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August 25, 2010

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA23
Federal Housing Finance Agency
Fourth Floor
1700 G Street, N.W.
Washington, D.C. 20552

Re: Proposed Rule Regarding Conservatorship and Receivership
75 Fed. Reg. 39,462 (July 9, 2010); RIN 2590-AA23

Dear Mr. Pollard:

We submit the following comments and objections to RIN 2590-AA23 (the "Proposed Rule") on behalf of Lead Plaintiffs Ohio Public Employees Retirement System and State Teachers Retirement System of Ohio and the Class in the currently pending federal securities fraud class action against Fannie Mae, Franklin Raines, Timothy Howard, and Leanne Spencer (*In Re Fannie Mae Securities Litigation*, Consolidated Case No. 04-cv-1639 (D.D.C.)). The pending litigation is based on the 2001-2005 fraud at Fannie Mae that was discovered and detailed in two comprehensive public reports by the Office of Federal Housing Enterprise Oversight, the predecessor to the Federal Housing Finance Agency ("FHFA" or the "Agency"). FHFA, through its predecessor, has already obtained a $50 million settlement from Fannie Mae and settlements valued at over $30 million from Raines, Howard, and Spencer based upon that same fraud. Now that FHFA (which was not damaged by the fraud) has obtained those settlements, it has proposed a new rule to prevent the more than 30 million pensioners throughout the 50 States who *were* damaged by the fraud, as well as other members of the class, from obtaining their just compensation.

That effort violates the express provisions of the Housing and Economic Recovery Act of 2008 ("HERA" or the "Act"), Pub. L. No. 110-289, 122 Stat. 2654, which requires FHFA to accord tort victims priority equivalent to that of other unsecured creditors. The Agency's Proposed Rule improperly subverts that express statutory priority scheme. Because the Proposed Rule conflicts with the statute, exceeds FHFA's authority, and is otherwise arbitrary, illegal, and unconstitutional, we respectfully request that the Agency reject the Proposed Rule or eliminate the improper provisions discussed below.

I. BACKGROUND

HERA authorizes FHFA to act as conservator or receiver for regulated entities including Fannie Mae and Freddie Mac. 12 U.S.C. § 4617(a)(1). The Act sets forth specific powers the Agency may exercise as conservator or receiver, including power to "prescribe such regulations as the Agency determines to be appropriate regarding the conduct of conservatorships and receiverships." *Id.* § 4617(b). But the Act also contains provisions that limit FHFA's exercise of that authority. One such provision is the statutory priority scheme for receivership set forth in 12 U.S.C. § 4617(c)(1). Under that provision, "[u]nsecured claims against a regulated entity, or the receiver therefor, . . . *shall* have priority in the following order":

> (A) Administrative expenses of the receiver.
>
> (B) Any other general or senior liability of the regulated entity (which is not a liability described under subparagraph (C) or (D)).
>
> (C) Any obligation subordinated to general creditors (which is not an obligation described under subparagraph (D)).
>
> (D) Any obligation to shareholders or members arising as a result of their status as shareholder or members.

12 U.S.C. § 4617(c)(1) (emphasis added). Subject to limited exceptions not applicable here, "[a]ll creditors that are similarly situated under paragraph (1) shall be treated in a similar manner." *Id.* § 4617(c)(2). The statutory priority scheme thus plainly distinguishes between general creditor claims (subsection (B)) and mere equity interests (subsection (D)).

On September 6, 2008, FHFA placed Fannie Mae and Freddie Mac in conservatorship pursuant to HERA. On July 9, 2010, FHFA published the Proposed Rule at issue. *See Conservatorship and Receivership*, 75 Fed. Reg. 39,462 (proposed July 9, 2010). The Proposed Rule purports to implement HERA for conducting any conservatorship or receivership of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. *Id.* at 39,462-72.

In fact, however, the Proposed Rule significantly departs from HERA's statutory framework. Section 1237.9(a) of the Proposed Rule sets forth a revised priority scheme, in which claims in receivership are satisfied in the following order:

> (1) Administrative expenses of the receiver (or an immediately preceding conservator).
>
> (2) Any other general or senior liability of the regulated entity (that is not a liability described under paragraph (a)(3) or (a)(4) of this section).
>
> (3) Any obligation subordinated to general creditors (that is not an obligation described under paragraph (a)(4) of this section).
>
> (4) Any obligation to current or former shareholders or members arising as a result of their current or former status as shareholders or members, *including, without limitation, any Securities Litigation Claim*.

Proposed 12 C.F.R. § 1237.9(a) (emphasis added). The term "Securities Litigation Claim" is defined very broadly to include "any claim, whether or not reduced to judgment, liquidated or unliquidated, fixed, contingent, matured or unmatured, disputed or undisputed, legal, equitable, secured or unsecured, arising from rescission of a purchase or sale of an equity security of a regulated entity or for damages arising from the purchase, sale, or retention of such a security." Proposed 12 C.F.R. § 1237.2. The Proposed Rule thus classifies securities fraud claims — even those reduced to final judgment in federal court — as the lowest priority, on par with equity.

The Agency attempts to justify reclassifying securities fraud claims as equity claims on the ground that doing so is "fair and appropriate." 75 Fed. Reg. at 39,466. The Agency notes that Section 510(b) of the 1978 Bankruptcy Code expressly subordinates securities litigation claims to the lowest level of priority with shareholder claims in bankruptcy. *Id.* (citing 11 U.S.C. § 510(b)). Although HERA contains no analogous language, the Agency attempts to explain away that omission: HERA "does not contain all of the details governing insolvent entities that the Bankruptcy Code does," the Agency asserts, "because Congress expected FHFA to fill in the gaps." *Id.* The Agency contends that its choice is permissible because Congress enacted HERA "against the backdrop of . . . statutory and common law . . . treating Securities Litigation Claims derived from equity ownership as subordinated to or having the same priority as the underlying equity." *Id.* at 39,466-67. The Agency also claims support from certain appeals court cases, such as *Gaff v. FDIC*, 919 F.2d 384 (6th Cir. 1990), that have "looked to the Bankruptcy Code for guidance on relative priorities of shareholder claims as well as other issues arising in receiverships of financial institutions." 75 Fed. Reg. at 39,467.

Having proposed to subordinate the claims of securities fraud victims in receivership, the Agency also proposes corresponding changes to the provisions governing conservatorship. In particular, Section 1237.13(a), entitled "Payment of Securities Litigation Claims while in conservatorship," would provide that "[t]he Agency, as conservator, will not pay a Securities Litigation Claim against a regulated entity, except to the extent the Director determines is in the interest of the conservatorship." And Section 1237.12(a) would provide that, subject to limited exceptions, "a regulated entity shall make no capital distribution while in conservatorship," which is also defined to include payments on securities litigation claims. *See* Proposed 12 C.F.R. § 1777.3(3). The Agency explains its non-payment policy as a corollary of its revised priority scheme: "If the Conservator were to authorize payment of Securities Litigation Claims despite the statutory receivership priority system ranking such claims below all other claims, the purpose of the receivership priority system could be thwarted." 75 Fed. Reg. at 39,468.

For the reasons explained below, neither the Agency's proposed surgery on the statutory receivership priority scheme, nor its proposal to rely on that revised scheme to refuse to pay even valid judgments in conservatorship, is consistent with the statute. Neither proposal can be reconciled with general legal principles or basic notions of fairness. And neither will withstand constitutional scrutiny. In short, both are arbitrary, capricious, and unlawful.

II. FHFA'S PROPOSED PRIORITY SCHEME CONFLICTS WITH THE PRIORITIES CONGRESS EXPRESSLY SET FORTH IN HERA

The Proposed Rule should be rejected because subordination of securities fraud claims is directly contrary to the priority scheme Congress enacted. Contrary to the Agency's claim, there is no "backdrop of . . . statutory and common law" that allows an agency to treat securities fraud claims — even those reduced to judgment — as mere equity interests. Rather, under Supreme Court precedent that the Agency does not even deign to cite (let alone attempt to distinguish), securities fraud claims *must be treated as creditor claims* absent statutory language mandating different treatment. Nothing in HERA supports that different treatment here. To the contrary, the legislative history of the statute on which HERA was modeled shows that Congress specifically considered subordination but overwhelmingly decided against it on a bipartisan basis. Moreover, the sound policy reasons that led Congress to reject subordination of securities fraud claims there — that doing so "would undermine fraud enforcement" and be "unfair to private plaintiffs who were innocent victims of wrongdoing" — apply with compelling force here. As a matter of law and policy alike, the Proposed Rule cannot be adopted.

A. UNDER THE SUPREME COURT'S DECISION IN *OPPEN-HEIMER*, SECURITIES FRAUD CLAIMS MUST BE TREATED AS CREDITOR CLAIMS ABSENT STATUTORY LANGUAGE TO THE CONTRARY

HERA's statutory priority scheme expressly distinguishes between creditor claims ("Any other general or senior liability of the regulated entity (which is not a liability described under subparagraph (C) or (D))") and equity claims ("Any obligation to shareholders or members arising as a result of their status as shareholder or members"), reserving the lowest priority for the latter. 12 U.S.C. § 4617(c)(1)(B), (D). Thus, the dispositive question here is whether, under governing legal principles, a defrauded investor's securities fraud claim is properly considered a creditor claim (like any other tort victim's claim against the company) or rather a mere equity interest.

1. Although FHFA does not even bother to cite the case, the Supreme Court directly answered that question over 70 years ago in *Oppenheimer v. Harriman National Bank & Trust Co.*, 301 U.S. 206 (1937). That case stands squarely for the proposition that securities fraud claims are creditor claims, not equity interests, in a receivership, unless Congress provides specific statutory language providing for contrary treatment.

Oppenheimer involved a fraud claim by the purchaser of stock in a bank that had become insolvent and entered receivership. 301 U.S. at 207-08. Much like the class members here, the plaintiff in *Oppenheimer* claimed he had been defrauded into purchasing stock by the bank officers' misrepresentations, and sought rescission. *Id.* at 208. The court of appeals ordered judgment for the plaintiff, but subordinated his claim to other creditors' claims. *Id.* The fraud victim sought review, and the Supreme Court unanimously reversed.

The Court described the issue before it as "whether plaintiff's judgment is entitled to share equally in the receivership estate with other unsecured creditors' claims." *Oppenheimer*, 301 U.S. at 213. It answered that question in the affirmative. "The fraudulent sale was subject to rescission by the plaintiff," the Court explained, and "[n]either lapse of time while plaintiff remained ignorant of the fraud nor insolvency of the bank detracted from its liability." *Id.* at 214. The plaintiff "merely s[ought] to share in the estate as do other unsecured creditors." *Id.* That, the Court held, he was entitled to do: Securities fraud claimants "stand on the same footing as other creditors." *Id.* at 215. And "[d]iscrimination against their claims is not authorized by the statute." *Id.* "It follows," the Court concluded, "that plaintiff's judgment is entitled to rank on a parity with other unsecured creditors' claims." *Id.*

Oppenheimer thus stands squarely for the proposition that, except where discrimination is expressly "authorized by the statute," securities fraud claimants must be treated the same as any other creditor in receivership. 301 U.S. at 213-15. That 70-year-old holding reflected what was then already well-established law. *See Richardson v. Olivier*, 105 F. 277, 280 (5th Cir. 1900) ("There is no sound reason, we think, for refusing to give a shareholder the same remedies against the bank on account of its frauds that are given to other creditors."); *Clark v. Boston-Cont'l Nat'l Bank*, 84 F.2d 605, 607 (1st Cir. 1936) (victim of securities fraud "participate[s] ratably with other creditors in the distribution of the bank's assets");

Salter v. Williams, 244 F. 126, 130 (3d Cir. 1917) (defrauded investor "approaches the receiver like an ordinary creditor"); *Williams v. Green*, 23 F.2d 796, 797-98 (4th Cir. 1928); *Fla. Land & Imp. Co. v. Merrill*, 52 F. 77, 80-81 (5th Cir. 1892); *see also Oppenheimer*, 301 U.S. at 215 nn.15-16 (citing *Richardson*, *Clark*, *Salter*, *Williams*, and *Florida Land*).

Oppenheimer has never been overruled. And for decades, its holding was understood to govern not only the bank-receivership context the Court addressed, but also bankruptcy proceedings predating adoption of the 1978 Bankruptcy Code. Indeed, for many years, the Securities and Exchange Commission vigorously enforced and defended the *Oppenheimer* rule in bankruptcy cases. As the Solicitor General urged the Supreme Court on behalf of the SEC in one case: "If [securities fraud] claims can be established, they are entitled to rank on a parity with those of other general unsecured creditors." Memorandum for the Securities and Exchange Commission at 19 n.19, *Protective Comm. v. Anderson*, 390 U.S. 414 (filed March 1967) (citing *Oppenheimer*); *see also SEC v. Ins. Investors Trust Co.*, No. 5753, 1971 WL 953, at *1-2 (W.D. Ky. Oct. 29, 1971) (granting parity based on (among other things) the "specific pronouncements of *Oppenheimer* to the effect that [defrauded] stockholder claims rank on parity with unsecured creditors"); *In the Matter of Four Seasons Nursing Ctrs. of Am., Inc.*, SEC Release No. CR-310, 1972 WL 129648, at *19 n.32 (Mar. 16, 1972) ("[F]raud claims are on parity with unsecured claims generally . . . ."); Kenneth B. Davis, *The Status of Defrauded Securityholders in Corporate Bankruptcy*, 1983 Duke L.J. 1, 9-10 & nn.40-41 (citing additional authorities). Except when provided otherwise by statute, that remains the law today.

2. In 1978, of course, Congress changed the rule *for entities in bankruptcy* by adding a new provision in the 1978 Bankruptcy Code for the specific purpose of subordinating securities fraud claims. Section 510(b) of the Bankruptcy Code currently provides:

> For the purpose of distribution *under this title*, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, *shall be subordinated* to all claims or interests that are senior to or equal the claim or interest represented by such security, except

> that if such security is common stock, such claim has the same priority as common stock.

11 U.S.C. § 510(b) (emphasis added). That provision by its terms governs *only* for the limited "purpose of distribution *under this title*," *i.e.*, for bankruptcies under the Bankruptcy Code. And notably, the provision does not say that securities fraud claims "are" equity claims or otherwise express any disagreement with the underlying logic of *Oppenheimer*. Instead, it simply directs that this particular class of creditor claims "shall be subordinated" in bankruptcy. Far from repudiating the reasoning of *Oppenheimer*, therefore, Congress merely accepted *Oppenheimer*'s invitation to "authorize[ ] by . . . statute" differential treatment of one particular category of creditor claims in the bankruptcy context.

For that reason, the Agency's reliance on an analogy to Section 510(b) is misplaced. The existence of that special provision for bankruptcies shows that, when Congress intends to depart from the Supreme Court's *Oppenheimer* rule, it knows how to do so — by specifying different treatment in the statute. Indeed, the Bankruptcy Code's legislative history confirms that Congress, in enacting Section 510(b), consciously departed from prior law and adopted a new and different rule for bankruptcies. The House Report observed that *Oppenheimer* "permits a rescinding security holder to share *pari passu* in the bankrupt estate with general creditors," and that "[t]he Supreme Court has not withdrawn from this position since 1937" (although it declined to reach the issue in one bankruptcy case). H.R. Rep. No. 95-595, at 194-95 (1978). The House Report further noted that the SEC had urged retention of the *Oppenheimer* rule in the bankruptcy context because "a security holder who has been defrauded should be treated the same as any other tort victim of the debtor." *Id.* at 195-96. But, relying largely on one 1973 law review article that advanced various policy reasons for a different approach, Congress changed the law in the bankruptcy context by adopting Section 510(b). *See id.* (citing John J. Slain & Homer Kripke, *The Interface Between Securities Regulation and Bankruptcy*, 48 N.Y.U. L. Rev. 261 (1973)). That article itself likewise recognized that this was a *change* in the law. *See* Slain & Kripke, *supra*, at 261 ("[I]t is currently held that the investor's [fraud] claim either shares pari passu with, or is preferred to, claims of general creditors."); *id.* at 281 (noting the "contemporary learning that rescinding stockholders share pari passu with . . . general creditors"); *id.* at 285 (advocating a "reconsideration" of the law); *id.* at 294 (outlining a "new approach").

Section 510(b) thus supersedes *Oppenheimer* in the bankruptcy context. But that statutory provision does not alter the application of *Oppenheimer* in other contexts — including the bank receivership context that *Oppenheimer* itself addressed. That point was made clearly in a case relied upon, ironically, by the Agency here — *In the Matter of Stirling Homex Corp.*, 579 F.2d 206 (2d Cir. 1978). *See* 75 Fed. Reg. at 39,466. *Homex* subordinated securities fraud claims in bankruptcy, relying on the pending enactment of Section 510(b) as well as the Slain & Kripke article (although deciding the case under pre-1978 law). *See* 579 F.2d at 212, 214-15. The court specifically distinguished *Oppenheimer* on the ground that it involved bank receivership rather than bankruptcy: "Significantly, the *Oppenheimer* decision . . . was made not pursuant to the Bankruptcy Act but under an entirely different statutory scheme — the National Bank Act, 12 U.S.C. § 1 *et seq.*" 579 F.2d at 211 n.8. That difference mattered because, according to the court, bankruptcy law afforded greater discretion to assure a "fair and equitable" distribution, as opposed to the strict "ratable" priority scheme that governs bank receiverships. *Id.*; *see also In re U.S. Fin. Inc.*, 648 F.2d 515, 523-24 (9th Cir. 1980) (distinguishing *Oppenheimer* on the same basis). *Homex* thus clearly demonstrates that *Oppenheimer* remains good law outside the bankruptcy context.

FHFA claims that courts have "looked to the Bankruptcy Code for guidance on relative priorities of shareholder claims as well as other issues arising in receiverships of financial institutions." 75 Fed. Reg. at 39,467. But none of the cases it cites involves a situation like the one here, where the Supreme Court had already established a binding legal principle applicable to receiverships, and Congress had established a statutory *departure* from that otherwise applicable principle in the Bankruptcy Code that was expressly limited to the bankruptcy context. The cited cases acknowledge that the Bankruptcy Code does not apply of its own force to bank receiverships. *See Gaff v. FDIC*, 919 F.2d 384, 393 (6th Cir. 1990) ("We recognize that the principles of equitable subordination do not apply to this case directly. This case is not in bankruptcy and the Bankruptcy Code does not govern bank failures. 11 U.S.C. § 109(b)(2) (1988)."); *Office & Prof'l Employees Int'l Union, Local 2 v. FDIC*, 962 F.2d 63, 68 (D.C. Cir. 1992) (*Local 2*) ("Bankruptcy Rules, we recognize, do not govern of their own force in a FIRREA liquidation."). The Supreme Court's *Oppenheimer* decision has already established the legal rule that governs absent contrary congressional direction. Because Section 510(b)'s contrary direction does not apply here, *Oppenheimer* does. And *Oppenheimer* requires defrauded investors to be treated like any other victim of the company's tortious misconduct — as creditors, not equityholders.

The cases the Agency cites are unsupportive for other reasons as well. As explained below, *Gaff* is an outlier that has been rejected by three other circuits. And *Local 2* involved a narrow procedural question about a union's ability to file claims on behalf of its members without a power of attorney, 962 F.2d at 68 — hardly sound authority for the fundamental reconfiguration of priority that FHFA attempts here. FHFA also cites *First Empire Bank—New York v. FDIC*, 572 F.2d 1361, 1368 (9th Cir. 1978). *See* 75 Fed. Reg. at 39,467. But that case likewise has nothing whatsoever to do with Section 510(b), much less reliance on that provision outside the bankruptcy context. It deals with the "provability" of claims. 572 F.2d at 1368. Most importantly, though, none of the cases involved a situation like this one, where the Supreme Court had already established the general rule and Congress, while enacting a limited departure for the bankruptcy context, did not extend that departure to other contexts.

The law under *Oppenheimer* is clear: Unless different treatment is specifically "authorized by the statute," securities fraud claims must be treated as creditor claims, not equity interests. Section 510(b) provides that specific authority in the bankruptcy context. Because the Agency can point to no similar authority in HERA, *Oppenheimer* compels rejection of its Proposed Rule.

B. CONGRESS DID NOT DEPART FROM THE *OPPENHEIMER* RULE WHEN IT ENACTED HERA

Congress was clearly familiar with *Oppenheimer*'s requirement that it expressly provide for subordination of securities fraud claims if that is what it intends. Yet HERA contains no language analogous to Section 510(b)'s express subordination of securities fraud claims in bankruptcy. To the contrary, the legislative history shows that Congress consciously rejected subordination when it enacted the statute on which HERA was patterned. Consistent with that rejection, courts have repeatedly rebuffed attempts to import subordination into the receivership context. For multiple reasons, therefore, the Proposed Rule contravenes Congress's plain intent.

1. The Agency cannot assume that Congress intended to depart from otherwise governing Supreme Court precedent absent a clear indication in the

statute. Courts "will not assume Congress to have intended . . . a departure from well-established doctrine without a clear expression to disavow it." *Dorszynski v. United States*, 418 U.S. 424, 441 (1974); *see also United States v. U.S. Gypsum Co.*, 438 U.S. 422, 437 (1978). Congress is deemed to be "familiar with [the Supreme Court's] precedents . . . and [to] expect[ ] its enactment[s] to be interpreted in conformity with them." *N. Star Steel Co. v. Thomas*, 515 U.S. 29, 34 (1995). When Congress enacted HERA, the law was clear: Unless different treatment is specifically "authorized by the statute," securities fraud claims have the same priority as any other unsecured creditor claim. *Oppenheimer*, 301 U.S. at 213-15. Congress provided no indication of any intent to supersede that settled rule in HERA — much less a "clear expression" of its intent to do so.

Congress, moreover, knew full well how to depart from the *Oppenheimer* rule: It needed only to add a provision to HERA similar to Section 510(b) of the Bankruptcy Code. But HERA contains no provision remotely comparable to Section 510(b)'s express subordination clause. Congress's provision of an express subordination clause in the Bankruptcy Code and its omission of such a clause from HERA proves that Congress did not intend to grant FHFA power to subordinate securities fraud claims. When Congress includes language in one statutory provision but omits it from another closely related provision, courts presume that "Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Cf. Burlington N. & Santa Fe Ry. Co. v. White*, 548 U.S. 53, 62-63 (2006) (quotation marks omitted); *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 176-77 (1994). The omission of express subordination language comparable to Section 510(b) from HERA thus makes the Agency's position untenable.

The Agency strains to extract some indication of Congress's intent to authorize subordination from the language of the statutory priority scheme. *See* 75 Fed. Reg. at 39,466. But nothing in that scheme evinces any intent to authorize subordination. The statute clearly reserves the lowest priority for obligations to shareholders "arising as a result of [the claimant's] status as shareholder." 12 U.S.C. § 4617(c)(1)(D). A securities fraud claim does not arise from the plaintiff's "status as shareholder." Rather, it arises from the plaintiff's status as a *tort victim* of a company's fraudulent misrepresentations. *See Howard v. Haddad*, 916 F.2d 167, 170 (4th Cir. 1990) (securities fraud claims "do not . . . arise out of [the plaintiff's] status as a Bank shareholder" but rather from "the allegedly fraudulent inducements to buy the stock"). The victim's "status as shareholder" may be a *consequence* of the fraud, but it is not the status out of which the fraud claim "arises." And while stock ownership may be a necessary *corollary* of being a securities fraud victim, *cf.* 75 Fed. Reg. at 39,466 (proposing a "but for" test), that is not the statutory test. The test is "arising" from. 12 U.S.C. § 4617(c)(1)(D). Here, the claims "arise" from fraud — not from the mere status of being a shareholder. *Howard*, 916 F.2d at 170. Shareholders *unaffected* by the fraud have no claim, and fraud victims may still have a claim even if they are no longer shareholders; "status" as a shareholder is thus not the basis for the claim. The Agency's broader "but for" test also proves too much: If a shareholder suffers a slip-and-fall injury due to the company's negligence while attending the annual stockholder's meeting, he is still a tort victim with a creditor's claim, even though he would not have suffered the injury "but for" his status as a stockholder.[1]

Because securities fraud claims do not "aris[e] as a result of [the claimant's] status as shareholder," but instead from his status as a fraud victim, the Agency's reliance on the exclusionary language of the senior priority provisions likewise fails. *See* 75 Fed. Reg. at 39,466. The Agency notes that the statute defines creditor claims to exclude equity claims. *See* 12 U.S.C. § 4617(c)(1)(B) ("Any other general or senior liability of the regulated entity *(which is not a liability described under subparagraph (C) or (D))*" (emphasis added)). Contrary to the Agency's contention, however, that parenthetical reference is not a subtle attempt by Congress to reclassify securities fraud claims as equity claims. Its obvious purpose is to make clear that *genuine* equity claims — like the right to collect dividends or share in ownership — are not "general liabilities" entitled to creditor priority. Because securities fraud claims do not "aris[e] as a result of [the

[1] As the Supreme Court has explained, a claim can be said to "arise" from or under a statute if "both the *standing* and the *substantive basis* for the presentation of the claim" come from the statute. *Heckler v. Ringer*, 466 U.S. 602, 615 (1984) (emphasis added) (citing *Weinberger v. Salfi*, 422 U.S. 749, 760-61 (1975)). Here, securities fraud claimants do not have "standing" because of their status as shareholders; some may no longer own shares. And the substantive basis for their claims does not come from the rights given them as shareholders. It comes from the right not to be subjected to fraud. Besides, if Congress had meant to subordinate securities class-action claims, it would have used the language it used in Section 510(b): It would have subordinated any claim "arising from the purchase or sale of a security" of the regulated entity. That Congress did not do so here speaks volumes about its intent.

claimant's] status as shareholder," they are not covered by subsection (D), and the parenthetical language in subsection (B) is irrelevant.

Ultimately, the Agency's textual analysis simply fails to come to grips with *Oppenheimer*. The Agency opines that "[c]laims for damages by shareholders *could be* considered to be creditor claims." 75 Fed. Reg. at 39,466 (emphasis added). That is true only in the same sense that Supreme Court holdings "*could be* considered binding." The more accurate statement of the law would be that "[c]laims for damages by defrauded shareholders *are* considered to be creditor claims," absent statutory language mandating a different treatment. Congress knows how to provide such language — as it did in the Bankruptcy Code — but Congress did not do so here. Because HERA contains no provision authorizing subordination of securities fraud claims — let alone the "clear expression" necessary to displace "well-established doctrine," *Dorszynski*, 418 U.S. at 441 — the Proposed Rule cannot be reconciled with *Oppenheimer*.

2. While HERA's text provides reason enough to reject the Proposed Rule, its legislative history underscores how far the Agency has strayed from Congress's design. HERA's legislative history clearly indicates that Congress modeled FHFA's powers as conservator and receiver on the pre-existing statutory framework governing the Federal Deposit Insurance Corporation ("FDIC"): "The conservatorship and receivership provisions were modeled after similar provisions in the Federal Deposit Insurance Act that apply to federally insured depository institutions." H.R. Rep. 110-142, at 90 (2007). The influence of that pre-existing regime is clear on HERA's face, since HERA's text closely tracks the FDIC's statute in many respects. *Compare, e.g.*, 12 U.S.C. § 4617(a)-(b) *with* 12 U.S.C. § 1821(c)-(d).

Congress's reliance on that prior *bank receivership* statute further undermines any claim that Congress intended to incorporate subordination principles from Section 510(b) of the Bankruptcy Code *sub silentio*. *Oppenheimer* rejected securities-fraud subordination *in the very context of bank receivership*. *See* 301 U.S. at 213-15. The Second Circuit in *Homex* allowed equitable subordination of a securities fraud claim *precisely because* that case did *not* involve a bank receivership. *See* 579 F.2d at 211 n.8. Congress thus modeled HERA on a statute that lies at the core of the Supreme Court's holding in *Oppenheimer*. By attempting to extend Section 510(b) of the Bankruptcy Code to

HERA, when Congress has not extended Section 510(b) to that context, the Proposed Rule strikes at the very heart of *Oppenheimer*.

The legislative history of the FDIC's statute makes that even more clear. When Congress granted the FDIC receivership and conservatorship authority in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183, it considered, but consciously rejected, subordinating certain securities fraud claims. A proposed Senate amendment would have subordinated shareholders' claims against directors and officers of failed financial institutions to the FDIC's own claims. It provided:

> In any proceeding related to any claim acquired under section 11 or 13 of this Act against an insured financial institution's director, officer, employee, agent, attorney, accountant, appraiser, or any other party employed by or providing services to an insured financial institution, any suit, claim, or cause of action brought by the Corporation shall have priority over any such suit, claim, or cause of action asserted by depositors, creditors, or shareholders of the insured financial institution . . . . This priority shall apply to both the prosecution of any suit, claim, or cause of action, and to the execution of any subsequent judgments resulting from such suit.

S. 774, 101st Cong., 1st Sess. § 214(*o*)(1) (1989). That provision was deleted, however, from the bill that became law. *See* Pub. L. No. 101-73, 103 Stat. 183.

Members of Congress explained that they deleted the subordination provision in conference because subordination was "fundamentally unsound as a policy matter." 135 Cong. Rec. 18,571 (1989) (Rep. Glickman). "[G]iving the FDIC an absolute priority [over securities fraud claims] would undermine fraud enforcement, would be potentially unfair to private plaintiffs who were innocent victims of wrongdoing, and would be at cross-purposes with the thrust of the savings and loan legislation." *Id.* "[P]rivate parties would have little chance of recovery and as a result would no longer bring fraud suits," eliminating a "necessary supplement to the enforcement efforts of the SEC and the Department of Justice, which do not have the resources to enforce the law on their own." *Id.* "[T]here was no evidence that [subordination] would benefit the American taxpayers in any meaningful way, especially in view of the likelihood of increased fraud." *Id.* And subordination would be "a disincentive to investment in savings institutions, since an investor would have no recourse if his investment was procured through fraud." *Id.*; *see also id.* at 18,575 (Rep. Staggers) (making the same points). The House conferees thus voted "overwhelmingly," "on a bipartisan basis," to delete the subordination provision, and the Senate conferees agreed. *Id.* at 18,575.

In modeling FHFA's authority on FDIC's power under FIRREA, Congress followed a template that consciously excluded subordination of securities fraud claims. All the reasons legislators mentioned for rejecting subordination in FIRREA, moreover, are equally potent responses to FHFA's Proposed Rule here. By pursuing the rule nonetheless, the Agency thwarts Congress's plain intent.

3. Consistent with the legislative history discussed above, cases interpreting the FDIC's authority under FIRREA have repeatedly refused to grant the FDIC power to subordinate securities fraud claims. In *FDIC v. Jenkins*, 888 F.2d 1537 (11th Cir. 1989), the Eleventh Circuit held that the FDIC lacked authority to subordinate private securities fraud claims against officers and directors of a failed bank to its own claims. While not disputing that "preservation of the permanent insurance fund is vital to the continued health of the nation's banking system," the court saw "no indication of an intention" to authorize subordination in the statute, and refused to "approve of judicial expansion of the [FDIC's] express powers." *Id.* at 1541. Rejecting "the FDIC's invitation to act on arguments based in equity or on 'implicit' powers," the court opined that "a decision to give the FDIC [subordination power] is more properly within the domain of Congress." *Id.* at 1541 n.6. Congress's rejection of the proposed subordination amendment provided still further support. *See id.* at 1538 n.1.

Two other circuits have followed the Eleventh Circuit's lead. In *Howard v. Haddad*, the Fourth Circuit refused to allow the FDIC to subordinate a private securities fraud claim, "expressly adopt[ing]" the Eleventh Circuit's analysis in *Jenkins*. 916 F.2d at 170. The court rejected the FDIC's argument that a shareholder's securities fraud claim was "no different from the claims of any other shareholder." *Id.* "[The plaintiff's] claims on the defendants' assets do not . . . arise out of his status as a Bank shareholder," the court reasoned; "it was the allegedly fraudulent inducements to buy the stock that form the basis of his claims." *Id.* The Third Circuit then agreed with *Jenkins* and *Howard* in *Hayes v. Gross*, 982 F.2d 104 (3d Cir. 1992), a case that involved the parallel receivership authority of the Resolution Trust Corporation. *See id.* at 109-10 & n.6. The court stated: "We believe the RTC's statutory policy argument is, in essence, a claim that Congress, in enacting FIRREA, impliedly amended the Exchange Act so as to subordinate the latter to the former. We find nothing in the text or legislative history of FIRREA to support this proposition and therefore reject it." *Id.* at 110; *see also Greenfield v. Shuck*, 867 F. Supp. 62, 67-71 (D. Mass. 1994). Courts have thus overwhelmingly rejected the notion that FIRREA — the statute HERA is based on — authorizes the subordination of securities fraud claims. There is no reason for a different result under HERA.

Ignoring the overwhelming weight of authority, the Agency's Notice of Proposed Rulemaking relies on a single Sixth Circuit case, *Gaff v. FDIC*, 919 F.2d 384 (6th Cir. 1990), *modified*, 933 F.2d 400 (6th Cir. 1991). As courts have noted, *Gaff* stands alone in reaching the result it did. *See Greenfield*, 867 F. Supp. at 69 ("The majority of other courts that have considered the issue . . . have declined to create an absolute priority for the FDIC," contrasting *Gaff* with *Jenkins*, *Howard*, and *Hayes*); *Hayes*, 982 F.2d at 109 n.5 (identifying *Gaff* as the only authority supporting the FDIC's subordination argument and noting that *Jenkins* and *Howard* rejected it). FHFA offers no reason to follow an outlier decision on the short end of a 3-1 circuit split.

Gaff, moreover, is unpersuasive on its face. First, the court relied by "analogy" on Section 510(b) of the Bankruptcy Code — a provision expressly limited to bankruptcy cases — but did not even cite the Supreme Court's *Oppenheimer* decision, which rejected subordination in the precise context of bank receivership. *See* 919 F.2d at 394. Neither the Sixth Circuit nor FHFA can overrule Supreme Court precedent simply by ignoring it. Second, the court refused to attach any significance to Congress's decision not to enact the subordination amendment in FIRREA, relying on the patently erroneous assertion that "the legislative history says nothing about why the Senate did not include this proposal" and that "the best explanation is that Congress thought it best that the law of priorities in bank receiverships should be developed by the federal courts on a case-by-case basis." *Id.* at 395-96. As already explained, the legislative history explains precisely why Congress did not adopt that proposal: Because it was bad policy, would harm innocent securities fraud victims, and would undermine the important objectives the securities laws seek to achieve. Finally, *Gaff* attempted to distinguish *Jenkins* in part on the ground that *Jenkins* involved "causes of action granted by statute, namely the state and federal securities laws," whereas *Gaff* involved only state common-law mismanagement and related fraud claims that affected the corporation generally. *Id.* at 396. For that reason, it is not even clear that the Sixth Circuit's holding applies to the violations of the federal securities laws at issue here.

The overwhelming weight of authority refusing to subordinate securities fraud claims under FIRREA is powerful evidence of Congress's intent under HERA. It is a settled principle of statutory interpretation that, where "Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law." *Lorillard v. Pons*, 434 U.S. 575, 581 (1978); *see also Hibbs v. Winn*, 542 U.S. 88, 115-16 (2004); *Pollard v. E.I. du Pont de Nemours & Co.*, 532 U.S. 843, 853 (2001). When Congress enacted HERA in 2008, it was legislating against a twenty-year backdrop of near-unanimous refusal to read subordination powers into bank receivership statutes where those powers were not expressly set forth in the statutory text. By consciously modeling HERA on that prior law, Congress must be presumed to have intended the same result here.

4. The Agency cannot overcome those authorities by claiming to "fill in the gaps" in the statute pursuant to *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). 75 Fed. Reg. at 39,466. The Proposed Rule does not fill in any "gap." It revises an express priority scheme Congress set forth in the statute.

Chevron does not permit an agency to "fill in the gaps" when Congress has already filled the gaps for it. "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." 467 U.S. at 842-43. That perfectly describes the statute here. Congress set forth an express priority scheme that gives higher priority to creditor claims than equity interests. 12 U.S.C. § 4617(c)(1)(B), (D). Under the settled *Oppenheimer* rule, which Congress was deemed to be familiar with, securities fraud claims have the same priority as other creditor claims unless Congress specifically directs otherwise. Congress did not direct otherwise here. Congress has thus made its intent clear. It left no "gap" for the Agency to fill.

In determining whether a statute leaves "gaps," moreover, courts consider not only the ordinary meaning of the text, but also the principles of statutory construction that elucidate Congress's intent. Only if the statute remains unclear *after* application of those canons is deference to the agency's views appropriate. In *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000), for example, the Court refused to defer to the FDA's determination that it could regulate cigarettes as "drug delivery devices" under the Food, Drug, and Cosmetic Act, 21 U.S.C. §§ 301 *et seq.* The Court looked beyond the Act's bare text to the various tobacco-related laws over the previous 35 years and determined that Congress had clearly excluded regulation of tobacco products from the FDA's jurisdiction. 529 U.S. at 143-56. It emphasized in particular that Congress had rejected legislative proposals that would have granted the FDA clear authority to regulate tobacco products. *See id.* at 147-48; *see also, e.g.*, *Nat'l Credit Union Admin. v. First Nat'l Bank & Trust Co.*, 522 U.S. 479, 499-503 (1998) ("established canon[s] of construction" made clear that Congress had " 'directly spoken to the precise question at issue' ").

Accordingly, in evaluating whether Congress left "gaps" to fill in HERA, a reviewing court would consider not only the bare text of HERA's priority scheme, but also all the usual canons of construction that shed light on Congress's intent. Those canons include the principle that Congress is presumed not to "depart[] from well-established doctrine without a clear expression to disavow it." *Dorszynski*, 418 U.S. at 441; *see U.S. Gypsum*, 438 U.S. at 437. Here, the "well-established doctrine" was that Congress must provide for subordination of securities fraud claims if that is what it intends. Those canons also include the principle that Congress is presumed to act "intentionally and purposely in the disparate inclusion or exclusion" of language in different statutory provisions. *Burlington N. & Santa Fe Ry.*, 548 U.S. at 62-63 (quotation marks omitted); *see Cent. Bank of Denver*, 511 U.S. at 176-77. Here, Congress included specific language departing from *Oppenheimer* in the bankruptcy context but omitted any such language from HERA. Those canons also include the principle that, where "Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law." *Lorillard*, 434 U.S. at 581; *see Hibbs*, 542 U.S. at 115-16; *Pollard*, 532 U.S. at 853. Here, Congress modeled HERA on bank receivership statutes like FIRREA that have repeatedly been held *not* to allow subordination. For half a century, the SEC has championed the *Oppenheimer* rule as not just compelled by law, but fair and just. Nothing in HERA authorizes FHFA to reject all that established precedent and substitute its own policy preferences instead.

Finally, still another canon trumps agency discretion: the rule of constitutional avoidance. Even where a statute might otherwise leave "gaps," courts will not permit an agency to fill those gaps in a way that approaches constitutional bounds. *See Solid Waste Agency of N. Cook County v. U.S. Army Corps of Eng'rs*, 531 U.S. 159, 172-73 (2001); *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 574-75 (1988); *cf. Kent v. Dulles*, 357 U.S. 116, 129 (1958) (courts must narrowly construe statutes that would otherwise curtail or dilute constitutional rights). As explained below, the Proposed Rule raises substantial constitutional concerns on multiple fronts. A reviewing court will not defer under those circumstances. Wholly apart from constitutional constraints, moreover, courts will not presume that Congress intends to authorize retroactive rulemaking absent clear statutory authority. *See*, *e.g.*, *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208-09 (1988); *INS v. St. Cyr*, 533 U.S. 289, 320 n.45 (2001); *Nat'l Mining Ass'n v. Dep't of Labor*, 292 F.3d 849, 860 (D.C. Cir. 2002). As further explained below, the Proposed Rule is impermissibly retroactive and for that reason too will not be afforded deference. *Chevron* will not shield the Agency's unlawful Proposed Rule from judicial correction.

* * * * *

In short, the Agency fails to marshal any authority to support its claim that Congress authorized subordination of securities fraud claims, contrary to the settled law governing bank receiverships set forth in *Oppenheimer*. Every indication is to the contrary: The text of the statute, the legislative history, and the overwhelming weight of judicial authority refute the Agency's proposal. The Proposed Rule thus flouts the unambiguous intent of Congress and should be rejected.

III. FHFA'S PROPOSED REFUSAL TO PAY VALID CLAIMS DURING CONSERVATORSHIP ALSO VIOLATES HERA

1. In addition to rearranging the statutory receivership priority scheme, the Agency proposes to refuse to pay valid securities fraud claims — even those reduced to judgments by a federal court decree — during conservatorship. Proposed 12 C.F.R. §§ 1237.12(a), .13(a). The Agency attempts to justify that proposal as necessary to give effect to its revised priority scheme: "The statutory receivership priority scheme, as implemented by [the Proposed Rule], provides that claims derived from ownership of an equity security of an Enterprise are sub-

ordinated to all other claims. If the Conservator were to authorize payment of Securities Litigation Claims despite the statutory receivership priority system ranking such claims below all other claims, the purpose of the receivership priority system could be thwarted . . . ." 75 Fed. Reg. at 39,468. For the reasons given above, however, FHFA's proposed effort to revise the receivership priority scheme is arbitrary, capricious, and contrary to law. FHFA cannot rely on an unlawful change to the receivership priorities to justify new rules for conservatorship. To the contrary, because the revisions to the receivership priorities are unlawful, FHFA's avowed effort to give those illegal priorities effect by limiting payments during conservatorship is necessarily unlawful as well.

2. Even apart from that fatal flaw, the proposed conservatorship provisions are contrary to the statute. Nothing in HERA authorizes FHFA, as conservator, to refuse to pay valid claims. The statute carefully enumerates FHFA's powers during conservatorship, including authority to "operate the regulated entity with all the powers of the shareholders, the directors, and the officers of the regulated entity." 12 U.S.C. § 4617(b)(2)(B), (D). But nowhere among those powers did Congress grant authority to disregard valid court judgments or other claims. As one author stated regarding the pre-2008 conservatorship provisions governing Fannie Mae and Freddie Mac, a conservator has "[no] statutory authority to require creditors to exchange debt for equity or to accept only partial payment of their claims." Richard Scott Carnell, *Handling the Failure of a Government-Sponsored Enterprise*, 80 Wash. L. Rev. 565, 613 (2005). "This conclusion follows from the terms of the conservator's authority: the statute granting the conservator 'the powers of the [regulated entity's] shareholders, directors, and officers' and the absence of any statute specifically authorizing the conservator to restructure or impair creditors' claims." *Id.* "Thus, if a [regulated entity's] assets fall short of its liabilities, the conservator lacks statutory power to resolve the shortfall." *Id.* at 613-14. Those observations are no less true following the 2008 amendments: FHFA still has authority to exercise "powers of the [regulated entity's] shareholders, directors, and officers," but there still is no provision authorizing refusal to pay valid claims in conservatorship.

The Agency discerns such authority in its duty to "'preserv[e] and conserv[e] the assets and property of the regulated entity.'" 75 Fed. Reg. at 39,468 (quoting 12 U.S.C. § 4617(b)(2)(D)). But it cites no authority suggesting that this generic "preserve and conserve" power includes the prerogative of defying federal court judgments and other claims in conservatorship. Neither of the cases it cites is supportive. *In re Federal National Mortgage Association Securities, Derivative, & "ERISA" Litigation*, 629 F. Supp. 2d 1 (D.D.C. 2009), did not concern non-payment of claims at all, but rather merely affirmed the conservator's exclusive authority to *prosecute derivative claims* on behalf of the entity. *See id.* at 4 & n.4. And *Gibralter Financial Corp. v. Federal Home Loan Bank Board*, No. CV 89 3489, 1990 WL 394298 (C.D. Cal. June 15, 1990), while recognizing a conservator's discretion over the precise *timing* of payments, reaffirmed that the conservator had to "'pay all valid credit obligations of the association.'" *See id.* at *5 & n.9 (quoting former 12 U.S.C. § 1729(b)(1)(B)). That case thus refutes rather than supports the Agency's position.

Simply put, if Congress had wanted to grant FHFA the extraordinary power to refuse to pay valid claims during conservatorship — indeed, to defy court judgments — the statute would say so. It does not. To the contrary, the very fact that Congress created a priority scheme *for receivership*, but not conservatorship, belies the Agency's theory that Congress intended it to pick and choose among creditors while an entity is merely in conservatorship. *See* 12 U.S.C. § 4617(c)(1). If the Agency wishes to deny certain creditors payment on their valid debts, it must put the entity into receivership and then distribute assets according to the statutory priority scheme. It cannot simply invoke the statutory priority scheme for receivership (let alone its own unlawful revised receivership priority scheme) to deny payment on valid claims during a potentially lengthy conservatorship.

3. Other provisions of HERA make it clearer still that Congress did not grant FHFA as conservator unilateral authority to defy federal court judgments and other claims. For example, Section 4617(b)(11)(C) states that "[n]o attachment or execution may issue by any court upon assets in the possession of the *receiver* . . . of a regulated entity for which the Agency has been appointed *receiver*." 12 U.S.C. § 4617(b)(11)(C) (emphasis added). The provision thus suspends execution of court judgments during *receivership*. But there is no corresponding provision suspending execution during *conservatorship*. Given that omission, the Proposed Rule would be totally ineffectual: Even if the Agency refused to pay a securities fraud claim during conservatorship, the plaintiff could simply reduce his claim to judgment and then use the traditional means of execution to seize the entity's assets involuntarily. Nothing in HERA authorizes the Agency to suspend those means of execution during conservatorship — means that are provided by other provisions of law over which FHFA has no authority. *See*, *e.g.*, Fed. R. Civ. P. 69(a)(1).

The irrationality of that outcome proves that Congress did not intend to authorize the Agency to refuse payment of valid claims during conservatorship. Congress could not rationally have granted FHFA authority to deny payment while simultaneously preserving a creditor's right to execute on assets involuntarily. Indeed, the notion that Congress intended to allow FHFA to hold on to its funds in the face of valid creditor claims, while at the same time permitting creditors to seize those same funds out from under the Agency, borders on the absurd. The statute plainly contemplates that FHFA will continue to pay valid claims during conservatorship. Only once the entity enters receivership may the Agency refuse to pay claims, and even then, only according to the statutory priority scheme Congress enacted.

4. The Agency finally seeks support from the Preferred Stock Agreements that Fannie Mae and Freddie Mac executed to receive funding from the Treasury. 75 Fed. Reg. at 39,468-69. The HERA provision authorizing those agreements, however, makes no mention of securities fraud claims. *See* Pub. L. No. 110-289, § 1117, 122 Stat. 2654, 2683 (2008) (codified at 12 U.S.C. § 1719(g)). The only *statutory* provision even arguably addressing priorities is one requiring the Secretary of the Treasury to "take into consideration" the "need for preferences or priorities regarding payments *to the Government*" in deciding whether to purchase securities. 12 U.S.C. § 1719(g)(1)(C) (emphasis added). The Agency points out that the particular *agreements* it negotiated with the Treasury, allegedly pursuant to that statutory authority, exclude from the Treasury's funding obligation securities fraud claims "*that the Conservator determines* shall be subordinated." 75 Fed. Reg. 39,248-69 (emphasis added) (citing Amended and Restated Senior Preferred Stock Purchase Agreement § 1 (Sept. 26, 2008)). But that contract provision says nothing at all about the antecedent question of *whether* the conservator can or should subordinate such claims (let alone refuse to pay them during conservatorship). A contract between Treasury and FHFA cannot possibly give FHFA subordination authority that HERA withholds. And it is impossible to fathom how the particular terms of agreements that FHFA and Treasury negotiated *after* HERA's enactment shed any light on what authority Congress intended to confer when it passed that statute.

The actual financial terms of those Treasury Agreements speak volumes about FHFA's lack of ability or inclination to operate the companies in the interests of fraud victims. As has recently been reported, Fannie Mae and Freddie Mac are "paying steep *dividends to the government* in return for the aid," and "[t]he dividend rate, 10 percent, is far more than the companies would pay to raise money in the capital markets." Zachary A. Goldfarb, *Freddie's Loss Narrows, But Firm Needs More Aid*, Wash. Post, Aug. 10, 2010, at A14 (emphasis added). "After the latest round of assistance, Freddie will be required to pay $6.4 billion in annual dividends to the government," an amount that " 'exceeds the company's annual historical earnings in most periods.' " *Id.* Those dividends are "forcing Fannie and Freddie to borrow money from the Treasury to repay taxpayers, creating a cycle of ever-increasing demands for government infusions of money and dividend payments." *Id.* FHFA's ongoing fleecing of the two enterprises to pay dividends to the government at 10% — at a time when market rates are much less — underscores the wisdom of Congress's decision not to grant the Agency authority to refuse to pay valid claims in conservatorship.

IV. THE PROPOSED RULE IS UNCONSTITUTIONAL AND SHOULD BE REJECTED TO AVOID CONSTITUTIONAL DOUBT

The Proposed Rule should also be rejected because it violates the Constitution, or at the very least raises substantial constitutional questions. Administrative agencies, no less than courts, have a duty to ensure that their actions comply with the Constitution. *See Meredith Corp. v. FCC*, 809 F.2d 863, 872-74 (D.C. Cir. 1987). And it is settled law that, "where an otherwise acceptable construction of a statute would raise serious constitutional problems," the statute *must* be construed "to avoid such problems unless such construction is plainly contrary to the intent of Congress." *Edward J. DeBartolo Corp.*, 485 U.S. at 575. Here, the Proposed Rule raises serious constitutional doubts in at least three respects: (1) it deprives securities fraud victims of their property in violation of the Fifth Amendment's Takings Clause; (2) it violates securities fraud victims' Fifth Amendment due-process rights by retroactively changing the law; and (3) it violates separation-of-powers principles by granting an executive-branch officer authority to decide whether to honor judgments issued by Article III courts.

1. The Fifth Amendment's Takings Clause provides that "private property" shall not "be taken for public use, without just compensation." U.S. Const. amend. V. The Proposed Rule would violate that provision by allowing the Agency to take securities fraud victims' property rights in pending claims against a regulated entity in receivership while paying *no* compensation — let alone *just* compensation — for that taking.

Several courts have held that, for purposes of the Takings Clause, "claims for compensation are property interests that cannot be taken for public use without compensation." *In re Aircrash in Bali, Indonesia on April 22, 1974*, 684 F.2d 1301, 1312 (9th Cir. 1982); *see also Greyhound Food Mgmt., Inc. v. City of Dayton*, 653 F. Supp. 1207, 1218-19 (S.D. Ohio 1986), *aff'd*, 852 F.2d 866 (6th Cir. 1988); *Edwardsen v. Morton*, 369 F. Supp. 1359, 1379 (D.D.C. 1973); *cf. Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 428 (1982) (it is "affirmatively settled" that "a cause of action is a species of property"); *First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279, 1287-88 (Fed. Cir. 1999) (bank shareholder "ha[d] a property interest in any eventual liquidation surplus" following FDIC receivership sufficient to support standing for takings claim). Securities fraud claims filed against the regulated entities before those entities entered conservatorship are thus vested property interests protected by the Takings Clause.

The Proposed Rule would "take" those interests without just compensation in violation of the Clause. As the Supreme Court made clear in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992), it is a *per se* taking to deprive a property owner of "all economically beneficial uses" of its property. *Id.* at 1019. Subordinating securities litigation claims to the lowest priority in receivership would have precisely that effect here: If the regulated entities do not have sufficient assets to pay their creditors (such as the Treasury), relegating judgment creditors and other tort victims to the priority of stockholders is tantamount to expropriating their claims without any compensation at all.

Even if no *per se* taking has occurred, a court may well conclude that the subordination of securities fraud claims in receivership or the indefinite refusal to pay such claims in conservatorship constitutes a taking under the balancing test of *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978). Under *Penn Central*, a court looks to a variety of factors including "[t]he economic impact of the regulation on the claimant," "the extent to which the regulation has interfered with distinct investment-backed expectations," and the "character of the governmental action." *Id.* at 124. Here, the economic impact of the Proposed Rule is devastating: The rule will eviscerate the ability of millions of defrauded tort victims to obtain meaningful redress. Moreover, investors purchased Fannie Mae stock based on the reasonable "investment-backed expectation" that they were not being defrauded, and the Proposed Rule would undermine their ability to seek satisfaction for the frustration of that expectation. Finally, the character of the government action supports finding a taking here because the Proposed Rule "forc[es] [fraud victims] alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 537 (2005) (quotation marks omitted). At the very least, those burdens should be borne *pro rata* by all the regulated entities' unsecured creditors, as they have been in bank receiverships for decades, without singling out one disfavored class of tort victims for discriminatory treatment.

2. The Proposed Rule also violates due process restrictions on retroactive legislation. The Fifth Amendment's Due Process Clause provides that "[n]o person shall . . . be deprived of life, liberty, or property without due process of law." U.S. Const. amend. V. Due process concerns are particularly acute when a statute operates retroactively. Government action operates retroactively "if it changes the legal consequences of acts completed before its effective date," *Miller v. Florida*, 482 U.S. 423, 430 (1987) (quotation marks omitted), or "attaches new legal consequences to events completed" before the law takes effect, *Landgraf v. USI Film Products*, 511 U.S. 244, 270 (1994). "Retroactivity is not favored in the law," *Bowen*, 488 U.S. at 208, because "it can deprive citizens of legitimate expectations and upset settled transactions," *General Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992). As a result, the Supreme Court "has given careful consideration to due process challenges to legislation with retroactive effects." *E. Enters. v. Apfel*, 524 U.S. 498, 547 (1998) (Kennedy, J., concurring in judgment).

The Proposed Rule violates those principles by attempting to eliminate fraud victims' already-accrued causes of action, including claims that accrued before HERA's enactment. The Proposed Rule would retroactively deprive fraud victims of their legitimate expectation that tort law would provide compensation for fraud based on accrued causes of action. Several courts have held that, where government action upsets such expectations, due process provides protection. *See, e.g.*, *Bourgeois v. A.P. Green Indus., Inc.*, 783 So. 2d 1251, 1259 (La. 2001) ("Plaintiffs contend retroactive application of Act 989 to their claims would contravene due process guarantees by divesting them of their vested rights in their causes of action which accrued prior to the effective date of the Act. We agree."); *Resolution Trust Corp. v. Fleischer*, 892 P.2d 497, 500-07 (Kan. 1995) (retroactive legislation affecting accrued causes of action constitutes violation of state-law due process clause). Due process violations are especially likely to be found where, as here, retroactive legislation does not merely impair a party's expectations but strips away a remedy completely. *Cf. Crane v. Hahlo*, 258 U.S. 142, 147 (1922) ("No one has a vested right in any given mode of procedure and *so long as a substantial and efficient remedy remains or is provided* due process of law is not denied by a legislative change." (emphasis added)). Because the Proposed Rule violates those restrictions on retroactive lawmaking, it also violates the Due Process Clause.

3. Finally, the Proposed Rule disregards fundamental separation-of-powers principles. It is a longstanding principle, dating back to the Nation's founding, that "Congress cannot vest review of the decisions of Article III courts in officials of the Executive Branch." *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 218 (1995) (citing *Hayburn's Case*, 2 U.S. 408 (1792)). The "firm and unvarying practice" of federal courts has been "to render no judgments . . . that are subject to later review or alteration by administrative action." *Chicago & S. Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103, 113 (1948).

The Proposed Rule purports to establish precisely that arrangement by vesting FHFA's Director with discretion either to satisfy or to repudiate federal court judgments. Under the Proposed Rule, "[t]he Agency, as conservator, will not pay a Securities Litigation Claim against a regulated entity, *except to the extent the Director determines is in the interest of the conservatorship*." Proposed 12 C.F.R. § 1237.13(a) (emphasis added). The Director likewise has broad discretion to determine whether to authorize the "capital distribution" necessary to effect payment, subject to specified criteria. Proposed 12 C.F.R. §§ 1237.12, 1777.3(3). "Securities Litigation Claims" are defined to include claims "whether or not reduced to judgment." Proposed 12 C.F.R. § 1237.2. The Proposed Rule thus gives the Agency's Director — an *executive* official — sole discretion to determine whether judgments of Article III courts will be given effect. The Director's decision not to pay a claim in conservatorship would be tantamount to reversal of the court's judgment, particularly given the Proposed Rule's relegation of such claims to the lowest priority in receivership and the almost certainty that Fannie Mae will not have sufficient assets to pay the lowest priority claims if put into receivership. That is precisely the sort of authority the Constitution prohibits Congress from vesting in an executive officer — and, *a fortiori*, prohibits an executive officer from arrogating to himself.

4. The foregoing constitutional infirmities also foreclose the Agency's Proposed Rule under the doctrine of constitutional avoidance. Clearly, there is an "otherwise acceptable construction" of the statute here that would avoid the

constitutional doubt. *Edward J. DeBartolo*, 485 U.S. at 575. The Agency need only follow the statute's plain terms. Consequently, the statute *must* be construed "to avoid such problems." *Id.* A reviewing court will not allow the Agency to adopt an expansive construction of its authority under the statute that needlessly raises significant constitutional concerns when an alternative construction that raises no such concerns is clearly possible. For that reason too, the Proposed Rule's reconfiguration of the statutory priority scheme and authorization of non-payment during conservatorship must be rejected.

V. CONCLUSION

FHFA's current rulemaking proceeding is not an ordinary "fill in the gaps" exercise. It is a transparent attempt to avoid payment of legitimate securities fraud claims against Fannie Mae, which accrued prior to HERA's enactment, by revising the statutory receivership priority scheme that Congress enacted in HERA. FHFA then uses that unlawful change to receivership priorities as a reason for corresponding changes to the payment regime in conservatorship. Both changes disregard decades of precedent and authority evidencing Congress's contrary intent. FHFA simply does not have power under current law to promulgate rules that relegate securities litigation claims to the lowest level of priority in receivership and allow the Director to refuse payment of claims — even court-approved judgments — in conservatorship.

Overwhelming authority refutes FHFA's claimed power to subordinate securities fraud claims. That same authority also explains convincingly why FHFA's contrary construction is not just unlawful, but also bad and inequitable policy. The Proposed Rule would discourage the private securities fraud suits that have long played an instrumental role in enforcement of the Nation's securities laws. And it would deny recovery to innocent investors who, while accepting the risk of business failure, never accepted the risk of fraud and misrepresentation. Millions of public service pensioners throughout the 50 States, and the many other victims of fraud, should not be denied their just compensation. Those investors were substantially harmed by the regulated entities' wrongful conduct, and they are entitled to their day in court and to have any resulting judgments paid along with other creditor claims.

For all of the foregoing reasons, FHFA should not adopt the Proposed Rule.

Respectfully submitted,

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