be cast aside "according to the government's whim." Investors Unite Br. 20-21. The FDIC, which supervises financial institutions with $17.2 trillion in assets, has conservatorship authority substantially identical to FHFA's.[1] *Compare* 12 U.S.C. § 1821(c),(d) (FDIC), *with* 12 U.S.C. § 4617(a),(b) (FHFA). According to former FDIC General Counsel Michael Krimminger—counsel to *amicus curiae* Investors Unite—"FDIC conservatorships were never run as profitmaking enterprises" for the government's benefit because that "would have been inconsistent with the essential purpose of a conservatorship." Investors Unite Br. 20.

The D.C. Circuit's decision risks upsetting those norms, built up over decades. Because the court of appeals based its unbounded view of FHFA's conservatorship authority on its interpretation of HERA, Pet.App. 22a-27a, its statutory interpretation will apply with equal force to the conservatorship authority granted to the FDIC under the substantially identical

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[1] FDIC, Statistics at a Glance (as of Sept. 30, 2017), https://tinyurl.com/y7lztayy.

statute from which HERA was drawn. If the D.C. Circuit's decision stands, once the FDIC installs itself as a conservator, it similarly could transfer for the government's benefit all of the net assets of the bank under its supervision, with no recourse to judicial review.

The government does not dispute that the D.C. Circuit's statutory interpretation applies perforce to the FDIC. The government claims that "singular circumstances" prompted FHFA's decision to place the Companies into conservatorship and that this "readily distinguish[es] this case from a typical conservatorship scenario." BIO 35. But under the D.C. Circuit's statutory interpretation, no court may question what circumstances prompted a conservator's actions because that would "'second-guess[]' [a conservator's] 'business judgment.'" BIO 20 (quoting Pet.App. 43a). The only protection from expropriation and ruin would be the hope that the government conservator acts in accordance with the common-law fiduciary tenets of conservatorship.

D. The Government's View Of Section 4617(f) As Insulating Agencies Other Than FHFA From Judicial Review Upends Congress's Careful Limitations On Treasury's Ability To Intervene In The Companies.

The decision below undermines the statutory framework governing Treasury's interactions with FHFA. In HERA, Congress authorized Treasury to purchase securities directly from the Companies, but, concerned that "Treasury was antagonistic to the

Companies," placed numerous limitations on Treasury's authority.[2] For example, to exercise it, Treasury must first make an "emergency determination" taking account of six considerations. 12 U.S.C. § 1455(*l*)(1)(B)-(C). And after December 31, 2009, Congress substantially terminated Treasury's powers, authorizing it only to "hold, exercise any rights received in connection with, or sell, any obligations or securities purchased." *Id.* § 1455(*l*)(2)(D). Under well-established administrative-law principles, if Treasury exceeded these authorities, an aggrieved party could sue to enjoin Treasury's *ultra vires* conduct. 5 U.S.C. § 702.

Under the D.C. Circuit's decision, however, these critical limitations on Treasury's authority may be disregarded whenever Treasury acts in concert with FHFA. Indeed, FHFA could, tomorrow, on behalf of the Companies sell new securities to Treasury and, according to the D.C. Circuit, no aggrieved party could seek to hold Treasury to Congress's clear limits on its purchasing authority. Even in that circumstance, on the government's reading, Section 4617(f) would bar courts from enforcing HERA's limitations on Treasury's authority because enforcement against Treasury "would have just as direct and immediate an effect" on the conservator's decision to sell the securities to Treasury. BIO 24 (quoting Pet.App. 45a). But if enforcing the statutory limits on Treasury's authority affects FHFA, it would be only because FHFA chose a course of action requiring it to act jointly with Treasury in a manner that Congress said Treasury could not.

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[2] Michael Krimminger & Mark Calabria, The Conservatorships of Fannie Mae and Freddie Mac 20-21 (Jan. 29, 2015), https://tinyurl.com/zkjauwa.

Displacing the presumption of judicial review of unlawful administrative action requires "clear and convincing evidence." *Kucana* v. *Holder*, 558 U.S. 233, 251-52 (2010). But Section 4617(f) does not mention Treasury at all and does not otherwise suggest that Congress intended that it could be deployed to circumvent the limits on ***Treasury's*** authority that Congress set out elsewhere in HERA. Extending Section 4617(f) to preclude judicial review of any actions Treasury might undertake with the conservator or receiver subverts Congress's carefully crafted limits on Treasury's authority. One provision of a statute should not be presumed to so readily and deeply undermine Congress's proscriptions in another provision of the same statute.[3]

II. The Decision Below Is Wrong.

A. The Net Worth Sweep Exceeds FHFA's Statutory Authority As Conservator.

FHFA exceeded its conservatorship powers when it agreed to send to Treasury the Companies' net worth in perpetuity. HERA required FHFA to "preserve and conserve" the Companies assets, and to attempt to put the Companies in a "sound and solvent condition," 12 U.S.C. § 4617(b)(2)(D). HERA states that FHFA "may" pursue these objectives, but FHFA previously acknowledged that these were its "primary objectives" and "statutory goals" as conservator. 76

[3] The government cites cases for the proposition that the limitation on judicial review of a conservator's actions may bar suits against the conservator's counterparty. BIO 24-25. But none of those cases involved actions undertaken by other federal agencies in excess of their authority, and they therefore did not benefit from the strong presumption of the availability of judicial review applicable to allegations of unlawful administrative action. *See Kucana*, 558 U.S. at 251-52.

Fed. Reg. 35,724, 35,727 (June 20, 2011); *see also* Fairholme Petitioners' Reply Br. 5-6. The Net Worth Sweep is transparently—indeed, avowedly—antithetical to those obligations. Far from preserving the Companies' assets, FHFA agreed to transfer them to Treasury, which the government explained was intended to "act[] upon the [government's] commitment … that the [Companies] will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." Treasury Dep't Announces Further steps to Expedite Wind Down of Fannie Mae and Freddie Mac (Aug. 17, 2012), https://tinyurl.com/jony4co ("2012 Press Release"). And by stripping away the Companies' capital, FHFA has conceded that the Net Worth Sweep renders the Companies "effectively balance sheet insolvent, a textbook example of financial instability." Def's. Mot to Dismiss 19, *Samuels* v. *FHFA*, No. 1:13-22399-Civ (S.D. Fla. Dec. 6, 2014).

To reconcile the Net Worth Sweep with the most basic tenets of conservatorship, the government now argues that the Sweep reflected a "business judgment" to save the Companies from a "debt spiral." BIO 19-20. That argument should be rejected for at least two reasons.

First, the premise of the "debt spiral"—that the Companies had obligations to pay cash dividends to Treasury—is demonstrably false. The Companies had the unqualified right under the securities to pay these fixed-rate dividends in-kind by increasing Treasury's liquidation claim, which would not require any cash payment. The government's footnote repetition of the district court's incorrect reading of the securities—that "10% cash dividends were 'required,'" BIO 6 n.5—is answered both by the securities' plain text, which

place no limitation whatsoever on the right to pay dividends in-kind, and the D.C. Circuit's acknowledgement that the conservator "could instead have adopted a payment-in-kind dividend option." Pet.App. 30a.

Second, the government does not dispute that, before it imposed the Sweep, it learned that the Companies would be immensely profitable. Pet. 8-9. The government knew there was no imminent danger of a "debt spiral." Instead, there was the possibility of a rapid replenishment of capital within the Companies that might call into question the need for continued conservatorship and government control. That—"rebuild[ing] capital"—is what the government said the Sweep was intended to forestall. ***That*** is the "ground[] upon which [FHFA] acted," and the only ground "upon which its action can be sustained." *SEC* v. *Chenery Corp.*, 318 U.S. 80, 95 (1943).

B. Treasury Had No Authority To "Renegotiate" Securities Previously Purchased.

The brief in opposition does not argue that Treasury had authority to agree to the Net Worth Sweep. And rightly so, because while the government characterizes the Net Worth Sweep as "renegotiat[ing] the [Companies'] financial obligations," BIO 34, whatever authority Treasury had to "renegotiate" its investments in the Companies expired on December 31, 2009. After that date, HERA prescribes Treasury's residual powers: "to hold, exercise any rights received in connection with, or sell" the stock it had purchased from the Companies. 12 U.S.C. § 1455(*l*)(2)(D). "Renegotiating" the terms of already-issued stock plainly does not entail "hold[ing]" or "sell[ing]." And a party does not "exercise [a] right" when it negotiates with a

counterparty because a "right" is only a right if it can be exercised unilaterally. Treasury's 2012 renegotiation of its securities in the Companies was *ultra* vires and should be set aside.

CONCLUSION

The Net Worth Sweep is a stark example of lawless government overreach. FHFA jettisoned Congress's clear instructions, decades of FDIC precedent, and centuries of the common law in order to help Treasury seize hundreds of billions of dollars from two shareholder-owned private companies and thereby ensure that those Companies never emerge from government control. A divided panel of the D.C. Circuit sanctioned this expropriation by effectively limiting judicial review of the conservator's actions to a null set, limitations on judicial review that are certain to apply to future FDIC conservatorships. This legal innovation dangerously upends the rule of law on which the orderly resolution of financial institutions is based. If, indeed, this is what Congress intended, that ruling should come from this Court. This Court should grant the petition.

Respectfully submitted.

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January 30, 2018