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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
OAKLAND DIVISION

PEOPLE OF THE STATE OF CALIFORNIA *ex rel.* EDMUND G. BROWN, JR., ATTORNEY GENERAL Plaintiff, v. FEDERAL HOUSING FINANCE AGENCY, EDWARD DeMARCO, in his capacity as Acting Director of FEDERAL HOUSING LOAN MORTGAGE CORPORATION; CHARLES E. HALDEMAN, JR., in his capacity as Chief Executive Officer of FEDERAL HOME LOAN MORTGAGE CORPORATION; FEDERAL NATIONAL MORTGAGE ASSOCIATION; MICHAEL J. WILLIAMS, in his capacity as Chief Executive Officer of FEDERAL NATIONAL MORTGAGE ASSOCIATION Defendants.	CASE NO. 4:10-CV-03084-CW **DEFENDANTS' MOTION TO DISMISS AND SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES** DATE: December 2, 2010 TIME: 2:00 pm COURTROOM: Courtroom #2 JUDGE: The Honorable Claudia Wilken

COUNTY OF SONOMA, Plaintiff, v. FEDERAL HOUSING FINANCE AGENCY; EDWARD DeMARCO, in his capacity as Acting Director of FEDERAL HOUSING FINANCE AGENCY; FEDERAL HOME LOAN MORTGAGE CORPORATION; CHARLES E. HALDEMAN, JR. in his capacity as Chief Executive Officer of FEDERAL HOME LOAN MORTGAGE CORPORATION; FEDERAL NATIONAL MORTGAGE ASSOCIATION; MICHAEL J. WILLIAMS, in his capacity as Chief Executive Officer of FEDERAL NATIONAL MORTGAGE ASSOCIATION, Defendants.	**Case No. 4:10-CV-03270-CW**
SIERRA CLUB, Plaintiff, v. FEDERAL HOUSING FINANCE AGENCY; EDWARD DeMARCO, in his capacity as Acting Director of FEDERAL HOUSING FINANCE AGENCY; Defendants.	**Case No. 4:10-CV-03317-CW**

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

MOTION TO DISMISS AND NOTICE OF HEARING

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on December 2, 2010 at 2:00 p.m., or such other date and time as the Court may direct, in Courtroom 2 of the U.S. District Court, 1301 Clay Street, Oakland, CA 94612, Defendants will appear to argue this motion to dismiss three related actions pending in this Court — *California v. Federal Housing Finance Agency* (No. 4:10-cv-03084-CW), *County of Sonoma v. Federal Housing Finance Agency* (No. 4:10-cv-03370-CW), and *Sierra Club v. Federal Housing Finance Agency* (No. 4:10-cv-03317-CW).

By this motion, Defendants Federal Housing Finance Agency, Federal Home Loan Mortgage Corp., Federal National Mortgage Association, DeMarco, Haldeman, and Williams respectfully ask the Court to dismiss the actions in their entirety and with prejudice, pursuant to Fed. R. Civ. P. Rules 12(b)(1) and 12(b)(6). Defendants have submitted contemporaneously herewith the Declaration of Scott Border and a Request for Judicial Notice covering many of the non-legal sources cited herein.

MEMORANDUM OF POINTS AND AUTHORITIES

INTRODUCTION

In these actions, Plaintiffs seek to enjoin the federal regulator and Conservator of Fannie Mae and Freddie Mac (the "Enterprises") from undertaking the central mission entrusted to it by Congress — the prompt identification and mitigation of risks and practices inconsistent with the safe and sound conduct of the Enterprises' financial operations.

Plaintiffs advocate financing energy-related home-improvement projects through liens that, as to properties with outstanding mortgages, shift the risk of default from the provider of the home-improvement funds to the mortgage holder. Cal. Am. Compl. ¶ 21.[1] Shifting risk from another creditor to the mortgage holder in this way makes mortgage loans and mortgage-related assets riskier and less valuable. Plaintiffs not only admit this fact, they embrace it — Plaintiff California quantifies the incremental "risk" such programs pose, computing the diminution in the value of an

[1] Plaintiff Sonoma County operates a PACE program. Plaintiffs California and Sierra Club do not, but assert that their citizens and members respectively may benefit from such programs.

"average" mortgage encumbered by Plaintiffs' programs. Cal. Am. Compl. ¶ 41.[2] Other facets of PACE programs exacerbate those already-serious financial risks. For example, no uniform underwriting criteria apply, and many PACE programs apply credit standards that are plainly insufficient to meet any credible standard of financial prudence.

Fannie Mae and Freddie Mac hold more than $5 *trillion* in mortgage-related assets, but would be insolvent and in receivership but for quarterly infusions of taxpayer capital contributed by the U.S. Treasury. Hence, even a minor diminution in the value of a small fraction of mortgages in the Enterprises' portfolios could deplete the Enterprises' net worth, disrupting the enormously costly federal effort to stabilize the Enterprises and leaving taxpayers at even greater risk of financial loss. In effect, Plaintiffs would export much of the financial risk associated with California PACE programs to taxpaying residents of other states.

Assessment and management of such risks is the primary responsibility of the Federal Housing Finance Agency ("FHFA"), which presently acts in two relevant statutory capacities with respect to the Enterprises. *First*, FHFA is the congressionally appointed supervisory regulator of Fannie Mae and Freddie Mac. As such, FHFA is charged with the responsibility to ensure that the Enterprises operate safely and soundly. *Second*, FHFA is also the Conservator of Fannie Mae and Freddie Mac. As Conservator, FHFA directs the Enterprises' operations with a mandate to "preserve and conserve the [Enterprises'] assets and property."

On July 6, 2010, after meeting with stakeholders and studying programs such as those run by Plaintiffs (known generically as Property Assessed Clean Energy, or "PACE," programs) for more than a year, FHFA issued a Statement expressing "significant safety and soundness concerns" with PACE programs and directing the Enterprises to take certain "prudential actions" to "protect their safe and sound operations" in light of the risks. The Enterprises, under FHFA's conservatorship, have since announced that they will no longer purchase mortgages subject to a PACE obligation.

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[2] Plaintiffs' assertion that the incremental risk is "miniscule," Cal. Am. Compl. ¶ 41, is not correct. *See* fn. 37 *infra*.

Plaintiffs' lawsuits claim that "FHFA has effectively precluded PACE programs in California." Cal. Am. Compl. ¶ 4. They demand that the Court "set aside FHFA's July 6, 2010 Statement" and "enjoin[] Fannie Mae or Freddie Mac from taking any adverse action against any mortgagee [that] is participating, or may participate, in [such] program[s] under California law, or other action that has the effect of chilling [such] programs in California." *Id*. at Prayer ¶¶ 2, 5. In essence, Plaintiffs ask the Court (i) to enjoin FHFA from doing its statutory job — as regulator and as Conservator — of taking the risks associated with PACE programs into account in supervising and directing the Enterprises' operations, and (ii) to force the Enterprises to bear those risks.

SUMMARY OF THE ARGUMENT

In response to their identification of a serious financial risk, Defendants acted responsibly, appropriately, and legally. FHFA did what Congress had expressly directed it to do — FHFA diligently investigated and analyzed an emerging risk to the safety and soundness of the financial institutions it supervises. FHFA then engaged with state and local authorities regarding FHFA's concerns, sought changes to the programs (including necessary consumer protections and energy retrofit standards) and ultimately directed the Enterprises to take reasonable and prudential actions to protect their safe and sound operations in light of that risk. The Enterprises, in conservatorship, did what their federal charters authorized and what safe and sound financial practice dictated — they took reasonable steps to protect their portfolios from the risks posed by PACE programs. Hence, Defendants are confident that any evenhanded review of FHFA's actions as regulator and Conservator challenged in this litigation would determine that those actions were soundly conceived, legally authorized, adequately supported, and reasonably implemented.

The Court need not undertake such a review; indeed, Congress has mandated that it cannot. Three specific statutory provisions divest all courts of any jurisdiction to grant the relief Plaintiffs seek:

- 12 U.S.C. § 4617(f) mandates that "*no court may take any action to restrain or affect the exercise of powers or functions of the Agency as conservator*";
- 12 U.S.C. § 4635(b) mandates that "*no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or enforcement of any notice or order*" under certain statutory provisions implicated here; and,

- 12 U.S.C. § 4623(d) mandates that "*no court shall have jurisdiction to affect, by injunction or otherwise, the . . . effectiveness of any . . . action of the Director*" under the relevant statutory provisions.

Hence, this action must be dismissed under Rule 12(b)(1) for want of subject-matter jurisdiction, an absolute bar to judicial review that neither Defendants nor the Court can waive.

Moreover, even if Congress had not divested the Court of jurisdiction to hear Plaintiffs' claims, those claims would all still be subject to dismissal under Rule 12(b)(6) for failure to state a claim upon which relief could be granted:

- Plaintiffs' state-law claims for purported unfair competition and interference with prospective economic advantage fail because the provisions of state law upon which Plaintiffs rely are pre-empted by federal law. Moreover, Plaintiffs have not alleged, and cannot plausibly allege, the factual elements that are a prerequisite to their pre-empted state-law claims.
- Plaintiffs' claim for a declaratory judgment that their programs involve "assessments" and not "loans" and that Defendants' mischaracterized the PACE program is non-justiciable because it would resolve a purely semantic dispute of no legal consequence. The Enterprises' Uniform Security Instrument ("USI") requires borrowers to discharge any liens that have priority over the mortgage loan, regardless of whether they result from an "assessment" or a "loan." In any event, Plaintiffs themselves have publicly, repeatedly, and authoritatively confirmed that their programs *do* involve "loans."
- Plaintiffs' claims that FHFA's actions contravene the Administrative Procedure Act ("APA") fail because Plaintiffs are not in the zone of interests protected by the statute under which FHFA acted, the Housing and Economic Recovery Act of 2008 ("HERA"), and because FHFA has not issued any rule or regulation subject to notice and comment under the APA.
- Plaintiffs' National Environmental Policy Act ("NEPA") claim fails because jurisdiction is lacking, because nothing FHFA did constitutes "major federal action," and because NEPA's procedural requirements did not attach since FHFA is not empowered to subordinate safety and soundness to environmental considerations, no matter how laudable.

Plaintiffs offer no specific allegations as to the individual defendants sued in their official capacities: Messrs. DeMarco, Haldeman, and Williams. This failure provides independently sufficient grounds for dismissal of all claims as to those defendants.[3]

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[3] The collective term "Defendants" is used throughout this brief for convenience and without waiver of this facial defect in Plaintiffs' allegations as to the individuals.

STATEMENT OF FACTS

A. Statutory Powers and Obligations of FHFA

FHFA is an independent federal agency created by HERA to supervise and regulate Fannie Mae, Freddie Mac and the Federal Home Loan Banks ("Banks"). 12 U.S.C. § 4501 *et seq.*; California Amend. Compl. ¶ 14; Sierra Club Compl. ¶ 21. Congress established FHFA in 2008 in the wake of a national crisis in the housing market. A key purpose of HERA was to create a single federal regulator with all of the authorities necessary to oversee critical components of our country's secondary mortgage markets — Fannie Mae, Freddie Mac, and the Banks. 12 U.S.C. § 4511(b)(2). "[HERA] combined the staffs of the Office of Federal Housing Enterprise Oversight (OFHEO), the Federal Housing Finance Board (FHFB), and the [government sponsored enterprise] mission office at the Department of Housing and Urban Development (HUD)." *About FHFA*, FEDERAL HOUSING FINANCE AGENCY, http://www.fhfa.gov/Default.aspx?Page=4 ("*About FHFA*") (last visited Oct. 14, 2010).

Fannie Mae and Freddie Mac are government sponsored enterprises that facilitate the secondary market in residential mortgages by purchasing loans from mortgage lenders, thereby freeing up capital for additional mortgage lending. Cal. Am. Compl. ¶¶ 10, 12, 3; Sonoma Compl. ¶¶ 7, 9. Fannie Mae and Freddie Mac are presently in conservatorship and being operated by FHFA in its capacity as Conservator.[4] The Enterprises hold or securitize and guarantee the mortgages they acquire. Fannie Mae and Freddie Mac together own or guarantee about half of all residential home mortgages. Cal. Am. Compl. ¶ 3; Sonoma Compl. ¶¶ 7, 9; Sierra Club Compl. ¶ 11. As of June 2008, the Enterprises' combined debt and obligations totaled $6.6 trillion — exceeding the national debt by $1.3 trillion.[5]

As their regulator, FHFA oversees the operations of the Enterprises in an effort to assure that they operate in a financially safe and sound manner; remain adequately capitalized; and comply with their respective authorizing statutes, as well as all rules, regulations, guidelines, and orders

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[4] We refer in this brief to Fannie Mae and Freddie Mac in conservatorship as "the Enterprises."

[5] *About FHFA.*

issued under law. 12 U.S.C. § 4513(a). To carry out its statutory mission, FHFA is empowered with an array of supervisory, examination, and enforcement tools. For example, HERA empowers the Director of FHFA to "issue any regulations or guidelines or orders as necessary to carry out the duties of the Director," including but not limited to ensuring that the Enterprises are adequately capitalized and operating safely. 12 U.S.C. §§ 4526(a), 4511(b)(2), 4513(a). Guidelines and orders, as opposed to regulations, are not subject to the notice and comment provisions of the APA. *See* 12 U.S.C. § 4526. Under HERA's authority, the FHFA Director issues policy guidance and directives to Fannie Mae, Freddie Mac, and the Banks addressing specific safety and soundness concerns, including the guidance and directives Plaintiffs challenge here.[6]

Congress, in order to facilitate the prompt and effective exercise of the FHFA's supervisory and regulatory expertise, sharply limited judicial oversight of the FHFA's supervision and regulation of the Enterprises. Specifically, drawing directly from the supervisory and regulatory scheme long in place with respect to the federal financial institution regulatory agencies, Congress directed that "no court shall have jurisdiction to affect, by injunction or otherwise," either (a) "the issuance or enforcement of any notice or order" under certain of HERA's supervisory provisions, or (b) "the issuance or effectiveness of any . . . action of the Director" under a different but overlapping set of HERA's supervisory provisions. 12 U.S.C. §§ 4635(b), 4623(d).

B. The Conservatorships

Immediately following passage of HERA in July 2008, FHFA, the Department of the Treasury ("Treasury"), and the Federal Reserve undertook a comprehensive financial review of the Enterprises.[7] At the same time, the national housing market was deteriorating. On September 6,

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[6] *See, e.g.,* OFHEO Policy Guidance PG-00-001, Minimum Safety and Soundness Requirements (December 19, 2000), *available at* http://www.fhfa.gov/webfiles/1336/pg00001.pdf (subsequently issued as regulation: Safety and Soundness Regulation, 67 Fed. Reg. 55691 (Aug. 30, 2002), *available at* http://www.fhfa.gov/webfiles/1880/20020830_Final_Rule_FR.pdf). *See also* 12 U.S.C. § 4511.

[7] Remarks by Treasury Secretary Henry M. Paulson, Jr. on the Role of the GSEs [*i.e.*, the Enterprises] in Supporting the Housing Recovery before the Economic Club of Washington (Jan. 7, 2009) ("Paulson Remarks"), *available at* http://ustreas.gov/press/releases/hp1345.htm (Border Decl. Ex. 1).

2008, the Director placed Fannie Mae and Freddie Mac into conservatorship "for the purpose of reorganizing, rehabilitating or winding up the[ir] affairs." 12 U.S.C. § 4617(a)(2). It quickly became apparent that the Enterprises could not continue to operate without infusions of billions of taxpayer dollars by Treasury.[8] Treasury entered into Preferred Stock Purchase Agreements with the Conservator, which was acting on behalf of the Enterprises, to ensure that the Enterprises maintained positive net worths and avoided receivership, which would have worsened the financial crisis. The Conservator is authorized to draw on that Agreement at the end of each quarter to make up any deficiency in the Enterprises' net worth.[9] Through August 31, 2010, Treasury has advanced $148 billion to the Enterprises through the Conservators' draws.[10] Any losses incurred through December 31, 2012 will be backed up by the Treasury: that is, by taxpayers across the United States.[11]

As Conservator, FHFA is charged with taking any action "necessary to put the regulated entity into sound and solvent condition" and "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). HERA provides the Conservator with extensive powers to accomplish its statutory mission. FHFA "by operation of law, immediately succeed[ed] to all rights, titles and powers, and privileges of the shareholders, directors, and officers of the regulated entity" and is empowered to (i) take over the assets of and operate the regulated entity; (ii) collect all obligations and money due the regulated entity; (iii) perform functions of the regulated entity consistent with appointment of the Conservator; and (iv) exercise such incidental powers as may be necessary to carry out all powers and authorities specifically granted. 12 U.S.C. § 4617(b)(2)(A), (B), (J).

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8 Paulson Remarks, *supra* fn.7.

9 FHFA, Data as of October 1, 2010 on Treasury and Federal Reserve Purchase Programs for GSE [*i.e.*, Enterprise] and Mortgage-Related Securities at 1-2 (Oct. 1, 2010), *available at* http://www.fhfa.gov/webfiles/17990/TreasFED10012010.pdf (Border Decl. Ex. 2).

10 *Id.* at 2.

11 Treasury Issues Update on Status of Support for Housing Programs (updated Jan. 5, 2010), http://www.financialstability.gov/latest/pr_1052010b.html (Border Decl. Ex. 3).

Congress has directed that the Conservator's powers are to be exercised without interference from any state or federal agency, or any court, mandating that "no court may take any action to restrain or affect the exercise of powers or functions of the Agency as conservator," 12 U.S.C. § 4617(f), and that "[w]hen acting as conservator or receiver, the Agency [is] not subject to the direction or supervision of any other agency of the United States or any State in the exercise of the rights, powers and privileges of the Agency." *Id.* § 4617(a)(7).

Pursuant to its statutory authority, the Conservator has assumed the power of the Enterprises' Boards of Directors and management.[12] One of the central goals of the conservatorships is the mitigation of losses, and in that regard the Conservator has made improving underwriting standards and the quality of assets purchased a principal focus.[13] As a result, the loans purchased since the appointment of the Conservator have had much lower rates of serious delinquency. The risks associated with continued housing market price declines, especially on loans originated in four particularly hard-hit states (including California), present a continuing and difficult challenge for FHFA and the Enterprises.[14] Indeed, because of continuing losses associated with pre-conservatorship purchases, as well as forecasted losses not yet realized, FHFA continues to designate both Enterprises as presenting "critical supervisory concerns."[15]

C. <u>PACE Programs</u>

PACE programs permit local governments to offer individual property owners government loans to fund energy retrofits to their homes. Homeowners repay the amount borrowed, with

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[12] Statement of FHFA Director James B. Lockhart at 7 (Sept. 7, 2008), *available at* http://www.fhfa.gov/webfiles/23/FHFAStatement9708final.pdf.

[13] "Current State of the Government Sponsored Enterprises," Statement of Edward DeMarco, Acting Director, Federal Housing Finance Agency, Before the U.S. House of Representatives Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises at 6-7 (May 26, 2010) ("DeMarco Stmt.") at 6-7, *available at* http://www.fhfa.gov/webfiles/15790/52610 DeMarcoTestimony.pdf (California house prices declined from peak through 4Q09 by 39%) (Border Decl. Ex. 4); Conservator's Report on the Enterprises' Financial Performance, Second Quarter 2010, at 12 (Aug. 26, 2010), *available at* http://www.fhfa.gov/webfiles/16591/ConservatorsRpt82610.pdf (in 2009, 24% and 32% of the total credit losses by the Enterprises were for mortgages originating in California) (Border Decl. Ex. 5).

[14] Demarco Stmt., *supra* fn.13, at 6.

[15] Demarco Stmt., *supra* fn.13, at 6.

interest, over a period of years through "contractual assessments" added to their property tax bill.[16] Over the last two years, more than 20 states have passed legislation authorizing local governments to set up PACE-type programs.

California PACE programs began "multiplying rapidly" across the state in 2008. Cal. Am. Compl. ¶¶ 21-22. Plaintiff Sonoma County ("Sonoma") is one of over 200 California municipalities that have authorized implementation of a PACE program. Sierra Club Compl. ¶ 6. Sonoma launched a pilot PACE program in March 2009. As of July 2010, Sonoma had financed over 1,000 PACE loans.[17] Sonoma has continued its PACE program after FHFA issued its July 6 Statement.[18] In California, the liens that result from PACE program loans have priority over mortgages, including pre-existing first mortgages.[19] The PACE lender "steps ahead" of the mortgage holder in priority of its claim against the collateral, adversely increasing the risk of the existing mortgage to its holder, a class that includes not only the Enterprises but also such investors as pension funds and mutual funds. Such liens "run" with the property. As a result, the mortgage holder becomes the effective guarantor of the PACE loan. A mortgagee foreclosing on a property subject to a PACE lien must pay off any outstanding assessments and remains responsible for the principal and interest payments that are not yet due. If a home is sold before the homeowner repays the municipality, the purchaser of the home assumes the obligation to pay the remainder. Sonoma Compl. ¶ 16.[20]

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16 Cal. Am. Compl. ¶¶ 1, 21; Sonoma Compl. ¶¶ 14, 17 18; Sierra Club Compl. ¶ 2 . *See also* Cal. Streets & Hwy Code § 5898.14; Cal. Gov. Code § 53311 *et seq.*

17 Cal. Am. Compl. ¶ 22; Sonoma Compl. ¶ 28.

18 *See* Sonoma Compl ¶ 46 (indicating that Sonoma continues to operate its PACE program)..

19 Cal Am. Compl. ¶¶ 21, 33; Sonoma Compl. ¶ 16. Lien-priming is not inherent in PACE financing; Maine has authorized PACE programs that do not include it. Me. Rev. Stat. tit. 35-A, § 10156 (2010) ("A PACE mortgage is not entitled to any special or senior priority.").

20 When a homeowner is delinquent on the payment of property tax assessments, the mortgage lender receives notice and must pay the arrearage to prevent a tax sale and avoid losing the lien on the secured property. If a mortgage lender is not in control of the sale of the property, the lender could lose its entire monetary interest in the property; there is no incentive in a tax sale to garner more than the amount of the tax arrears.

Unlike traditional assessments, PACE loans are voluntary: that is, homeowners opt in, submit applications, and contract with the municipality's PACE program. Each participating property owner controls the use of the funds, owns the energy retrofit fixtures, and must repair the fixtures — with no county assistance — should they become inoperable while the liability remains. There are no uniform requirements for homeowner participation in these programs as each locality sets its own terms and requirements. There are also currently no national standards for certification of contractors or for the level of energy savings required to qualify for PACE financing. Moreover, nothing in PACE requires that uniform underwriting standards be implemented by the local programs, such as minimum total loan-to-value ratios that take into account either (i) total debt or other liens on the property, or (ii) the possibility of subsequent declines in the value of the property.[21] Nor does PACE employ standard homeowner creditworthiness requirements other than that the homeowner not be in bankruptcy or in default on the mortgage or taxes.[22] Some local PACE programs do communicate to homeowners that participation in PACE may violate the terms of their mortgage documents.[23] For this reason, some municipalities require participants to obtain the lender's consent prior to participation. Sonoma Consent Agreement at 4.

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[21] Placer County Application at 2-3 (requiring that loan not exceed 10% of property value but no provision for decline in property values), http://www.mpowerplacer.org/forms/Placer%20Application%20Written%20Form.pdf ("Placer App.") (last visited Oct. 14, 2010) (Border Decl. Ex. 6); Sonoma County Application at 3 (retrofit costs must be "reasonable" relative to current property value, but no requirement of excess equity), http://www.drivecms.com/uploads/sonomacountyenergy.org/application.pdf ("Sonoma App.") (last visited Oct. 14, 2010) (Border Decl. Ex. 7).

[22] *See, e.g.*, Placer App., *supra* fn.21, at 2-3 (requiring only that property owner be current on property taxes and mortgage (with no defaults on taxes for the past three years and no default on mortgage for the past five years), that property owner not be in bankruptcy, that property owner not have a civil court record indicating failure to make payments within past five years, and that property not be subject to involuntary liens); Sonoma App. , *supra* fn.21, at 3 (requiring only that property owner be current on property taxes and mortgage, that property owner not be in bankruptcy, and that property not be subject to involuntary liens).

[23] *See, e.g.*, Yucaipa Loan Application at 7, http://www.yucaipa.org/cityPrograms/EIP/PDF_Files/Application.pdf (last visited Oct. 14, 2010) (Border Decl. Ex. 8); Sonoma App., *supra* fn.21, at 9.

D. The Defendants' Concerns Regarding PACE Programs

As PACE programs were being considered by more states, Defendants began to evaluate their impact on the Enterprises' portfolios. On June 18, 2009, FHFA issued a letter and background paper raising concerns about PACE programs, such as the programs at issue here, that retroactively created first liens. FHFA set forth the negative impact of such programs on the Enterprises, who, as holders of large portfolios of mortgage-related assets, are forced to take on the increased risk of default and exposure resulting from PACE loans, without any control over the underwriting of these loans. FHFA also explained that such programs may have negative consequences — not just for the Enterprises as mortgage holders, but also for "consumers facing increased mortgage interest rates, more restrictive borrower underwriting standards and reductions in both the availability and size of mortgage loans in areas with such programs."[24] To discuss the risks to lenders and the Enterprises as well as borrowers, FHFA met with PACE stakeholders all over the country, including the California Attorney General and Sonoma County. FHFA also caucused with other federal financial-institution regulators, the White House National Economic Council, and the Departments of Energy and Housing and Urban Development. The intention of these discussions and the year-long effort by FHFA was to develop a structure for PACE that would address lenders' and financial regulators' concerns while providing consumers with safe access to energy efficiency lending.[25] Despite the significant efforts of those involved, a resolution that addressed the concerns of FHFA and other financial regulators has not been reached.

On May 5, 2010, in response to continuing questions about PACE programs, the Enterprises issued advisories ("Advisories") to lenders and servicers of mortgages owned or guaranteed by the Enterprises.[26] Fannie Mae's Advisory provided:

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[24] Letter from James B. Lockhart III, Director, FHFA, to Neil Milner, President and CEO, Conference of State Bank Supervisors, *et al.*, at 2 (June 18, 2009), *available at* https://www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/pdf/fhfaeltapletter.pdf (attached as 9).

[25] *See also* FHFA, Legal and Market Issues Related to Energy Loan Tax Assessment Programs (ELTAPs) (Sept. 10, 2009) (attached to Sept. 17, 2009 letter from Alfred M. Pollard to Rodney A. Dole, County of Sonoma) (Border Decl. Ex. 10).

[26] Fannie Mae Lender Letter LL-2010-06 (May 5, 2010), *available at* https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2010/ll1006.pdf (Border Decl. Ex. 11);

(Footnote Continued on Following Page)

> Fannie Mae has received a number of questions from seller-servicers regarding government-sponsored energy loans, sometimes referred to as [PACE] loans. PACE loans generally have automatic first lien priority over previously recorded mortgages. The terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit loans that have senior lien status to a mortgage. As PACE programs progress through the experimental phase and beyond, Fannie Mae will issue additional guidance to lenders as may be needed from time to time.

Freddie Mac's Advisory provided:

> The purpose of this Industry Letter is to remind Seller/Servicers that an energy-related lien may not be senior to any Mortgage delivered to Freddie Mac. Sellers/Servicers should determine whether a state or locality in which they originate mortgages has an energy loan program and whether a first lien is permitted.

The May 5 Advisories referred to Fannie Mae's and Freddie Mac's jointly developed master uniform security instruments ("USIs"), which prohibit liens senior to that of the mortgage.[27]

Shortly after the May 5 Advisories were issued, FHFA received a number of inquiries, including from the California Attorney General, seeking FHFA's position.[28] On July 6, 2010, FHFA affirmed its long-standing concerns with the assessment regime, the absence of enforceable consumer protections, and the lack of national energy retrofit standards by issuing a Statement (the "Statement") that, consistent with the views expressed in the Enterprises' Advisories, provided:[29]

> After careful review and over a year of working with federal and state government agencies, the Federal Housing Finance Agency (FHFA) has determined that certain energy retrofit lending programs present significant safety and soundness concerns that must be addressed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks . . . .

(Footnote Cont'd From Previous Page)

Freddie Mac Industry Letter (May 5, 2010), *available at* http://www.freddiemac.com/sell/guide/bulletins/pdf/ iltr050510.pdf ((Border Decl. Ex. 12).

[27] The relevant provision appears in Section 4. *See* Freddie Mac Form 3005, California Deed of Trust, *available at* http://www.freddiemac.com/uniform/doc/3005-CaliforniaDeedofTrust.doc; Fannie Mae Form 3005, California Deed of Trust, *available at* https://www.efanniemae.com/sf/ formsdocs/documents/secinstruments/doc/3005w.doc (Border Decl. Ex. 13).

[28] Letter from Edmund G. Brown, Jr. to Edward DeMarco (May 17, 2010) (Border Decl. Ex. 14); Letter from Edmund G. Brown, Jr. to Edward DeMarco (June 22, 2010) (Border Decl. Ex. 15).

[29] California Amend. Compl. ¶ 4 (July 6 Statement "affirmed" May 5 Letters); Sonoma Compl. ¶ (July 6 Statement "confirms" May 5 Letters); Sierra Club Compl. ¶ 12 (July 6 Statement "echoes" May 5 Letters).

> First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives.
>
> FHFA urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation.[30]

Given the safety and soundness issues raised by first-lien PACE programs, the Statement directed that the May 5 Advisories "remain in effect" and that the Enterprises "should undertake prudential actions to protect their operations," including: (i) adjusting loan-to-value ratios; (ii) ensuring that loan covenants require approval/consent for any PACE loans; (iii) tightening borrower debt-to-income ratios; and, (iv) ensuring that mortgages on properties with PACE liens satisfy all applicable federal and state lending regulations. However, FHFA opted to protect homeowners who had already obtained a PACE loan with a priority first lien, directing that any prohibition against such liens in the Enterprises' USIs be waived.

Also on July 6, 2010, the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), and the National Credit Union Administration ("NCUA") issued statements supporting FHFA's position. The OCC released a "Supervisory Guidance" informing national banks that they should "carefully consider [PACE] programs' impact on both banks' current mortgage portfolios and ongoing mortgage lending activities," and suggested steps "to mitigate exposures and protect collateral positions."[31] The FDIC noted that it "shares the FHFA's concerns about the lack of appropriate underwriting and consumer protection

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[30] FHFA Statement on Certain Energy Retrofit Loan Programs (July 6, 2010), *available at* http://www.fhfa.gov/webfiles/15884/PACESTMT7610.pdf (Border Decl. Ex. 16).

[31] OCC Bulletin 2010-25, Property Assessed Clean Energy (PACE) Programs (July 6, 2010), *available at* http://www.occ.treas.gov/ftp/bulletin/2010-25.html (Border Decl. Ex. 17).

standards."[32] The NCUA issued a "Regulatory Alert" to "All Federally Insured Credit Unions," warning that "[i]n addition to potentially affecting loans held in your credit union's portfolio, certain PACE loan programs could also adversely affect earnings and liquidity."[33]

On August 31, 2010, the Enterprises issued further guidance to their sellers and servicers.[34] This guidance provided that the Enterprises would not purchase mortgages secured by properties subject to a first-lien PACE obligation. They also provided guidelines for refinancing of mortgages secured by properties subject to PACE obligations originated before July 6, 2010.

In sum, Defendants have four primary concerns about PACE programs.[35]

First, and most significantly, first-lien PACE programs pose material financial risks to the Enterprises (and thereby present serious safety and soundness issues that FHFA must address) because they retroactively subordinate first mortgages, effectively shifting the risk of default from PACE financers to mortgage holders such as the Enterprises.[36] Plaintiffs do not deny that this feature of PACE programs makes mortgage assets riskier and therefore less valuable. Rather, they acknowledge the incremental risk but attempt to trivialize Defendants' safety and soundness concern with a series of facially implausible and erroneous calculations purporting to show that the

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[32] FDIC, Financial Institution Letter FIL-37-2010, Alert on FHFA Statement Relative to Concerns with Certain Energy Lending Programs (July 6, 2010), *available at* http://www.fdic.gov/news/news/financial/2010/fil10037.pdf (Border Decl. Ex. 18).

[33] National Credit Union Administration, Regulatory Alert No. 10-RA-10, Potential Risks of Property Assessed Clean Energy Loans (July 2010), *available at* http://www.ncua.gov/news/express/xfiles/10-RA-10.pdf (Border Decl. Ex. 19).

[34] Fannie Mae Announcement SEL-2010-12 (Aug. 31, 2010), *available at* https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2010/sel1012.pdf (Border Decl. Ex. 20); Freddie Mac Bulletin No. 2010-20 (Aug. 31, 2010), *available at* http://www.freddiemac.com/sell/guide/bulletins/pdf/bll1020.pdf (Border Decl. Ex. 21);

[35] *See also* FHFA, Legal and Market Issues Related to Energy Loan Tax Assessment Programs (ELTAPs) (Sept. 10, 2009) (attached to Sept. 17, 2009 letter from Alfred M. Pollard to Rodney A. Dole, County of Sonoma)).

[36] Retroactive legislative alteration of an existing security interest is so unusual that the Supreme Court has held that it may "result in a complete destruction of the property right of the secured party," and that accordingly "there is substantial doubt whether [it] comports with the Fifth Amendment." *U.S. v. Security Indus. Bank*, 459 U.S. 70, 75, 78 (1982).

risk to the Enterprises, now in conservatorship, and thereby to taxpayers, is "miniscule." *See* Cal. Am. Compl. at ¶ 41.[37]

Second, PACE programs lack sound and consistent underwriting standards, consumer disclosures, and assessment of a borrower's ability to pay, thereby posing significant risk not only to mortgage holders such as the Enterprises, but also to homeowners.[38] For example, PACE statutes authorize loans based on assessed value — known as collateral base lending — a key element in the subprime financial crisis and a reason why the recent Dodd-Frank Act reminded lenders and secondary market parties about the need to focus not on property but on borrower "ability to repay."[39] *Third*, PACE-funded projects may not generate sufficient energy savings to justify their cost on a cash-flow basis or to increase the value of the underlying property commensurately with the expenditure, but there is no recognized standard for determining the likely economic

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[37] Plaintiffs equate the "risk" to the mortgage holder with the maximum reduction in proceeds that the presence of a PACE obligation would cause the mortgagee to realize in a foreclosure sale. Cal. Am. Compl. at ¶ 41. Plaintiffs assert that, so defined, the "risk" would equal "one year's worth of PACE assessments," purportedly because "there is no acceleration of the entire amount financed [in a PACE loan] for failure to a pay a [PACE] assessment." *Id*. But any rational purchaser will treat his "assum[ption] [of] the continuing obligation to pay the [PACE] assessments" — *i.e.*, his assumption of the remaining PACE obligation — as a cost, and will reduce his cash bid accordingly. *See id*. Because reducing the purchaser's bid reduces the mortgagee's proceeds, the "risk" to the mortgagee, as Plaintiffs quantify it, must include the entire PACE obligation, not just the amount in default. Hence, Plaintiffs underestimate the incremental risk significantly.

[38] PACE financing is available to homeowners without appropriate or uniform underwriting standards, such as minimum total loan-to-value ratios or adequate consumer credit requirements. *See*, *e.g.*, Placer App., *supra* fn. 21, at 2-3 (requiring that financing cannot exceed 10 percent of property value, but no requirement that there be excess equity to allow for declines in property value); Sonoma App., *supra* fn. 21 (improvement costs must be "reasonable" to current property value, but no excess equity requirement; property owner must be current on taxes and mortgage, and not in bankruptcy, but not other credit requirements applicable).

[39] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1402, 124 Stat. 1376, 2139 (2010) (to be codified at 15 U.S.C. § 1639b ("It is the purpose of this section . . . to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans . . . ."). *Id*. at § 1639c (requiring creditors to take into consideration borrowers' ability to repay, including the "consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, [and] debt-to-income ratio.").

consequences of retrofit projects.[40] *Fourth*, while the Enterprises do business in all parts of the United States, PACE financing terms and program standards are not uniform throughout the country.[41] The patchwork of municipalities with PACE programs, each posing its own set of financial risks to mortgage holders (particularly the risk of borrower default), presents a safety and soundness concern due to the Enterprises' large holdings of mortgage-related assets.

ARGUMENT

II. LEGAL STANDARD

FHFA respectfully requests that all claims of the three Plaintiffs against all Defendants be dismissed under Federal Rule of Civil Procedure 12(b)(1) for lack of subject matter jurisdiction and Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim.

Subject matter jurisdiction is a threshold requirement; without it, a court cannot hear a claim. *See Morongo Band of Mission Indians v. Cal. State Bd. of Equalization*, 858 F.2d 1376, 1380 (9th Cir. 1988). The party asserting jurisdiction must establish that it exists over each claim. *See Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 377 (1994). General grants of jurisdiction do not apply where a specific statute precludes it. *First Nat'l Bank of Scotia v. United States*, 530 F. Supp. 162, 166-68 (D.D.C. 1982) ("none of the general jurisdictional statutes cited in the complaint are operative here, because those provisions confer jurisdiction upon this Court only to the extent that Congress has previously carved out a role for the district courts in the more focused and controlling statutory scheme set forth in 12 U.S.C. § 1818").

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[40] As late as June 8, 2010, the Department of Energy issued a request for information regarding residential energy retrofits and noted that this was a leading problem for consumer acceptance of retrofit borrowing. Department of Energy, National Energy Rating Program for Homes, Request for Information at 4 (June 8, 2010), *available at* http://apps1.eere.energy.gov/buildings/publications/pdfs/corporate/rating_rfi_6_2_10.pdf (Border Decl. Ex. 22).

[41] The Department of Energy has identified "best practices" for PACE programs. Department of Energy, Guidelines for Pilot PACE Financing Programs (May 7, 2010), *available at* http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf (Border Decl. Ex. 23). Not only are these best practices not mandatory, they also assume that standard underwriting practices are inadequate for PACE. *Id.* at 1 ("These best practice guidelines are significantly more rigorous than the underwriting standards. currently applied to land-secured financing districts."). FHFA indicated to Department of Energy that the best practices were still insufficiently rigorous to protect the borrowers.

A complaint must be dismissed under Rule 12(b)(6) for failure to state a claim if it (a) does not allege a cognizable legal theory or (b) alleges insufficient facts under a cognizable legal theory. *See Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1990). A case must be dismissed where the complaint fails to state a "'claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. __, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 540, 570 (2007)). While the Court must assume the truth of all properly pleaded allegations of fact, "conclusory allegations of law and unwarranted inferences are insufficient to defeat a motion to dismiss." *Ove v. Gwinn*, 264 F.3d 817, 821 (9th Cir. 2001). Stripped of unsupported legal conclusions, the factual allegations must do more than "create[] a suspicion of a legally cognizable right of action"; they must "raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 555 (internal quotations, citations, and alterations omitted).

III. THE COURT LACKS JURISDICTION OVER PLAINTIFFS' CLAIMS

Three specific statutory provisions — 12 U.S.C. § 4617(f), 12 U.S.C. § 4635(b), and 12 U.S.C. § 4623(d) — expressly preclude jurisdiction over Plaintiffs' claims.

A. Section 4617(f) Withdraws Jurisdiction over Plaintiffs' Claims Because the Relief Sought Would Affect the Exercise of FHFA's Powers as Conservator of the Enterprises

The first such provision, 12 U.S.C. § 4617(f), mandates that "no court may take any action to restrain or affect the exercise of powers or functions of the [FHFA] as a conservator." The plain language of § 4617(f) and the rationale behind its enactment both support its application here.

1. The Plain Language of § 4617(f) Bars Jurisdiction over Plaintiffs' Claims

Congress modeled HERA's conservatorship provisions on the corresponding provisions of the statutes governing federal banking agencies. *See* H. Comm. on Fin. Servs., 110th Cong., Detailed Summary of H.R. 3221 (2008). The jurisdictional bar provision that applies to FHFA conservatorships, § 4617(f), is materially identical to the provision applicable to FDIC conservatorships, § 1821(j), which states that "no court may take any action, except at the request of the [FDIC] by regulation or order, to restrain or affect the exercise of powers or functions of the

[FDIC] as a conservator or a receiver." *Compare* 12 U.S.C. § 4617(f) *with* § 1821(j). Hence, decisions applying § 1821(j) provide particularly useful guidance in applying § 4617(f).

In affirming a dismissal for lack of jurisdiction, the D.C. Circuit has confirmed that the materially identical language of § 1821(j) is to be applied specifically as enacted:

> [Section] 1821(j) does indeed bar courts from restraining or affecting the exercise of powers or functions of the FDIC as a conservator or a receiver unless it has acted or proposes to act beyond, or contrary to, its statutorily prescribed, constitutionally permitted, powers or functions. Congress undoubtedly did not contemplate anything like the parade of possible violations of existing laws — civil and criminal — that creative judges can conjure up, but *given the breadth of the statutory language, untempered by any persuasive legislative history pointing in a different direction, the statute would appear to bar a court from acting in virtually all circumstances*.

Nat'l Trust for Historic Preservation in U.S. v. FDIC, 21 F.3d 469, 472 (D.C. Cir. 1994) (Wald, J. concurring) (internal brackets, quotation marks, and citation omitted; emphasis added).

The § 4617(f) jurisdictional bar applies "regardless of [Plaintiffs'] likelihood of success on the merits of [any] underlying claims." *Freeman v. FDIC*, 56 F.3d 1394, 1398-99 (D.C. Cir. 1995) (applying § 1821(j)). Indeed, the jurisdictional bar would apply even if it were (incorrectly) assumed that Plaintiffs could otherwise state a viable claim. *See Nat'l Trust for Historic Preservation in the U.S. v. FDIC*, 995 F.2d 238, 240 (D.C. Cir. 1993) ("We do not think it possible, in light of the strong language of § 1821(j), to interpret the FDIC's 'powers' and 'authorities' to include the limitation that those powers be subject to — and hence enjoinable for non-compliance with — any and all other federal laws."), *vacated by* 5 F.3d 567 (D.C. Cir. 1993), *but reinstated in relevant part by* 21 F.3d 469 (D.C. Cir. 1994). And it makes no difference whether FHFA has acted (or could act) under its powers as a Conservator or its authority as a supervisory regulator. FHFA acts in both capacities, and is vested with "discretion regarding whether it will wear one hat or the other, or both." *Nat'l Trust*, 21 F.3d at 471 (applying § 1821(j)). Regardless of the "hat" or hats worn by FHFA in issuing issued the Statement, setting the Statement aside would affect the FHFA's exercise of its powers as Conservator.

a. Plaintiffs' Requested Relief Would Inevitably Restrain and Severely Affect the Exercise of the Conservator's Power to Preserve and Conserve Enterprise Assets

Because the Conservator is statutorily bound to "preserve and conserve the assets and property" of the Enterprises, by enacting HERA Congress prescribed that the Conservator must be accorded broad latitude to make its own supervisory judgments about financial risk (such as judgments as to the type and magnitude of risks that PACE loans pose), to determine how to mitigate such risks, and to direct the Enterprises to manage their portfolios accordingly. *See* 12 U.S.C. § 4617(b)(2)(B), (D), (J). As the Eastern District of Virginia held last year, "[i]n granting the conservator broad, sweeping authority over Freddie Mac's assets, Congress made it clear that it left to the FHFA . . . the discretion to decide how best to manage the assets of Freddie Mac." *In re Federal Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 798 (E.D. Va. 2009).

Here, all of the injunctive relief that Plaintiffs seek would "affect the exercise of powers or functions of [FHFA] as a conservator," and is therefore precluded by § 4617(f). Principally, Plaintiffs seek to enjoin the Enterprises (and, thus necessarily the Conservator) from "taking any . . . action . . . that has a chilling effect on the implementation of PACE programs," particularly from "taking any adverse action against any mortgagee . . . participating . . . in a PACE program."[42] But if the Conservator cannot take "any adverse action against a mortgagee participating in a PACE program," then the Conservator must treat such mortgagees as if they were *not* participating in PACE programs. Thus, Plaintiffs' relief, if granted, would preclude the Conservator from taking *any* account of the added risks that PACE loans pose to mortgages acquired by the Enterprises; this would restrain and affect the Conservator's ability to exercise its statutory power "to preserve and conserve [Enterprise] assets." The vague request to bar "any adverse action," likewise might pose unintended consequences.

Such injunctive relief "violates the heart of what is commonly termed [the] 'anti-injunction provision'" of the § 1821(j)/4617(f) jurisdictional bar. *Bank of Am. Nat'l Ass'n v. Colonial Bank*,

[42] All of the injunctive relief Plaintiffs seek is fairly subsumed within that request. Regardless, all of their requests for injunctive relief fail for the same reasons.

604 F.3d 1239, 1244 (11th Cir. 2010) (applying § 1821(j)). While it is true that certain of Plaintiffs' injunctive requests are formally directed at Fannie Mae and Freddie Mac, FHFA in its statutory capacity as Conservator "operates" those Enterprises. 12 U.S.C. § 4617(b)(2)(B). Any injunctive restraint on the Enterprises would, as a matter of law, therefore restrain and affect the exercise of the Conservator's statutory authority to "operate" Fannie Mae and Freddie Mac and "to perform all functions" of the Enterprises in their "name[s]." *Id*. Hence, the jurisdictional bar of § 4617(f) is not limited to claims pleaded directly against the Conservator. As the Third Circuit explained:

> [T]he plain language of the statute is not so limited [as to apply only to claims formally pled against a conservator or receiver]. Rather, the statute, by its terms, can preclude relief even against a third party, . . . where the result is such that the relief "restrain[s] or affect[s] the exercise of powers or functions of . . . a conservator or a receiver." After all, an action can "affect" the exercise of powers by an agency without being aimed directly at it.

Hindes v. FDIC, 137 F.3d 148, 160 (3d Cir. 1998) (citations omitted) (holding that § 1821(j) barred jurisdiction over claim that FDIC acted improperly as regulator because the relief sought would limit FDIC's ability to act as receiver).

All of Plaintiffs' requests for declaratory relief also founder on the jurisdictional bar of § 4617(f), which, like the parallel § 1821(j), is not limited to requests for injunctions. Rather, such provisions also bar any "declaratory judgment that would effectively 'restrain' the [conservator]." *Kuriakose v. Federal Home Loan Mortgage Corporation*, 674 F. Supp. 2d 483, 493-94 (S.D.N.Y. 2009) (quoting *Freeman*, 56 F.3d at 1399 (applying§ 1821(j)); *see also Hindes*, 137 F.3d at 166 (3d Cir. 1998) (explaining that § 1821(j) "precludes injunctive *and declaratory relief* which would restrain or affect the powers" of a conservator or receiver) (emphasis added). Plaintiffs first ask the Court to declare that the PACE loans are, in fact, "assessments," notwithstanding that Plaintiffs themselves have stated repeatedly and authoritatively that their programs involve "loans." *See* § V *infra*. To the extent that such a declaration would have any legal consequence, it would restrain and affect the Conservator's power to "preserve and conserve" assets — regardless of semantic labels, the Conservator cannot blind itself to the real risks PACE programs pose to the Enterprises' portfolios. Plaintiffs' requests for declaratory judgments that FHFA violated the APA or NEPA are also barred. As the D.C. Circuit explained in confirming that the analogous provision of § 1821(j) barred a claim that an FDIC receiver's planned sale of a building would violate another generally applicable federal statute, the National Historic Preservation Act, "We do not think it possible, in light of the strong language of § 1821(j), to interpret the FDIC's 'powers' and 'authorities' to include the limitation that those powers be subject to — and hence enjoinable for *non-compliance with — any and all other federal laws*." *Nat'l Trust*, 995 F.2d at 240 (emphasis added). Not only does § 4617(f) preclude jurisdiction directly, but it also triggers the APA provision foreclosing APA claims where another "statute[] preclud[es] judicial review." 5 U.S.C. § 701; *see also id*. § 702.

2. <u>The Policy Rationale behind § 4617(f) Supports Its Application Here</u>

In § 1821(j) cases, courts have explained the policies supporting the jurisdictional bar. As the Fifth Circuit noted in 1991, Congress enacted the § 1821(j) jurisdictional bar so that conservators and receivers could "act in a quick and decisive manner in reorganizing, operating, or dissolving" troubled financial institutions. *281-300 Joint Venture v. Onion*, 938 F.2d 35, 39 (5th Cir. 1991) (applying § 1821(j)). Indeed, as the D.C. Circuit explained four years later, "[a]lthough [the § 1821(j)] limitation on courts' power to grant equitable relief may appear drastic, it fully accords with the intent of Congress . . . to enable the [federal banking agencies] to expeditiously wind up the affairs of literally hundreds of failed financial institutions throughout the country." *Freeman*, 56 F.3d at 1398 (citing H.R. Rep. No. 101-54(I), 101st Cong., 1st Sess. 291, 307, *reprinted in* 1989 U.S.C.C.A.N. 86, 87, 103).

Here, those same policies apply. Given the importance of housing finance to the overall economy, it is imperative that all courts respect Congress's determination that the Conservator's ability to exercise its powers, functions, and discretion to respond decisively and efficiently to challenges as they arise, without becoming exposed to entangling litigation at each step, is paramount. Indeed, given the magnitude and complexity of the Fannie Mae and Freddie Mac conservatorships, the need for the FHFA Conservator to act decisively and efficiently is not only more acute but also more enduring than in even the largest banking-agency conservatorships or receiverships.

B. HERA Separately Withdraws Jurisdiction Because the Relief Plaintiffs Seek Would Undermine FHFA's Supervisory Authority

In addition to withdrawing jurisdiction to grant relief that would "affect the exercise of powers or functions of [FHFA] as a conservator," 12 U.S.C. § 4617(f), Congress also included provisions in HERA that withdraw court jurisdiction over actions that would interfere with FHFA's regulatory supervision of the Enterprises. *See* 12 U.S.C. §§ 4635(b), 4623(d). These provisions are closely analogous to a provision applicable to the federal banking agencies, 12 U.S.C. § 1818(i)(1), and they apply both during "ongoing administrative proceeding[s]" and prior to their commencement. As the Third Circuit explained, "by its terms[,] section 1818(i)," and, thus, its HERA analogues, are "not restricted to precluding judicial review which would interfere with an ongoing administrative proceeding." *Hindes*, 137 F.3d at 164. Indeed, "[t]he fact that no administrative action [i]s pending . . . is irrelevant to th[e] determination" that jurisdiction is withdrawn. *Board of Governors v. DLG Fin. Corp.*, 29 F.3d 993, 999 (5th Cir. 1994

1. The Plain Language of Section 4635(b) Bars Relief That Would Affect FHFA's Issuance and Enforcement of Supervisory Notices and Orders

In 12 U.S.C. § 4635(b), Congress mandated that "no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or enforcement of . . . any notice or order" under several HERA provisions. Because of the risks first-lien PACE loans pose to mortgage-related assets, the Enterprises' treatment of such assets implicates many of FHFA's supervisory and enforcement powers, including those powers specifically referenced in § 4635(b).

At its core, § 4635(b) withdraws jurisdiction over actions that would affect the "issuance or enforcement of notices or orders" under the entirety of "subchapter II," *i.e.*, 12 U.S.C. §§ 4611-4624.[43] One of the "subchapter II" provisions, 12 U.S.C. § 4624(c), states that "the Director may, by order, require [an Enterprise], under such terms and conditions as the [FHFA] determines to be appropriate, to dispose of or acquire any asset," provided that "the Director determines that such action is consistent with the purposes of [HERA]." Another section, 12 U.S.C. § 4624(b), provides that "the Director may, by order, make temporary adjustments to the established standards [for

[43] Sections 4619, 4620, and 4621 have been repealed and are therefore not relevant here.

Enterprise portfolio holdings], such as during times of economic distress or market disruption." Here, all of the relief Plaintiffs seek would affect FHFA's issuance or enforcement of notices or orders under provisions covered by § 4635(b); jurisdiction to grant it is therefore lacking.

a. The July 6 Statement Stands as an Order or Presages an Order Reiterating Its Terms

Section 4635(b) is triggered here because the Statement stands as, or could lead to, an "order" issued under one of the HERA provisions enumerated in § 4635(b).

If it is assumes (as Plaintiffs assert) that the Statement represents final agency action, then the Statement must be deemed a declaratory order. Under the APA, "'order' means the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rule making." 5 U.S.C. § 551(6).[44] The APA provides that an agency "in its sound discretion, may issue a declaratory order to terminate a controversy or remove uncertainty." *Id*. § 554(e). One obvious purpose of FHFA's issuance of the July 6 Statement was to terminate the brewing controversy as to whether PACE programs present significant safety and soundness concerns; another was to remove uncertainty as to whether FHFA would direct the Enterprises to take any prudential actions regarding PACE programs (and, if so, what such actions would be). Plaintiffs themselves assert that the Statement bears all indicia of finality. Hence, to the extent the Statement is deemed final agency action, it fits neatly within the APA definition of a "declaratory order."

But even if the Statement is *not* itself deemed a declaratory order, it is readily foreseeable that FHFA might re-issue the same guidance in declaratory-order form — it is not uncommon for an administrative agency to transform its informal supervisory guidance into a formal declaratory

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[44] It is true that under the APA, by definition, "orders" result from "adjudication." *See* 5 U.S.C. § 551(7). But here, it is indisputable that the Statement addresses the conduct of a small number of parties — the Enterprises and the Home Loan Banks — that all had ample notice and opportunity to be heard. Under the governing case law, that is sufficient to meet the APA definition of adjudication. *See American Airlines, Inc. v. Dep't of Transp.*, 202 F.3d 788, 798 (5th Cir. 2000) ("informal" process by which agency issued declaratory order that "interpreted the rights of a small number of parties properly before it" properly deemed adjudicative); *Sierra Club v. Peterson*, 185 F.3d 349, 366-67 (rejecting parties' "vehement assertions" that agency actions were not adjudicatory and therefore could not have led to an "order").

order. *See*, *e.g.*, *British Caledonian Airways, Ltd. v. Civil Aeronautics Bd.*, 584 F.2d 982, 984-85 (D.C. Cir. 1978) (describing process by which agency first sent a "letter to the industry" containing "precise and definite" guidance, which certain entities treated as "a non-binding advisory notice," then "issued [a] Declaratory Order [that] generally reaffirmed the industry letter.").

b. The § 4635(b) Jurisdictional Bar Applies Regardless of Whether the Statement Is Deemed a Declaratory Order

Whether the Statement is or could lead to an order, any such order would be issued pursuant to 12 U.S.C. § 4624 (b) or (c), provisions that trigger the § 4635(b) jurisdictional bar.

The stated basis for the Statement and its operative provisions conform precisely to § 4624(c), which states that "the Director may, by order, require [an Enterprise], under such terms and conditions as the [FHFA] determines to be appropriate, to dispose of or acquire any asset," if "the Director determines that such action is consistent with the purposes of [HERA]." By "direct[ing]" the Enterprises to take certain "prudential actions" regarding mortgages subject to PACE loans, FHFA attached "terms and conditions [that FHFA] deems appropriate" to the acquisition of such assets. The Statement notes that the directive to take those prudential actions deals with "significant safety and soundness concerns that must be addressed," meeting the § 4624(c) requirement that FHFA "determine that such action is consistent with the purposes of [HERA]."

The Statement also falls within the scope of § 4624(b), which provides that "the Director may, by order, make temporary adjustments to the established standards [for Enterprise portfolio holdings], such as during times of economic distress or market disruption." The "prudential actions" FHFA "directs" in the statement reflect "adjustments to the established standards" for Enterprise portfolio holdings — Plaintiffs allege that the Statement precludes the Enterprises from purchasing mortgages subject to PACE loans — and the Statement was indisputably issued "during [a] time[] of economic distress."

And, as noted *supra*, even if the Statement itself is not deemed a declaratory order, it is readily foreseeable that FHFA would reiterate the directives in the Statement as a more formal declaratory order issued pursuant to § 4624(b) or (c). Hence, regardless of whether the Statement is itself deemed an "order," all the relief Plaintiffs seek would "affect" the "issuance or enforcement of a[n] . . . order" issued pursuant to § 4624, thereby triggering the § 4635(b) jurisdictional bar.

c. Section 4635(b) Bars All Forms of Relief Plaintiffs Seek

Plaintiffs principally ask this Court to enjoin Fannie Mae and Freddie Mac (and thus, necessarily, FHFA) from "taking any . . . action . . . that has the effect of chilling PACE programs in California," particularly from "taking any adverse action against any mortgagee . . . participating . . . in a PACE program." *See* Cal. Am. Compl. at Prayer ¶ 2. Enjoining any action that would have "the effect of chilling PACE programs" would surely "affect" FHFA's ability to "enforce[]" the directives set forth in the July 6 Statement through direct enforcement of the Statement or through the issuance of a more formal declaratory order reiterating the same directives. Because all of the injunctive relief Plaintiffs seek would affect the issuance or enforcement of an order under § 4624, it is barred by § 4635(b).

As to Plaintiffs' declaratory relief claims, as noted *supra*, jurisdiction withdrawal provisions like § 4635(b) "[n]ot only . . . bar injunctive relief," but also bar any "declaratory judgment that would effectively 'restrain' the [conservator]." *Freeman*, 56 F.3d at 1399. As we explained *supra* in the § 4617 context, the declaratory relief Plaintiffs seek would have the effect of an injunction. Hence, under § 4635(b) the Court has no jurisdiction to consider such relief.

2. The Plain Language of a Second, Similar Section — § 4623(d) — Bars Jurisdiction over Claims That Would Affect Other Supervisory Action

A second jurisdiction withdrawal provision, § 4623(d), extends the reach of the jurisdictional bar beyond notices and orders in some circumstances, mandating that "no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or effectiveness of *any . . . action of the Director*" pursuant to any of the subchapter II sections, *i.e.*, §§ 4611-24. 12 U.S.C. § 4623(d) (emphasis added). Among other things, those sections authorize the Director to "require" a "significantly undercapitalized" Enterprise "to terminate, reduce, or modify any activity that the Director determines creates excessive risk." 12 U.S.C. § 4616(b)(4). The Enterprises were placed into conservatorship as a result of their significant undercapitalization, and the directives set forth in the July 6 Statement fit well within the authority granted and the actions prescribed under § 4616(b)(4). Accordingly, § 4623(d) bars jurisdiction over all of Plaintiffs' claims.

3. The Policy Rationale behind Sections 4635(b) and 4623(d) Supports Their Application Here

As with the conservatorship provisions, Congress modeled the supervisory and enforcement provisions of HERA on corresponding provisions of the statutes governing federal banking regulatory agencies. Accordingly, decisions articulating the policy basis behind the banking agency jurisdiction withdrawal provision, § 1818(i)(1), equally illuminate the policy behind the jurisdiction withdrawal provisions that apply here to FHFA in its regulatory capacity, §§ 4635(b) and 4623(d).

Several such decisions explain that Congress intended expert federal financial agencies such as the OCC, FDIC, and FHFA to have wide latitude in supervisory matters, and that Congress therefore chose to permit judicial intervention at limited times and in limited circumstances only. As the Fifth Circuit explained in the 1978 *Groos* decision, the relevant statutory "provisions establish a closely meshed administrative structure through which the [financial regulatory agencies] may curtail unsafe . . . practices." *Groos Nat'l Bank v. Comptroller of the Currency*, 573 F.2d 889, 894 (5th Cir. 1978) (addressing title 12 provisions applicable to OCC, including 12 U.S.C. § 1818). The court further explained that the statute "as a whole provides a detailed framework for regulatory enforcement and for orderly review of the various stages of enforcement; and [the jurisdictional bar provision] in particular evinces a clear intention that *this regulatory process is not to be disturbed by untimely judicial intervention*." *Id*. (emphasis added). *See also Henry v. Office of Thrift Supervision*, 43 F.3d 507, 513 (10th Cir. 1994).

The District Court for the District of Columbia, in the 1982 *First Nat'l* case, explained the same reasoning in greater detail:

> The statutory scheme . . . grants federal agencies such as the [OCC], the [FDIC] and the Federal Reserve Board wide[-]ranging supervisory and enforcement authority over our nation's banking system. . . . These agencies are charged with the task of overseeing that banking system for the protection of the public and the national economy as a whole . . . .

First Nat'l Bank of Scotia, 530 F. Supp. at 166 (internal quotation marks and citations omitted). The court continued:

> Given the magnitude of the public and private interests that are impacted by such extensive agency regulation of financial institutions, it is not surprising that Congress has seen fit to prescribe a specific statutory mechanism for obtaining judicial review of agency

> enforcement actions in this area. . . . Aside from the[] carefully delineated circumstances where federal district courts are granted jurisdiction over [such] controversies, Congress has categorically determined that "no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order." . . . [Hence,] both common sense and the language of the statute preclude this Court from exercising jurisdiction over [plaintiffs' claims for declaratory and injunctive relief under the APA].

Id. at 166-68. *See also RTC v. Ryan*, 801 F. Supp. 1545, 1550 (S.D. Miss. 1992); *Leuthe v. Office of Fin. Inst. Adjudication*, 977 F. Supp. 357, 360-61 (E.D. Pa. 1997).

As these decisions confirm, litigating the propriety of the supervisory activities of expert financial regulatory agencies like FHFA outside of the statutorily prescribed review process (which Plaintiffs do not even purport to invoke here) would subvert the regulatory mission of these agencies — the precise result Congress wished to avoid. Accordingly, the policy rationale behind the § 4635(b) and § 4623(d) jurisdictional bars fully supports dismissal of the Plaintiffs' claims.

IV. <u>PLAINTIFFS' STATE LAW CLAIMS FAIL BECAUSE THEY ARE PREEMPTED</u>

California and Sonoma each bring a state law claim against the Enterprises. California alleges that the Enterprises (*i.e.*, the Conservator) have engaged in acts that constitute unfair competition as defined by California Business & Professional Code § 17200 (California's Unfair Competition Law, or "UCL").[45] Cal. Am. Compl. ¶¶ 59-60. The alleged acts "include, but are not limited to" (a) "characterization of PACE assessments as loans without support for such characterization under California law," and (b) "claims that PACE assessments providing first-lien priority are contrary to Fannie Mae's and Freddie Mac's Uniform Security Instruments." *Id.* ¶ 60. Sonoma alleges that the Enterprises have interfered with prospective contractual relationships between Sonoma and its residents by treating assessments as loans and by "taking, or threatening to take, certain adverse actions against residents who participate in [PACE]." Sonoma Compl. ¶ 66. As a result, Sonoma alleges, the County and its residents are being deprived of economic and

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[45] Cal. Bus. & Prof. Code § 17200 provides that "unfair competition shall mean and include any unlawful, unfair or fraudulent business act or practice . . . ."

environmental benefits. *Id.* ¶ 67. The Court need not address the dubious merits of these claims because federal law preempts California's UCL claim and Sonoma's claim for interference with prospective contractual relations.

A. Plaintiffs' State Law Claims Are Preempted Because They Conflict with HERA's Delegation of Safety and Soundness Authority to FHFA

Under conflict preemption doctrine, "[a] state law, whether arising from statute or common law, is preempted if it creates an 'obstacle to the accomplishment and execution of the full purposes of Congress.'" *Chae v. SLM Corp.*, 593 F.3d 936, 943 (9th Cir. 2010) (quoting *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 373 (2000)).[46] In this case, Plaintiffs are not entitled to a presumption against preemption because "the State regulates in an area where there has been a history of significant federal presence." *Bank of America*, 309 F.3d at 558 (quoting *United States v. Locke*, 529 U.S. 89, 108 (2000)). Just like the regulation of national banks, to which the presumption does not apply, the safety and soundness of the Enterprises is an area with a history of significant federal presence, now delegated to FHFA.[47]

Here, Plaintiffs seek to enjoin conduct of the Enterprises that is exclusively within the power of FHFA to supervise and as to which FHFA has issued an express directive. A state lawsuit must be dismissed if the relief sought would frustrate federal law. *See, e.g., Martinez*, 598 F.3d at 557-58 (affirming dismissal of § 17200 claim because it was preempted by the National Bank Act, as interpreted by the OCC in regulations and an interpretive letter); *Montgomery v. Bank of America Corp.*, 515 F. Supp. 2d 1106, 1114 (C.D. Cal. 2007) (granting motion to dismiss § 17200 claim because "plaintiff's attempt to require defendants to set overdraft fees in a manner that conflicts with the [National Bank Act] and the regulations promulgated thereunder necessitates the conclusion that plaintiff's claims are barred by the doctrine of conflict preemption.").

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46 *See also Martinez v. Wells Fargo Home Mortgage*, 598 F.3d 549, 555 (9th Cir. 2010) ("State attempts to control the conduct of national banks are void if they conflict with federal law, frustrate the purposes of the National Bank Act, or impair the efficiency of national banks to discharge their duties." (quoting *Bank of America v. San Francisco*, 309 F.3d 551, 561 (9th Cir. 2002)).

47 *See* 12 U.S.C. §§ 1451 *et seq.* (Freddie Mac charter), 1716 *et seq.* (Fannie Mae charter).

By conferring broad authority on FHFA to exercise its discretion in supervising the Enterprises,[48] Congress directed that FHFA would be the arbiter of safety and soundness judgments governing the Enterprises, notwithstanding any conflicting state law.[49] In its July 6, 2010 Statement, FHFA explained its safety and soundness concerns relating to first-lien PACE programs and directed the Enterprises to undertake prudential action to protect their assets.[50] By seeking to enjoin the Enterprises from taking "adverse action" against PACE participants and from "interfering" with PACE programs, Plaintiffs effectively demand a court order requiring the Enterprises to purchase mortgages with PACE first liens and thereby to take on all of the associated risks — with no compensation. In other words, they ask this Court to hold that state law compels the Enterprises to ignore FHFA's concerns and directives. This outcome would undermine FHFA's Congressionally delegated authority and permit fifty states to regulate the Enterprises in accordance with their other goals and interests. The creation of state-imposed obligations regarding PACE first-lien mortgages in California would undermine the Enterprises' ability to operate under uniform and consistent standards. A lack of uniformity can itself be a threat to safety and soundness. As courts have observed in the national bank context:

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[48] *See* 12 U.S.C. § 4511(b)(2) ("The Director shall have general regulatory authority over each regulated entity and the Office of Finance, and shall exercise such general regulatory authority, including such duties and authorities set forth under section 4513 of this title, to ensure that the purposes of this Act, the authorizing statutes, and any other applicable law are carried out.").

[49] *See Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153-54 (1982) ("Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily."); *Franklin Savs. Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127, 1145-46 (10th Cir. 1991) ("Whether a financial institution is in an unsafe or unsound condition is largely a predictive judgment (i.e., what may happen if this practice continues), and reviewing courts should be particularly deferential when they are reviewing an agency's predictive judgments, especially those within the agency's field of discretion and expertise.").

[50] FHFA may exercise its authority through orders or guidelines rather than notice-and-comment regulations. HERA distinguishes between "regulations" and "guidelines," and makes clear that FHFA may fulfill its duties through either mechanism. *See, e.g.*, 12 U.S.C. § 4526 ("The Director shall issue any regulations, *guidelines*, or orders necessary to carry out the duties of the Director under this chapter or the authorizing statutes . . . . Any *regulations* issued by the Director under this section shall be issued after notice and opportunity for public comment . . . ." (emphases added)); § 4513b(a) ("The Director shall establish standards, by regulation or guideline . . . ."); § 4513b(b)(1)(A) (explaining consequences of failing to meet standards, which differ according to whether standards were established via regulation or guideline).

> When national banks are unable to operate under uniform, consistent, and predictable standards, their business suffers, which negatively affects their safety and soundness. The application of multiple, often unpredictable, different state or local restrictions and requirements prevents them from operating in the manner authorized under Federal law, is costly and burdensome, interferes with their ability to plan their business and manage their risks, and subjects them to uncertain liabilities and potential exposure.[51]

Thus, a finding of liability would "stand[] as an obstacle to the accomplishment and execution" of Congress's objective that FHFA be the supervisory financial regulator and Conservator of the Enterprises. *See* 12 U.S.C. § 4617(a)(7) (Conservator is not subject to the direction or supervision of any State in the exercise of its rights, powers, and privileges); § 4617(f) ("no court may take any action to restrain or affect the exercise of powers or functions of" FHFA as a Conservator). Accordingly, Plaintiffs' state law claims against the Enterprises must be dismissed as preempted by HERA.

B. Plaintiffs' State Law Claims Are Expressly Preempted Because They Would Subject the Conservator to the Direction and Supervision of a State

Not only are Plaintiffs' state-law claims pre-empted by virtue of the inherent conflict between (a) subjecting the Enterprises to state-law claims of the sort Plaintiffs assert, and (b) Congress's delegation to FHFA of exclusive authority to regulate the safety and soundness of the Enterprises, but Congress has also expressly preempted the assertion of such claims to the extent that they would affect the Conservator. In HERA, Congress decreed that "When acting as conservator . . . , the Agency shall not be subject to the direction or supervision of any other Agency of the United States or any State in the exercise of the rights, powers, and privileges of the Agency." 12 U.S.C. § 4617(a)(7). *See also Waterview Mgmt. Co. v. FDIC*, 105 F.3d 696, 700-01 (D.C. Cir. 1997) (describing operation of analogous banking-agency provision as "express preemption"). Here, with both Enterprises in conservatorship, Plaintiffs' state-law claims would interpose the

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[51] *Nat'l City Bank of Indiana v. Turnbaugh*, 463 F.3d 325, 332-33 (4th Cir. 2006) (quoting OCC, Bank Activities and Operations: Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004)). Further, PACE programs vary not only by counties within a state but as well among states; for example, California permits loans of up to 10% of a property's assessed value, while New Mexico sets a 40% maximum. N.M. Stat. Ann. § 4-55C-4(D)(2) (West 2010); Cal. Pub. Res. Code § 26123.

environmental policies of the State of California and its attorney general directly between the Conservator and its mission to "preserve and conserve [the Enterprises'] assets and property." Hence, Plaintiffs' state-law claims are expressly and entirely preempted by § 4617(a)(7).

V. PLAINTIFFS' STATE CLAIMS FAIL AS A MATTER OF LAW

A. California's Unfair Competition Law Claim Fails As A Matter of Law

California's UCL claim fails because the Complaint does not and cannot allege the necessary prerequisite that the Enterprises have "violated another law" or engaged in any "unfair business practice."[52]

First, no underlying violation of "another law" has occurred. California alleges that under "California law, liens resulting from PACE assessments, like other assessments, have priority over mortgages," and that the Enterprises "seek to change that priority for [their] own benefit *in violation of California law*," Cal. Am. Compl. ¶ 33 (emphasis added), but that is wrong. No facts are alleged to suggest that the Enterprises are ignoring or "changing" any lien priority. To the contrary, the facts alleged make clear that by considering and applying the terms of the USIs in response to the financial risks posed by PACE programs, the Enterprises (under the conservatorship of the FHFA) have acted in acknowledgement, not contravention, of the lien-priming feature of such programs. And nothing about the Enterprises' decisions in that regard violates any term of any California law. Neither the statewide PACE legislation nor any local government PACE program purports to (a) impose any duty on the Enterprises to purchase loans secured by a property subject to a senior PACE lien or (b) address the legal effect of a lien arising from a PACE program on compliance with the terms of the Enterprises' USIs. To the contrary, numerous PACE programs explicitly highlight for homeowners that they must carefully review their mortgage documents to confirm whether PACE financing may violate the loan documents' terms.[53] The decision not to purchase

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[52] *See* Cal. Bus. & Prof. Code § 17200; *Ingels v. Westwood One Broad. Servs., Inc.*, 129 Cal. App. 4th 1050, 1060 (2005) (a defendant does not violate the unlawful prong of the UCL without violating some other law); *see also Newson v. Countrywide Home Loans, Inc.*, --- F. Supp. 2d ----, 2010 WL 2034769, *8 (N.D. Cal. May 19, 2010) (same).

[53] Yucaipa Loan Application at 7, http://www.yucaipa.org/cityPrograms/EIP/PDF_Files/ Application.pdf (last visited Oct. 14, 2010); Sonoma County Loan Application at 9, http://www.drivecms.com/uploads/sonomacountyenergy.org/application.pdf (last visited Oct. 14,

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and hold loans that are subject to a PACE lien simply does not violate any law.[54] Indeed, FHFA has recognized the priority accorded PACE loans under California law, has made this clear in its public statements and has noted the safety and soundness threat posed by this alteration to the credit risk profile of the Enterprises.

Second, California law imposes no liability for either "unlawful" or "unfair" business practices against a defendant where the challenged conduct has been expressly sanctioned or approved by the governing authority, as occurred here. Thus, for example, the Ninth Circuit affirmed dismissal of a claim in *Webb v. Smart Document Solutions, LLC*, noting that a practice cannot violate the UCL if the responsible federal agency intended to permit the conduct.[55] FHFA's July 6, 2010 Statement affirms the May 5 Advisories and concludes that, because the first liens created by PACE financing create significant safety and soundness issues, prudential actions must be taken with respect to loans with senior PACE liens. *See* Cal. Compl. ¶ 4.

Third, California does not allege conduct by the Enterprises that is otherwise "unfair" under the UCL. In construing a claim under the unfairness prong of the UCL, "[c]ourts may not simply impose their own notions of the day as to what is fair or unfair." *Cel-Tech Comm'c'ns, Inc. v. Los Angeles Cellular Tel. Co.*, 20 Cal. 4th 163, 182, 186-87 (scope of unfair practices under the UCL in

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2010). *See* [Yucaipa Disclosure Regarding Assessment Financing; Sonoma Disclosure Regarding Assessment Financing; Sonoma Consent Agreement at 4].

[54] California also contends that the Enterprises violate the UCL when they "intentionally mischaracterize" California law relating to PACE "to support their unfounded contention that participating in PACE is contrary to" their own Security Instrument. *See*, *e.g.*, Cal. Am. Compl., ¶¶ 32, 34, 60. As discussed *supra*, (i) the fact that the PACE legislation uses the term "assessment" rather than "loan" to describe PACE financing does not make it so and (ii) the Enterprises' interpretation of PACE obligations is consistent with the USI, a document they created and enforce under the supervision of their Conservator.

[55] 499 F.3d 1078, 1087-88 (9th Cir. 2007) (affirming dismissal of UCL claim based on alleged overcharging for medical records because the complaint "failed to sufficiently allege a violation of HIPAA," and the governing federal agency had indicated the charge at issue was permissible). *See also, e.g.*, *Cal Med. Ass'n v. Aetna Healthcare of Cal.*, 94 Cal. App. 4th 151, 169 (2002) (if the Legislature has permitted certain conduct, the courts cannot override that by making it actionable under the UCL); *People v. Duz-Mor Diagnostic Lab., Inc.*, 68 Cal. App. 4th 654, 662, 672 (1998) (conduct not unfair under the UCL because it was "known to and accepted as appropriate by the federal and state regulatory agencies").

competitor actions to include only "conduct that threatens an incipient violation of an antitrust law, or violates the policy or spirit of one of those laws because its effects are comparable to or the same as a violation of the law, or otherwise significantly threatens or harms competition"). Though California courts have not yet provided definitive guidance as to which test now applies in non-competitor actions such as this one, this District has cautioned that if the "unfairness" under the UCL is not "tethered to some legislative policy," courts would be invited to "roam across the landscape of consumer transactions picking and choosing which they like and which they dislike." *Van Slyke v. Capital One Bank*, No. C 07-00671 WHA, 2007 WL 3343943, *11 (N.D. Cal. Nov. 7, 2007).

Here, the Advisories have not had "effects [that] are comparable to or the same as a violation of the law." *See Cel-Tech*, 20 Cal. 4th at 187. California's PACE legislation does not declare as its purpose that the Enterprises should be obligated to accept loans that are subject to senior PACE liens. Rather, California's purpose in implementing PACE was to encourage real property energy efficient improvements to "reduce energy and water use, provide clean power" and "promote clean energy and green jobs," Cal. Am. Compl. ¶ 1.[56]

California's claim also fails under the pre-*Cel-Tech* balancing test because the benefit of guarding against unsafe and unsound lending practices far outweighs the speculative harm to Californians in the form of reduced utility costs.[57] While California alleges that the Enterprises'

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[56] *See Wolfe v. State Farm Fire & Casualty Ins. Co.*, 46 Cal. App. 4th 554, 564 (noting that cessation of sales of insurance policies underlying UCL claim was not "unfair" in light of policy of insurance law to "ensure that insurance is fair, available, and affordable for all Californians," since the supposed evil sought to be remedied was unavailability due to high insurance costs, not unavailability due to a cessation of sales).

[57] This Court has previously adopted the pre-*Cel-Tech* balancing test, at least in the context of a consumer action. *See Morgan v. AT & T Wireless Svcs., Inc.*, 177 Cal. App. 4th 1235, 1254-55 (2009) (to allege an unfair practice under the UCL, a plaintiff must plead that "(1) the consumer injury is substantial, (2) the injury is not outweighed by any countervailing benefits to consumers or competition, and (3) the injury is one that consumers themselves could not reasonably have avoided.") (internal citations omitted). The Ninth Circuit has indicated that district courts have discretion in applying either the *Cel-Tech* test or the balancing test in non-competitor actions brought under the unfair prong of the UCL. *Lozano v. AT&T Wireless Servs., Inc.*, 504 F.3d 718, 736 (9th Cir. 2007) (district court did not err by using balancing test, and adopting either the *Cel-Tech* or the balancing standard "does not necessitate rejection of the other").

actions are "depriving California and its residents of the economic and environmental benefits" of PACE, it overlooks that *all taxpayers* are placed at risk by unsafe and unsound lending practices, based in part on risk transfer, absence of consumer underwriting protections, and an absence of energy retrofit standards. *See* Cal. Am. Compl. ¶ 60. Conclusory assertions of harm to California, without consideration of the countervailing interests in maintaining the health of the fragile U.S. mortgage market and the economy as a whole, are insufficient to state a claim for unfair business practices. *See Twombly*, 550 U.S. at 555 (plaintiff must plead more than labels and conclusions; a formulaic recitation of the elements of a cause of action will not withstand a motion to dismiss).

B. Sonoma's Intentional Interference with Prospective Economic Advantage Claim Fails as a Matter of Law

To establish its claim, Sonoma must plead and prove (1) an economic relationship between Sonoma and some third party, with the probability of future economic benefit to Sonoma; (2) the Enterprises' knowledge of the relationship between Sonoma and the third party; (3) intentional and independently wrongful acts on the part of the Enterprises designed to disrupt the relationship; (4) actual disruption of the relationship; and (5) economic harm to Sonoma proximately caused by the acts of the Enterprises.[58] Sonoma fails to allege either an existing economic relationship or that the Enterprises engaged in any independently wrongful conduct.

1. Sonoma Does Not Allege an Existing Economic Relationship, Much Less One with a Reasonable Probability of Future Economic Benefit

Sonoma alleges that "through its [PACE] program [it] has prospective economic relations with its residents that would result in economic benefit to [Sonoma] in the form of a healthy local economy, a reduction in greenhouse gas emissions, and greater water conservation." *See* Sonoma Compl. ¶ 65. This allegation does not satisfy the first element of a claim for interference with prospective economic advantage because even if there were such a relationship, the complaint does not adequately allege a probability of economic benefit to Sonoma.

[58] *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 944 (2008); *Reeves v. Hanlon*, 33 Cal. 4th 1140, 1152 n.6 (2004) (citation omitted); *Korea Supply Co. v. Lockheed Martin Corp.*, 29 Cal. 4th 1134, 1153 (2003) (citations omitted); *Della Penna v. Toyota Motor Sales U.S.A., Inc.*, 11 Cal. 4th 376, 393 (1995); *Buckaloo v. Johnson*, 14 Cal.3d 815, 827 (1975).

The tort of intentional interference with prospective economic advantage protects only the expectation that an *existing* economic relationship will produce the desired benefit, not "'the more speculative expectation that a potentially beneficial relationship will arise.'" *Korea Supply Co. v. Lockheed Martin Corp.*, 29 Cal. 4th at 1164 (internal quotations omitted). Sonoma's claim— to the extent based on a broad class of all possible, yet to be unidentified SCEIP applicants— fails as a matter of law.[59] *See* Sonoma Compl. ¶ 46 ("Defendants' actions create substantial uncertainty for SCEIP participants going forward and are likely to prevent future participation in the program by many county property owners."). Alleging this hypothetical class of homeowners does not satisfy Sonoma's burden to plead an existing economic relationship, much less one with the probability of future economic benefit. *See Westside Center Assocs. v. Safeway Stores 23, Inc.*, 42 Cal. App. 4th 507, 523 (1996). California courts have refused to extend liability for interference with a prospective advantage to a relationship that is purely conjectural.[60] In the face of this authority, Sonoma asserts simply that it has "prospective contractual relationships with its residents that would result in economic benefit to the County in the form of a healthy local economy, a reduction in greenhouse gas emissions, and greater water conservation." Sonoma Compl. ¶ 65; *see also* Sonoma Compl. ¶ 46. Such a speculative and conclusory allegation is inadequate to survive a motion to dismiss.

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[59] The particular subsets of current and former PACE participants described by Sonoma do not satisfy the "existing relationship" requirement either. *See* Sonoma Compl., ¶ 46 (since issuance of the Advisories, "several property owners . . . have been unable to refinance or transfer their property without paying off the amount financed in full . . . . Since FHFA's issuance of its July 6, 2010 Statement, 21 applicants have withdrawn their applications from [PACE]"). Any harm allegedly caused by a property owner's inability to refinance (if true) flows to the property owner, not the County.

[60] *See*, *e.g.*, *Youst v. Longo*, 43 Cal.3d 64, 71 n.6 (1987) (no claim for interference where the requisite relationship involved as yet unknown or nonexistent third persons); *Blank v. Kirwan*, 39 Cal.3d 311, 331 (1985) (plaintiff had no protectable expectancy of a relation with a class of potential poker club patrons "but at most a hope for an economic relationship and a desire for future benefit."); *Salma v. Capon*, 161 Cal. App. 4th 1275, 1291 (2008) (reversing in part and directing dismissal of interference claim because there was no allegation of an existing relationship with potential lenders or purchasers for property); *Westside Center*, 42 Cal. App. 4th at 528 ("interference with the market theory" insufficient as a matter of law to show company had an economic relationship with prospective buyer that was reasonably likely to produce future economic benefits).

2. Sonoma Fails to Allege an Independently Wrongful Act

Sonoma also fails to specific allege facts demonstrating that the Enterprises engaged in any independently wrongful act beyond the supposed interference. *Reeves v. Hanlon*, 33 Cal. 4th 1140, 1152 (2004); *see also Della Penna*, 11 Cal. 4th at 392-93. "[A]n act is independently wrongful if it is unlawful, that is, if it is proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard." *Korea Supply Co.*, 29 Cal. 4th at 1159; *see Reeves*, 33 Cal. 4th at 1152. "[A]n act must be wrongful by some legal measure, rather than merely a product of an improper, but lawful, purpose or motive." *Korea Supply Co.*, 29 Cal. 4th at 1159 n.11.

As discussed with respect to California's UCL claim *supra*, Sonoma has not (and cannot) allege that the Enterprises violated PACE or any other law. Indeed, "[w]ith rare exceptions, a business entity has no duty to prevent financial loss to others with whom it deals directly. A fortiori, it has no greater duty to prevent financial losses to third parties who may be affected by its operations." *Quelimane Co., Inc. v. Stewart Title Guaranty Co.*, 19 Cal. 4th 26, 59 (1998). *Id.* Accordingly, the California Supreme Court in a related context has held that, "[w]hile title insurers cannot discriminate among purchasers on the basis of the purchasers' race, ethnicity, religion, gender or other personal characteristics . . . they may opt to limit their potential liability by declining certain risks without violating any statutory or common-law obligation." *Id.* (title insurers had no duty to issue policies for properties that had been sold at tax sales) (citation omitted). *See also Wolfe*, 46 Cal. App. 4th 554 (with certain exceptions, nothing in the Insurance Code prohibits an insurer from deciding to halt or curtail its sale of new policies). That is so here as well. Nothing in PACE or in California law dictates how the Enterprises as directed by FHFA must conduct their business. Put another way, nothing prohibits the Enterprises from declining, based on reasonable financial judgment, to accept mortgages subject to PACE liens.

VI. PLAINTIFFS' DECLARATORY JUDGMENT CLAIMS THAT PACE PROGRAMS DO NOT OFFER LOANS FAIL TO STATE A CLAIM AND MUST BE DISMISSED.

The premise of Plaintiffs' non-NEPA claims is that Defendants have incorrectly characterized the funding available from PACE programs as "loans" rather than "assessments." California and Sonoma both move for a declaration that (1) PACE programs operate through assessments, not loans; (2) assessments receive lien priority under California law; (3) lien priority for assessments does not violate and does not run contrary to Fannie Mae and Freddie Mac's USIs; and (4) the Enterprises' May 5, 2010 Advisories and FHFA's July 6, 2010 Statement mischaracterize California law and the operation of the Enterprises' own USIs.[61]

Plaintiffs' claims fail for a number of reasons. *First*, Plaintiffs' claims are an attempt to elevate semantics into justiciable claims by turning differences of opinion over the economic effect of the PACE program on the Enterprises into a declaratory judgment action over the meaning of "assessments" versus "loans" in a California statute. The parties agree that PACE funds are repaid using the local tax assessment system and that PACE obligations have first-lien priority — exactly what the California legislation provides. As FHFA's Statement makes clear, FHFA's concerns about first-lien PACE programs have to do with the risks they create for the Enterprises and, consequently, the economic effects they have on mortgages owned or guaranteed by the Enterprises — not the label that California or any state has placed on the mechanism by which PACE funds are repaid. Regardless of label, PACE obligations make the Enterprises' mortgage-related assets riskier and less valuable. Defendants have determined that the safer and sounder course is for the Enterprises not to buy mortgages encumbered with PACE obligations. These determinations are not actionable because Plaintiffs do not have a right to require that the Enterprises do business with them, or (as to the governmental plaintiffs) their residents or (as to Sierra Club) members. *See Groos Nat'l Bank*, 573 F.2d at 897 (plaintiffs "cannot claim a constitutionally protected right to do business with a particular bank").[62]

Second, California has repeatedly and authoritatively stated that PACE programs offer "loans." Specifically, the statute under which the state provides assistance to local governments implementing PACE programs mandates that the state must consider whether:

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[61] Cal. Am. Compl. ¶ 57; Sonoma Compl. ¶ 62. In addition, Sonoma alleges that FHFA's description of a PACE obligation as a "loan" is "arbitrary, capricious, an abuse of discretion, and otherwise not in accordance with law," in violation of the APA. Sonoma Compl. ¶ 53 (citing 5 U.S.C. § 706(2)(A)).

[62] Neither the California PACE legislation nor any local government PACE program purports to (a) impose any duty on the Enterprises to purchase loans secured by property subject to senior PACE obligations, or (b) addresses the legal effect of such programs under the Security Instruments.

- *"Loan recipients* are legal owners of underlying property;"
- "*Loan recipients* are current on mortgage and property tax payments;"
- "*Loan recipients* are not in default or in bankruptcy proceedings;" and
- "*Loans* are for less than 10 percent of the value of the property."

Cal. Pub. Res. Code § 26123(a)(1)-(a)(4) (West 2010) (emphases added). A related statute mandates that, in order to qualify for assistance, a PACE program must reflect a "[m]inimum legal *loan* structure and credit underwriting criteria as determined by the authority are met." Cal. Pub. Res. Code § 26121(b) (West 2010) (emphasis added). Similarly, the sponsor of California's PACE legislation stated that :

- PACE programs "provide low interest *loans* to property owners with long-term repayments added to their annual property tax[] bills;"
- "The *loans* for the upfront costs are repaid through a *voluntary* fee on the borrower's property tax bill"; and,
- "Individual property owners who take the *loan* then contract directly with qualified private solar installers or contractors for energy efficiency and solar projects on their buildings."

Legislative History & Intent, Government Code § 53340(c), vol. 4, at 280, 281 (emphasis added) (Border Decl. Ex. 24). Indeed, the California Attorney General has described PACE financing as a loan. In a letter to the then-Director of FHFA, James B. Lockhart, dated October 12, 2009, California Deputy Attorney General Janill L. Richards asserted that:

- "[FHFA] expressed concern about energy efficiency and renewable energy *loan* tax assessment programs, also referred to as Property Assessed Clean Energy (PACE) programs";
- "property owners pay back the *loans* through special assessments or taxes that appear on their property tax bills"; and,
- "The obligation to repay the *loan* runs with the land and is assumed by the new property owner on sale."

Letter from Janill L. Richards, Deputy Attorney General, California, to James B. Lockhart, Director, FHFA (Oct. 12, 2009) (emphases added), *available at* http://ag.ca.gov/globalwarming/pdf/

FHFA_Letter_re_PACE_programs.pdf (Border Decl. Ex. 25). Sonoma County even provides a form of "truth in *lending*" disclosure to PACE borrowers.[63]

Third, Plaintiffs' assertion that PACE obligations are not loans is wrong as a matter of law. PACE transactions have all the indicia of home improvement loans, notwithstanding Plaintiffs' efforts to characterize them as tax assessments. Just like other loans, PACE obligations must be repaid pursuant to a contract, with interest, over a set period of time. The "settled meaning under common law" of a loan is a transaction "where, pursuant to a contractual relationship, one party transfers a defined quantity of money, goods, and services to another and the receiving party agrees to pay for the sum or items transferred at a later date." *In re Hawkins*, 317 B.R. 104, 109 (9th Cir. B.A.P. 2004) (citing *In re Renshaw*, 222 F.3d 82, 88 (2d Cir. 2000)). Just like other loans, PACE obligations are voluntarily accepted. Tax assessments are just the opposite — compulsorily imposed within a defined geographic area. *See, e.g.*, *City of Marina v. Bd. of Trustees of the California State University*, 138 P.3d 692, 703 (Cal. 2006) ("An assessment connotes, at the very least, a compulsory charge imposed by the government on real property. . . . [The payment in this case] can properly be described neither as compulsory nor, for that reason, as an assessment."). And just like other loans, PACE financing funds property-specific improvements that inure to the benefit of either the individual homeowner or the public at large, but not a particular taxing district.[64] By contrast, purportedly comparable assessments — such as for sewer or water hook-up — fund collective, governmentally controlled and maintained improvements for the general use of

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[63] *See* Sonoma County Energy Independence Program, Truth in Lending Disclosure Statement, *available at* http://www.drivecms.com/uploads/sonomacountyenergy.org/1678785227truth_in_lending_disclosure_agreement.pdf (Border Decl. Ex. 26).

[64] Black's Law Dictionary in defining "assessment" notes that "'[t]here is a distinction between public improvements, which benefit the entire community, and local improvements, which benefit particular real estate or limited areas of land. The latter improvements are usually financed by means of special, or local, assessments. These assessments are, in a certain sense, taxes. But an assessment differs from a general tax in that an assessment is levied only on property in the immediate vicinity of some local municipal improvement and is valid only where the property assessed receives some special benefit differing from the benefit that the general public enjoys.'" BLACK'S LAW DICTIONARY 125 (8th ed. 2004) (quoting Robert Kratovil, Real Estate Law 465 (6th ed. 1974)).

the municipality. *Silicon Valley Taxpayers Ass'n, Inc. v. Santa Clara County Open Space Auth.*, 187 P.3d 37, 51 (explaining that "assessments may not be levied for purposes of conferring purely general benefits").[65]

Fourth, the Enterprises' interpretation of PACE obligations is also consistent with the USIs. California's PACE legislation specifically provides that PACE financing constitutes a first priority lien against the affected real property, and that PACE liens secure the full amount of the assessment. *See* Streets and Highways Code § 5898.30. Pursuant to Section 4 of the USI Deed of Trust, any lien "which has priority over [the] Security Instrument" must be discharged. *See* USI, § 4.[66] Regardless of whether PACE financing is characterized as a "loan" instead of "assessment," and regardless of the "historical treatment" of "other assessments," the unique risk-shifting characteristics of PACE support the Enterprises' determinations that PACE liens are disallowed under the Security Instrument.

Finally, Plaintiffs are incorrect in asserting that the Defendants' Advisories and Statement "mischaracterize" California law. Nothing in the Advisories or the Statement characterizes California law or how the California Code labels its PACE loans in order to provide first-lien priority. In fact, the Advisories explain that a first-lien PACE program in *any* state raises safety and soundness concerns and is prohibited by the USI.

Therefore, Plaintiffs' declaratory judgment and APA claims based on the premise that Defendants' use of the term "loan" is a mischaracterization fail as a matter of law. Defendants' Advisories and Statement acknowledge that the PACE programs operate through assessments. But in common parlance, even Plaintiffs state that the PACE programs are providing loans to

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[65] The California Legislature's declaration that the PACE program will serve a "public purpose" neither identifies any benefit that would primarily affect the municipality nor, to the extent such assertion might be implied, provides any substantiation. *See* Cal. Am. Compl. ¶ 43 (quoting Cal. Streets & Highways Code § 5898.14). Rather, the legislature identifies global benefits. Cal. Streets & Highways Code §§ 5898.14(a)(1) ("Energy conservation efforts . . . are necessary to address the issue of global climate change.").

[66] That the full amount of the lien is not accelerated upon default under PACE does not change the facts that PACE liens still take priority under California law and that under the express terms of the Security Instrument, they must be discharged.

homeowners for energy retrofits. In addition, Plaintiffs' requests for a declaration that Defendants "mischaracterize California law" should be denied because the Advisories and the Statement did not purport to characterize, adopt, or reject California's chosen terminology of "assessment." *See* Cal. Am Compl. ¶ 57(d); Sonoma Compl. ¶ 62(d). Similarly, given the common understanding of the PACE programs as offering loans, Sonoma's claim that FHFA's *description* is "arbitrary, capricious, an abuse of discretion, and otherwise not in accordance with law" also fails.[67]

VII. PLAINTIFFS' APA CLAIMS FAIL AS A MATTER OF LAW

A. Plaintiffs Lack Prudential Standing for Their APA Claims

To meet the statutory requirements for prudential standing under the APA, a plaintiff must establish that "its injury falls within the 'zone of interests' of the statutory provision the plaintiff claims was violated." *Nuclear Information and Resource Service v. Nuclear Regulatory Comm'n*, 457 F.3d 941, 950 (9th Cir. 2006) (quoting *Churchill County v. Babbitt,* 150 F.3d 1072, 1078 (9th Cir. 1998)). In determining whether a plaintiff satisfies the "zone of interests" requirement, the court must consider the "substantive statute whose duties the plaintiff [is] seeking to enforce." *See Cetacean Community v. Bush*, 386 F.3d 1169, 1177 (9th Cir. 2004).[68]

Here, Plaintiffs allege that FHFA's safety and soundness determination with respect to first-lien PACE programs was arbitrary and capricious, *i.e.*, that FHFA purportedly misapplied HERA. *See, e.g.*, Cal. Am. Compl. ¶ 63; Sonoma Compl. ¶ 53; Sierra Club Compl. ¶ 50. But HERA was not enacted to protect Plaintiffs' environmental or economic interests. The purpose of HERA was to "ensure that the government sponsored Enterprises supporting the mortgage markets operate in a safe and sound manner and *fulfill the missions assigned under their charters*, both through

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[67] "The scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency." *Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). This standard is "highly deferential, presuming the agency action to be valid and affirming the agency action if a reasonable basis exists for its decision." *Indep. Acceptance Co. v. California*, 204 F.3d 1247, 1251 (9th Cir. 2000).

[68] *See also Bennett v. Spear*, 520 U.S. 154, 175 (1997) ("In determining whether the petitioners have standing under the zone-of-interests test to bring their [APA] claims, we look . . . to the substantive provisions of the [statute], the alleged violations of which serve as the gravamen of the complaint.").

establishment of a strong, independent regulator and through enhancements to their mission responsibilities."[69] The Fannie Mae and Freddie Mac charters — congressionally enacted federal statutes — establish missions relating to housing finance, not environmentalism. *See* 12 U.S.C. § 1716 *et seq*. (Fannie Mae charter); 12 U.S.C. § 1451 *et seq*. (Freddie Mac charter).

Sierra Club gamely but erroneously attempts to come within the zone of interests of HERA by pointing to the provision that states that the Director must ensure that "each regulated entity and the manner in which such regulated entity is operated are consistent with the public interest." Sierra Club Compl. ¶ 50 (citing 12 U.S.C. § 4513(a)(1)(b)(iv)). However, the "public interest" referred to in HERA does not encompass every conceivable interest or public good such as environmental impact or economic effects on Sierra Club members. Rather, Congress defined the relevant public interest in the missions of the two Enterprises as set forth in their charters. As defined in their charters, the mission of the Enterprises is to provide stability and ongoing assistance to the secondary market for residential mortgages and to promote access to mortgage credit throughout the nation (including underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing. 12 U.S.C. § 1716; 12 U.S.C. § 1451 note. The relevant "public interest" is met by ensuring that the Enterprises operate in a safe and sound manner in fulfilling that mission.

B. <u>FHFA's July 6 Statement Falls Within the Interpretative Rule Exception to the Notice-and-Comment Requirements of the APA.</u>

Plaintiffs also allege that FHFA violated the APA by failing to provide notice and an opportunity for comment before issuing the July 6 Statement.[70] Contrary to Plaintiffs' contentions, the APA does not require federal agencies to follow notice and comment procedures for all pronouncements of the agency's views. Specifically exempt from the notice and comment

[69] H.R. Rep. No. 110-142, at 122 (2007) (House Report on the Federal Housing Finance Reform Act of 2007) (emphasis added).

[70] Count 4 of California Am. Compl. ¶¶ 64-67; Count 2 of Sonoma Compl. ¶¶ 56-60; Count 2 of Sierra Club Compl. ¶¶ 52-57. FHFA did spend over one year discussing the issues with stakeholders before issuing the Statement.

requirement are "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice." 5 U.S.C. § 553(b)(3)(A).

The APA distinguishes between interpretative and legislative rules. Legislative rules — those subject to notice-and-comment rulemaking — "create rights, impose obligations, or effect a change in existing law pursuant to authority delegated by Congress." *Hemp Indus. Ass'n v. DEA*, 333 F.3d 1082, 1087 (9th Cir. 2003); *see also National Latino Media Coalition v. F.C.C.*, 816 F.2d 785, 787-88 (D.C. Cir. 1987) (a substantive rule "is intended to have and does have the force of law"). An interpretative rule, by contrast, "merely explain[s], but do[es] not add to, the substantive law that already exists in the form of a statute or legislative rule." *Hemp Indus.*, 333 F.3d at 1087. The mere fact that an interpretative rule has a substantial impact does not, without more, mean that it is subject to notice and comment. *Alcaraz v. Block*, 746 F.2d 593, 614 (9th Cir. 1984). The "'interpretative rule' exception was designed to provide agencies with a degree of flexibility . . . and to allow administrative officers the freedom to explain what they think a regulation or statute means without undertaking cumbersome proceedings." *Sentara-Hampton Gen. Hosp. v. Sullivan,* 980 F.2d 749, 759 (D.C. Cir. 1992). To distinguish interpretative rules from legislative rules, the Ninth Circuit applies a three-part test: (1) whether, in the absence of the rule, there would not be an adequate legislative basis for an enforcement action; (2) whether the agency explicitly invoked its general legislative authority; or (3) whether the rule effectively amends a prior legislative rule. *Hemp Indus.*, 333 F.3d at 1088. FHFA's issuance of the July 6 Statement fails to satisfy each part of the test; FHFA properly exercised its statutory authority, as other financial regulators do as a matter of course, by providing guidance outside the notice-and-comment process to address a matter of safety and soundness concern.

First, because there is an adequate legislative basis for FHFA to act regarding PACE programs even absent the Statement, the Statement cannot be a legislative rule. "If there is no legislative basis for enforcement action on third parties without the rule, then the rule necessarily creates new rights and imposes new obligations. This makes it [a] legislative" rule. *Erringer v. Thompson* , 371 F.3d 625, 630-31 (9th Cir. 2004) (citations omitted). In *Erringer*, the Ninth Circuit held that rules issued by the Secretary of Health and Human Services giving criteria to Medicare contractors for the creation of Local Coverage Determinations ("LCDs") were interpretative and not legislative rules. The court concluded that because the Medicare Act required contractors to deny claims for services that were not "reasonable and necessary," even in the absence of the LCDs at issue, there was an adequate legislative basis for the agency to bring an enforcement action. *Erringer*, 625 F.3d at 631 (quoting 42 U.S.C. § 1395y(a)(1)(A)). Accordingly, the court held the LCD rules to be interpretative, explaining that they "simply interpret the reasonable and necessary standard contained in the" Medicare Act and were "not a case of pure delegation of authority to the agency to determine a standard."[71] *Erringer*, 625 F.3d at 631.

Here, the Statement does not create new rights; it directs the Enterprises to assert their pre-existing rights so as to fulfill their pre-existing obligation to operate safety and soundly. Providing supervisory guidance on safety and soundness issues is an exercise of FHFA's manifest regulatory authority under HERA, which the Statement did not purport to alter or expand. *See* 12 U.S.C. § 4513(a)(1)(A) & (a)(1)(B)(i). Accordingly, this is not "a case of pure delegation of authority to the agency to determine a standard." *Erringer,* 371 F.3d at 631.

Second, the Statement does not invoke FHFA's legislative authority. The second prong of the Ninth Circuit's analysis requires the court "to look at the agency's own treatment of the rule." *Erringer*, 371 F.3d at 631. For example, "if Congress had specifically delegated legislative power to the agency and the agency made it clear that it intended to use that power in promulgating the rule in question, that would militate toward the rule having the force of law and hence being legislative." *Erringer*, 371 F.3d at 631. Nothing in the Statement invokes the rule-making — that is, legislative — authority conferred by HERA on FHFA. The Statement provides FHFA's interpretation of the statutorily imposed safety and soundness parameters under which the Enterprises must operate and FHFA must regulate.

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[71] The court in *Erringer* contrasted the LCD provisions with the rules at issue in *American Min. Congress v. Mine Safety & Health Admin.*, 995 F.2d 1106 (D.C. Cir. 1993). *Erringer*, 625 F.3d at 630. In *American Min.*, proxy rules promulgated by the SEC were challenged for failure to follow notice and comment rulemaking. The Securities Exchange Act provision governing proxies proscribed no specific conduct, only prohibiting proxies "in contravention of such rules and regulations as the Commission may prescribe." *Id.* (citing *American Min.,* 995 F.3d at 1109 (quoting 15 U.S.C. § 78n(b)). Thus, the proxy rules were found to be legislative because in their absence, the Securities Exchange Act provision "provide[d] no legislative basis for the enforcement of anything." 995 F.3d at 1109.

Third, the Statement also does not effectively amend a prior legislative rule. Plaintiffs make no allegation that the Statement amends a prior FHFA regulation, and nothing suggests that the Statement is inconsistent with another rule having the force of law. Accordingly, under the third prong of the Ninth Circuit test, the FHFA Statement is not a legislative rule.

VIII. PLAINTIFFS' NEPA CLAIMS MUST BE DISMISSED

A. The Absence of APA Jurisdiction Requires Dismissal of the NEPA Claims

All three Plaintiffs allege that FHFA violated NEPA, 42 U.S.C. § 4321 *et seq.*, by failing to prepare an Environmental Impact Statement ("EIS") before issuing the Statement.[72.] NEPA does not contain a private right of action, and therefore Plaintiffs' NEPA claims are reviewable only if jurisdiction exists under the APA. *Ka Makani 'O Kohala Ohana Inc. v. Water Supply*, 295 F.3d 955, 959 (9th Cir. 2002). As described *supra*, however, this Court does not have jurisdiction under the APA to review FHFA's actions with respect to PACE programs. *See supra* and 5 U.S.C. § 702 (no APA jurisdiction if another statute withdraws jurisdiction). Consequently, Plaintiffs' NEPA claims must also be dismissed under Rule 12(b)(1). *See Nat'l Coalition to Save Our Mall v. Norton*, 161 F. Supp. 2d 14, 19-20 (D.D.C. 2001) ("Given that the court does not have jurisdiction under the APA to entertain plaintiffs' claims, the court also does not have jurisdiction under NEPA to review plaintiffs' specific NEPA arguments."). Although the Court need look no further than the lack of APA jurisdiction, several other grounds support dismissal of Plaintiffs' NEPA claims.

B. FHFA's July 6 Statement Was Not a Major Federal Action for Purposes of NEPA

Only a "major federal action" can trigger NEPA's procedural requirements. 42 U.S.C. § 4332(2)(c). The dual requirements that the action be "major" and "federal" operate independently. *Northcoast Environmental Center v. Glickman*, 136 F.3d 660, 668 (9th Cir. 1998).

The requirement of "federal" action means that a NEPA plaintiff's alleged environmental injury must be "fairly traceable to the challenged [federal action] and not the result of the independent action of some third party . . . ." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561

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[72] Cal. Am. Compl. ¶¶ 49-55, 68-75; Sonoma Compl. ¶¶ 68-74; Sierra Club Compl. ¶¶ 58-61.

(1992) (internal citations and quotations omitted). Here, Plaintiffs cannot "fairly trac[e]" any purported environmental consequence to any action of FHFA. The only apparently federal action alleged in Plaintiffs' complaint is FHFA's issuance of the Statement.[73] But the Statement addresses *purely financial* matters; it has *no* direct impact on the environment. *See generally Lujan*, 504 U.S. at 561. Indeed, FHFA has indicated that it would favorably consider other programs to support energy retrofits that did not create the risks the PACE programs pose to homeowners, lenders, and mortgage investors.[74] To the extent Plaintiffs assert that the Statement's issuance could cause significant *indirect* environmental impact, their assertions are impermissibly "speculative or hypothetical" and therefore not plausible. *See Northcoast*, 136 F.3d at 668.

FHFA has no regulatory authority over the terms of home-improvement financing. Hence, the Statement could not and does not require that municipalities shut down their PACE programs (indeed, Sonoma has not done so)[75] or that PACE programs take (or not take) any particular form. Moreover, although FHFA can and does supervise the criteria mortgage loans must meet in order to be eligible for purchase by the Enterprises, there is an active secondary market for mortgage loans that do not meet the Enterprises' portfolio criteria. Defendants' willingness to purchase mortgage with any particular set of attributes and risks simply is not a prerequisite for market acceptance. Rather, third parties (such a mortgage lenders seeking to market their loans) exercise their own independent judgment in determining whether, given the Enterprises' lack of appetite for the risks

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[73] For purposes of NEPA, it is irrelevant that the Enterprises are in conservatorship. Being in conservatorship does not make the Enterprises federal agencies. *See In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 795 (E.D. Va. 2009). As the Supreme Court has stated in the analogous national banking context, "the FDIC [receiver] is not the United States." *O'Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 85 (1994). *See also United States v. Ely*, 142 F.3d 1113, 1121 (9th Cir. 1998) ("This earnest argument does not succeed because the FDIC did not sue the defendants as the United States. The FDIC was acting only as the receiver of a failed institution. The United States was not a party.") (internal quotations omitted).

[74] FHFA Statement on Certain Energy Retrofit Loan Programs (July 6, 2010), *available at* http://www.fhfa.gov/webfiles/15884/PACESTMT7610.pdf (attached as exhibit C to the California amended complaint) ("FHFA remains committed to working with federal, state, and local government agencies to develop and implement energy retrofit lending programs with appropriate underwriting guidelines and consumer protection standards. FHFA will also continue to encourage the establishment of energy efficiency standards to support such programs.")

[75] *See* Sonoma Compl ¶ 46 (indicating that Sonoma continues to operate its PACE program).

inherent in mortgages subject to PACE obligations, to do business with the Enterprises, and it is the broader secondary market for residential mortgages that will ultimately determine whether first-lien PACE programs are or are not viable in light of the risks they pose to holders of mortgage-related assets. (Indeed, if Plaintiffs are correct that the risks first-lien PACE programs pose to mortgage assets are "miniscule," then other secondary market participants will profit from investing in PACE-encumbered mortgages and ultimately take market share from the Enterprises.) Plaintiffs' alleged injury is not "fairly traceable" to FHFA's issuance of the Statement or any other "federal" action.

The separate requirement of "major" federal action is lacking here as well. *Nat'l Wildlife Federation v. Espy*, 45 F.3d 1337 (9th Cir. 1995), is instructive. There, the Farmers Home Administration ("FmHA") took title to a wetlands parcel, which it then transferred to a private party. *Id*. Plaintiffs claimed that NEPA required FmHA to prepare an EIS concerning the transfer, because the transferee permitted an environmentally harmful activity — grazing — on the parcel. The court, however, held that the transfer did not constitute "major federal action," because the grazing predated FmHA's acquisition of the parcel. *Id*. at 1343-44. As the court explained, "[d]iscretionary agency action that *does not alter the status quo* does not require an EIS." *Id*. at 1344 (emphasis added). The Court reasoned that "[t]he complaint alleges FmHA's [transfer] of the [parcel] will result in but one injury — continued degradation of the wetlands from grazing. [But] [i]t is not alleged that the [transfer] will add to that harm." *Id*. Hence, under *Nat'l Wildlife Federation*, even federal action that permits "continued degradation" of the environment is not "major federal action" for NEPA purposes unless it "alter[s] the status quo" in such a way as to "add to that harm." *Id*. Here, there can be no plausible allegation that FHFA has altered the status quo or added to any alleged environmental harm. Rather, the most that can be said is that FHFA's action *did not facilitate environmental change* that Plaintiffs seek to foster (the reduction in emissions that Plaintiffs claim would result from the energy-efficiency projects Plaintiffs claim PACE programs would spawn), not that FHFA *altered the environmental status quo*. But under *Nat'l Wildlife Federation*, even if the "status quo" involves "continued degradation" of the environment — a circumstance FHFA would abhor and that FHFA actively seeks (within the bounds of its authority) to prevent — "[d]iscretionary agency action that does not alter the status quo does not require an EIS." *Id*.

Applying both requirements, a federal agency's mere affirmation or confirmation of non-federal action, which merely preserves the status quo, is not major federal action. *See Burbank v. Goldschmidt*, 623 F.2d 115, 116-17 (9th Cir. 1980) (holding that an EIS is not required when "[t]he only aim here is the preservation of the status quo."). But that is exactly what Plaintiffs' contend here. Plaintiffs themselves assert that their alleged injury flows primarily from the Enterprises' Advisories.[76] Plaintiffs have not alleged, nor could they credibly allege, that the Statement was necessary to effectuate the Advisories.[77] As Plaintiffs acknowledge, instead, the Statement provides that the Advisories "remain in effect"; that is, the Statement "affirms" or "confirms" the Advisories' views on the safety and soundness risks posed by first-lien PACE programs. Cal. Am. Compl. ¶ 4; Sonoma Compl. ¶ 45; *see also* Sierra Club Compl. ¶¶ 12, 14 (FHFA "condones and encourages" Enterprises' actions). There is no "major federal action" here, and Plaintiffs' NEPA claims therefore fail.

C. FHFA Is Statutorily Precluded from Altering Its Safety and Soundness Determinations Based on Environmental Considerations

Consistent with the maxim that "the law does not require a useless act, particularly where, as here, it would only enhance the actor's loss,"[78] a "rule of reason . . . inherent in NEPA and its implementing regulations" exempts an agency's decision-making process from NEPA's procedural requirements in circumstances where the agency cannot base its decision on environmental considerations. *Dep't of Transp. v. Pub. Citizen*, 541 U.S. 752, 786 (where preparation of an EIS would serve no purpose, "no rule of reason worthy of that title would require an agency to prepare an EIS."). Accordingly, where an agency has no discretion to take environmental considerations into account when taking particular actions, NEPA does not require the agency to prepare an EIS.

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[76] Cal. Am. Compl. ¶ 3; Sonoma Compl. ¶ 46; Sierra Club Compl. ¶ 10.

[77] The May 5 Freddie Mac Advisory states that "[t]he purpose of this Industry Letter is to remind Seller/Servicers that an energy-related lien may not be senior to any Mortgage delivered to Freddie Mac." The May 5 Fannie Mae Advisory states "[t]he terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit loans that have senior lien status to a mortgage."

[78] *U.S. v. Buffalo Coal Min. Co.*, 343 F.2d 561, 565 (9th Cir. 1965). *Buffalo Coal* is neither a NEPA case nor an administrative law decision; we cite it as a concise expression of the maxim.

For example, in *Grand Council of the Crees v. FERC*, plaintiffs sued the Federal Energy Regulatory Commission for, *inter alia*, failing to conduct an environmental assessment under NEPA when determining "just and reasonable rates" for the sale of electric power by a new entrant. 198 F.3d 950, 953-54, 956 (D.C. Cir. 2000). The court agreed with plaintiffs that the setting of rates had environmental consequences, but held that when fulfilling its statutory mandate to set "just and reasonable" rates, FERC "properly d[id] not consider environmental concerns" and, therefore, the court upheld that agency's decision not to conduct an EIS or an environmental assessment. *Id*. at 957, 959.[79]

Here, the compromise of safety and soundness that would necessarily result if fiscal imperatives were to be balanced against purported environmental considerations would be directly contrary to HERA.[80] FHFA was created amid a national housing crisis following the Congressional determination that "the continued ability of [Fannie Mae and Freddie Mac] to accomplish their public mission is important to providing housing in the United States and the health of the nation's economy" and therefore "more effective regulation is needed to reduce the risk of the failure of the Enterprises." 12 U.S.C. § 4501(2).[81] The Congressional mandate of FHFA is "to ensure that [the Enterprises] operate[] in a safe and sound manner . . . ." 12 U.S.C. § 4513(a)(1)(B)(i). All other considerations, including attenuated environmental impact, are subordinate, for if the Enterprises are to "effectively [] perform their public purposes, they must be financially sound and liquid." 12

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[79] *See also City of New York v. Minetta*¸ 262 F.3d 169, 177-178 (2d Cir. 2001) ("[W]here the agency's decision does not 'entail the exercise of . . . discretion,' an EIS is not required."); *Sugarloaf Citizens Ass'n v. F.E.R.C.*, 959 F.2d 508, 513 (D.C. Cir. 1992); ("[W]hen an agency has no discretion to consider environmental values implementing a statutory requirement, its actions are ministerial and not subject to NEPA.").

[80] The Enterprises abide by applicable state and federal environmental laws, and continue to support energy-efficiency lending with the appropriate safeguards. Further, the Enterprises require their seller-servicers to comply with all federal and state laws or they may put back loans made in violation of such laws.

[81] The Enterprises' financial infirmity at the time of HERA's passage imperiled not only their public missions but, as then-Secretary of the Treasury Hank Paulson described when they were put into conservatorship, threatened "great turmoil in our financial markets here at home and around the globe." *See* Statement by Secretary Henry M. Paulson Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008), *available at* http://www.ustreas.gov/press/releases/hp1129.htm (Border Decl. Ex. 27).

C.F.R. Pt. 1720, App. B (2002).[82] As the D.C. Circuit has held in the analogous national banking context, a federal regulator exceeds its statutory powers whenever "it undermines the safety and soundness of the [regulated entity]." *Indep. Cmty. Bankers Ass'n of S. Dak. v. Bd. of Governors of the Fed. Reserve Sys.*, 820 F.2d 428, 440 (D.C. Cir. 1987).

In short, while HERA's broad grant of discretion to FHFA "gives deference to the [Agency's] judgment, knowledge, and expertise," that discretion is limited to actions taken in the interests of the Enterprises fiscal health and stability. *See Franklin Sav. Ass'n*, 934 F.2d at 1137 (discussing the powers granted under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, upon which HERA is directly based).[83] Hence, FHFA (as regulator or Conservator) cannot, consistent with its statutory mandate, elevate the purported environmental benefits Plaintiffs claim that PACE programs might achieve over the financial risk Plaintiffs admit that PACE programs would inflict upon the Enterprises mortgage portfolios.[84] As Congress has not authorized FHFA to consider environmental effects in supervising the Enterprises' asset portfolio management in light of the financial risks posed by PACE programs, NEPA's procedural requirements did not attach and Plaintiffs' NEPA claims must be dismissed.

CONCLUSION

For the reasons presented, FHFA respectfully requests that this Court dismiss with prejudice each of the Plaintiffs' complaints against each of the Defendants.

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[82] Congressional intent is also reflected by the provisions that preclude judicial review of the agency's compliance with ancillary obligations, such as environmental review under NEPA. *See supra,* discussions of § 4635(b), § 4617(f).

[83] Plaintiff Sierra Club's citation to 12 U.S.C. § 4513(a)(1)(b)(iv), which states that FHFA shall ensure that "the activities of each regulated entity . . . are consistent with the public interest," does nothing to alter the analysis here. Sierra Club Compl. ¶ 30. Any action that undermines the safety and soundness of the Enterprises and increases their risk of failure is, by definition, contrary to the public interest and harmful to the Enterprises' public interest missions. *See* 12 U.S.C. § 4501(1)-(7). The "public interest" the Director must consider cannot be read to include every conceivable public good. *See supra.*

[84] *See supra* fn. 37.

Dated: October, 14, 2010

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

OAKLAND DIVISION

COUNTY OF SONOMA, Plaintiff, vs. FEDERAL HOUSING FINANCE AGENCY; EDWARD DeMARCO, in his capacity as Acting Director of FEDERAL HOUSING FINANCE AGENCY; FEDERAL HOME LOAN MORTGAGE CORPORATION; CHARLES E. HALDEMAN, JR. in his capacity as Chief Executive Officer of FEDERAL HOME LOAN MORTGAGE CORPORATION; FEDERAL NATIONAL MORTGAGE ASSOCIATION; and MICHAEL J. WILLIAMS, in his capacity as Chief Executive Officer of FEDERAL NATIONAL MORTGAGE ASSOCIATION, Defendants.	Case No.: 4:10-CV-3270 **DEFENDANTS' MOTION TO DISMISS THE PALM DESERT AND PLACER CLAIMS, WITH SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES** HEARING DATE: December 2, 2010 TIME: 2:00 p.m. COURTROOM: Courtroom #2 JUDGE: The Honorable Claudia Wilken

CITY OF PALM DESERT, a municipal corporation, Plaintiff, vs. FEDERAL HOUSING FINANCE AGENCY; FEDERAL NATIONAL MORTGAGE ASSOCIATION; and FEDERAL HOME LOAN MORTGAGE CORPORATION, Defendants.	)	Case No. 4:10-CV-4482

TABLE OF CONTENTS

TABLE OF AUTHORITIES

STATUTES

OTHER AUTHORITIES

MOTION TO DISMISS AND NOTICE OF HEARING

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on December 2, 2010 at 2:00 p.m., or such other date and time as the Court may direct, in Courtroom 2 of the U.S. District Court, 1301 Clay Street, Oakland, CA 94612, Defendants will appear to argue this motion to dismiss all claims asserted in *City of Palm Desert v. Federal Housing Finance Agency* (No. 4:10-cv-04482-CW) and all claims of plaintiff-intervenor Placer County in *County of Sonoma v. Federal Housing Finance Agency* (No. 4:10-cv-03370-CW).

By this motion, Defendants Federal Housing Finance Agency ("FHFA"), Federal Home Loan Mortgage Corporation ("Freddie Mac"), Federal National Mortgage Association ("Fannie Mae"), DeMarco, Haldeman, and Williams respectfully ask the Court to dismiss all claims asserted by Palm Desert and Placer County in their entirety and with prejudice, pursuant to Fed. R. Civ. P. Rules 12(b)(1) and 12(b)(6). Defendants have submitted contemporaneously herewith the Declaration of Asim Varma and a Request for Judicial Notice covering certain non-legal sources cited herein that were not submitted in connection with the Motion to Dismiss the Sonoma action that Defendants submitted on October 14, 2010.

MEMORANDUM OF POINTS AND AUTHORITIES

INTRODUCTION

By their complaints, plaintiff City of Palm Desert ("Palm Desert") and Plaintiff-Intervenor Placer County ("Placer," and, together with Palm Desert, "Plaintiffs") seek the very same injunctive relief as sought by plaintiffs in each of the related actions. The requested relief would effectively and unlawfully enjoin FHFA, the federal regulator and Conservator of Fannie Mae and Freddie Mac (the "Enterprises"), from undertaking the central mission entrusted to it by Congress—the prompt identification and mitigation of risks and practices inconsistent with the safe and sound conduct of the Enterprises' financial operations. In essence, Plaintiffs ask the Court to (i) enjoin FHFA from doing its statutory job—as regulator and as Conservator—of taking the financial risks associated with first-lien Property Assessed Clean Energy ("PACE") programs into account in supervising and directing the Enterprises' operations, and (ii) force the Enterprises to bear those risks without compensation. No principle of law supports Plaintiffs' extraordinary claims, which the Court in any event lacks jurisdiction to address. Accordingly, Plaintiffs claims should be dismissed with prejudice under Federal Rules of Civil Procedure 12(b)(1) and 12(b)(6).

STATEMENT OF FACTS

The statement of facts set forth in Defendants' Motion to Dismiss plaintiff Sonoma's Complaint (the "Motion to Dismiss Sonoma's Claims") is fully applicable to the Placer and Palm Desert Complaints.[1] The facts set forth below are limited to those that relate specifically to Placer's and Palm Desert's allegations.

A. Placer's mPOWER Program

Beginning December 2009 and continuing through May 2010, Placer County took a number of steps to implement a PACE program (known as mPOWER) pursuant to California's Assembly Bill 811 ("AB 811") from 2008. Placer Compl. at ¶ 26. The mPOWER program provides for the Placer County Public Financing Authority to issue bonds for the purpose of making a loan to Placer. Placer Compl. at ¶ 29. Placer then proposes to use the proceeds of the loan from the Financing Authority to provide loans to property owners for installation of home energy improvements. Placer Compl. at ¶ 29. The Financing Authority bonds are to be marketed to third-party investors at a later date. Placer Compl. at ¶ 29.

Any property owner wishing to participate in mPOWER must enter into an "assessment contract" with Placer. Placer Compl. at ¶ 31. Placer requires that applicants provide written notice of the proposed contractual assessment to the applicants' existing mortgage lenders to give the lenders an opportunity to object. Placer Compl. at ¶ 31. The mPOWER Disclosure Regarding

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[1] Placer asserts that it is bringing "this action in its own capacity, and as parens patriae on behalf of those citizens of Placer County who are also impacted by defendants' actions." Placer Compl. at ¶ 10. However, Placer does not cite any authority granting it parens patriae standing for any of its claims. Indeed, as the Ninth Circuit has held, "political subdivisions such as cities and counties, whose power is derivative and not sovereign, cannot sue as parens patriae . . . ." *In re Multidistrict Vehicle Air Pollution M.D.L. No. 31*, 481 F.2d 122, 131 (9th Cir. 1973); *see also U.S. v. City of Pittsburg, Cal.*, 661 F.2d 783, 787 (9th Cir. 1981) ("Although cities may sue to vindicate such of their own proprietary interests as might be congruent with the interests of their inhabitants, only the states and the federal government may sue as parens patriae.") (quotations and citations omitted).

Assessment Financing provided to applicants warns that entering into an assessment contract without the consent of existing lenders could constitute an event of default under existing mortgage agreements or security instruments.[2]

B. Palm Desert's EIP Program

Palm Desert's PACE program, the Energy Independence Program ("EIP"), was launched in August 2008.[3] Applicants for EIP funds must fill out a "Loan Application."[4] Palm Desert requires the disclosure of the State of California Fair Lending Notice to applicants. In addition, applicants are warned to obtain the consent of existing lenders because an EIP loan could constitute an event of default. Palm Desert initially ceased taking applications for EIP after FHFA issued its July 6 Statement concerning first-lien PACE programs (the "Statement"). On August 26, 2010, Palm Desert restarted the EIP "after reviewing the statements issued by FHFA and [the Enterprises]."[5]

C. The American Recovery and Reinvestment Act

In February 2009, Congress enacted the American Recovery and Reinvestment Act (ARRA), Pub. L. No. 111-5, 123 Stat. 115. ARRA allocated $3.2 billion in federal funds to the Department of Energy (DOE) for distribution to state and local governments to finance the implementation of energy efficiency and conservation programs authorized under the Energy Independence and Security Act of 2007 (42 U.S.C. § 17151 *et seq*.). DOE in turn allocated ARRA funds to California local public entities and the California Energy Commission ("CEC") for further distribution. Placer Compl. at ¶ 18. On July 29, 2010, purportedly as a result of FHFA's issuance

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2 mPOWER Application, *available at* http://www.mpowerplacer.org/forms/Placer%20Application%20 Written%20Form.pdf (Border Decl. Ex. 7).

3 *See* Palm Desert Energy Independence Program Loan Application, *available at* http://www.cityofpalmdesert.org/Modules/ShowDocument.aspx?documentid=5636 (Varma Decl. Ex. 1).

4 The instructions are titled "Summary of Loan Process." Palm Desert's Summary of Loan Process, *available at* http://www.cityofpalmdesert.org/Modules/ShowDocument.aspx?documentid=4820 (Varma Decl. Ex. 2).

5 Palm Desert, Energy Independence Program website, *available at* http://www.cityofpalmdesert.org/Index.aspx?page=484 (last visited Nov. 5, 2010) (Varma Decl. Ex. 3).

of the Statement, the CEC unilaterally reallocated a $30 million distribution that would have supported PACE programs in California to other energy conservation programs.[6] However, since then "CEC is again looking to distribute ARRA funds to California PACE programs. Placer County's PACE program is a recipient of these ARRA dollars and has received an allocation of $375,000 to date." Placer Compl. ¶ 18.

In October 2009, the White House issued a policy framework for PACE programs.[7] On May 7, 2010, DOE issued Guidelines for Pilot PACE Financing Programs.[8] In connection with its efforts to issue guidelines, DOE met with FHFA, bank regulators, and other stakeholders.[9]

ARGUMENT

Defendants respectfully request that all claims of Plaintiff Palm Desert and Plaintiff-Intervenor Placer against all Defendants be dismissed with prejudice under Federal Rule of Civil Procedure 12(b)(1) for lack of subject matter jurisdiction and Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim.

I. LEGAL STANDARD

Subject matter jurisdiction is a threshold requirement; without it, a court cannot hear a claim. *See Morongo Band of Mission Indians v. Cal. State Bd. of Equalization*, 858 F.2d 1376, 1380 (9th Cir. 1988). The party asserting jurisdiction must establish that it exists over each claim. *See Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 377 (1994). General grants of jurisdiction do not apply where a specific statute precludes it. *First Nat'l Bank of Scotia v. United*

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[6] California Energy Commission, News Release, Energy Commission Acts to Protect and Expand Property-Assessed Clean Energy Financing Options Strongly Rejects FHFA Faulty Logic (July 29, 2010), *available at* http://www.energy.ca.gov/releases/2010_releases/2010-07-29_clean_energy_financing.html (Varma Decl. Ex. 6).

[7] Policy Framework for PACE Financing Programs (Oct. 18, 2009), *available at* http://www.whitehouse.gov/assets/documents/PACE_Principles.pdf (Varma Decl. Ex. 7).

[8] Department of Energy, Guidelines for Pilot PACE Financing Programs (May 7, 2010), *available at* http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf, attached as (Border Decl. Ex. 23).

[9] *See* July 6 Statement noting discussions with stakeholders; May 24, 2010 letter from Cathy Zoi of the Department of Energy to Edward DeMarco, Acting Director, FHFA, attached as exhibit D to California's Request for Judicial Notice.

States, 530 F. Supp. 162, 166-68 (D.D.C. 1982) ("none of the general jurisdictional statutes cited in the complaint are operative here, because those provisions confer jurisdiction upon this Court only to the extent that Congress has previously carved out a role for the district courts in the more focused and controlling statutory scheme set forth in 12 U.S.C. § 1818").

A complaint must be dismissed under Rule 12(b)(6) for failure to state a claim if it (a) does not allege a cognizable legal theory or (b) alleges insufficient facts under a cognizable legal theory. *See Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1990). A case must be dismissed where the complaint fails to state a "'claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. __, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 540, 570 (2007)). While the Court must assume the truth of all properly pleaded allegations of fact, "conclusory allegations of law and unwarranted inferences are insufficient to defeat a motion to dismiss." *Ove v. Gwinn*, 264 F.3d 817, 821 (9th Cir. 2001). Stripped of unsupported legal conclusions, the factual allegations must do more than "create[] a suspicion of a legally cognizable right of action"; they must "raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 555 (internal quotations, citations, and alterations omitted).

II. <u>THE COURT LACKS JURISDICTION OVER PLAINTIFFS' CLAIMS</u>

As explained in greater detail in the Motion to Dismiss Sonoma's Claims, three specific statutory provisions—12 U.S.C. § 4617(f), 12 U.S.C. § 4635(b), and 12 U.S.C. § 4623(d)—expressly and independently preclude jurisdiction over all of Plaintiffs' claims. *See* Mot. to Dismiss Sonoma's Claims at 17-27. The first of the three independently applicable jurisdiction-withdrawal provision, 12 U.S.C. § 4617(f), mandates that "no court may take any action to restrain or affect the exercise of powers or functions of the [FHFA] as a conservator."[10] Injunctive relief that would restrain the Conservator's statutory powers and functions—even if exercised in a manner inconsistent with some other law—"violates the heart of what is commonly termed [the] 'anti-

[10] Not only does § 4617(f) preclude jurisdiction directly, but it also triggers the Administrative Procedure Act ("APA") provision foreclosing APA claims where another "statute[] preclud[es] judicial review." 5 U.S.C. § 701; *see also id*. § 702.

injunction provision'" of the § 1821(j)/§ 4617(f) jurisdictional bar. *Bank of Am. Nat'l Ass'n v. Colonial Bank*, 604 F.3d 1239, 1244 (11th Cir. 2010) (applying § 1821(j)). Yet the relief Plaintiffs seek here would do just that. The Conservator's statutory power to "preserve and conserve the assets and property" of the Enterprises necessarily includes the authority to make supervisory judgments about financial risk, to determine how to mitigate such risks, and to manage the Enterprises' portfolios accordingly. *See* 12 U.S.C. § 4617(b)(2)(B), (D), (J). The relief Plaintiffs seek would preclude the Conservator from taking (or even recommending) any specific action to mitigate the financial risks that mPOWER and EIP loans pose to the mortgage-related assets in the Enterprises' portfolios, or otherwise addressing the safety and soundness concerns associates with first-lien PACE programs, thereby restraining and affecting the Conservator's power to preserve and conserve the Enterprises' assets. Hence, § 4617(f) withdraws jurisdiction over Plaintiffs' claims.

The second independently applicable jurisdiction-barring provision, 12 U.S.C. § 4635(b), applies to actions that would interfere with FHFA's regulatory supervision of the Enterprises. Specifically, Congress mandated in 12 U.S.C. § 4635(b) that "no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or enforcement of . . . any notice or order" under several of HERA's supervisory provisions, including the entirety of "subchapter II," *i.e.*, 12 U.S.C. §§ 4611-4624. One of the "subchapter II" provisions, 12 U.S.C. § 4624(c), states that "the Director [of FHFA] may, by order, require [an Enterprise], under such terms and conditions as the [FHFA] determines to be appropriate, to dispose of or acquire any asset," if "the Director determines that such action is consistent with the purposes of [HERA]." Another section, 12 U.S.C. § 4624(b), provides that "the Director [of FHFA] may, by order, make temporary adjustments to the established standards [for Enterprise portfolio holdings], such as during times of economic distress . . . ." Because the Statement stands as, or could lead to, an "order" issued under § 4624(b) or (c)—HERA provisions enumerated in § 4635(b)—the jurisdictional bar is triggered.

The third independently applicable jurisdiction withdrawal provision, § 4623(d), also applies to actions that would interfere with FHFA's regulatory supervision of the Enterprises, extending the reach of the jurisdictional bar beyond notices and orders in some circumstances. Specifically,

§ 4623(d) mandates that "no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or effectiveness of *any . . . action of the Director*" pursuant to any of the subchapter II sections, *i.e.*, §§ 4611-24. 12 U.S.C. § 4623(d) (emphasis added). Among other things, those sections authorize the Director to "require" a "significantly undercapitalized" Enterprise "to terminate, reduce, or modify any activity that the Director determines creates excessive risk." 12 U.S.C. § 4616(b)(4). The Enterprises were placed into conservatorship as a result of their significant undercapitalization, which continues to the present, and the directives set forth in the Statement fit squarely within the scope of § 4616(b)(4). Accordingly, § 4623(d) bars jurisdiction over Plaintiffs' claims.

III. EVEN IF JURISDICTION IS ASSUMED, PLAINTIFFS' CLAIMS FAIL

A. Placer's Constitutional Claims Fail

Placer asserts two claims under the U.S. Constitution—for violations of the Tenth Amendment and the Spending Clause—that no other plaintiff raised and that defendants, therefore, did not address in the Motion to Dismiss Sonoma's Claims or the companion motions submitted in the related cases.

1. Placer's Tenth Amendment Claim Fails

Placer's claim that FHFA violated the Tenth Amendment by interfering with California's power "to regulate and define local taxation and assessment matters including the authority to obtain a senior tax or assessment lien on property," Placer Compl. at ¶ 46, fails for at least three reasons. *First*, Placer cannot plausibly allege that FHFA has interfered with any state or local tax, assessment, or lien power. To the contrary, California remains free to authorize any constitutional scheme of taxation and assessment as well as to establish whatever lien priority it wishes for taxes and assessments, while Placer remains free to implement a PACE program that incorporates assessments with first-lien priority under California law. The FHFA supervisory communications upon which Placer bases its claim simply direct that the Enterprises take prudent actions that FHFA, in the exercise of its supervisory discretion, deemed necessary and appropriate to protect the safety and soundness of the Enterprises' portfolios in light of the financial risks associated with mortgages that are (or that could become) subject to first-lien PACE assessments. Hence, FHFA's actions do not "invalidat[e] state laws in the areas of taxation, assessment, and contract," Placer Compl. at ¶ 50, or otherwise interfere with the first-lien attribute of PACE programs. Rather, FHFA's actions *acknowledge and respect* the priority of PACE liens under California law.

Second, even assuming (incorrectly) that FHFA's actions interfered with state power to tax (or any other state power), Placer still could not state a viable Tenth Amendment claim because FHFA's actions embody a proper exercise of federal Commerce Clause power. *See Watters v. Wachovia Bank, N.A.* 550 U.S. 1, 22 (2007) ("Regulation of national bank operations is a prerogative of Congress under the Commerce and Necessary and Proper Clauses. The Tenth Amendment, therefore, is not implicated here.") (citation omitted). As the Supreme Court explained in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 436 (1819):

> [T]he states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by congress to carry into execution the powers vested in the general government. This is, we think, the unavoidable consequence of that supremacy which the constitution has declared.

As the Ninth Circuit more recently noted, "We know of no authority for the proposition that Congress may not interfere with state taxation in furtherance of its power over interstate commerce." *Arizona v. Atchison, Topeka, and Santa Fe Railroad Co.*, 656 F.2d 398, 407 (9th Cir. 1981). Hence, the Tenth Amendment is not violated where the federal government exercises a Constitutional power in a way that impairs state tax power. *See, e.g.*, *In re: Brentwood Outpatient, Ltd.*, 43 F.3d 256, 263-64 (6th Cir. 1994) (Bankruptcy Code's negation of certain state tax liens did not violate Tenth Amendment); *Alabama v. Lyng*, 811 F.2d 567, 570 (11th Cir. 1987) (Food Stamp Act's exemption of certain goods from state sales tax did not violate Tenth Amendment); *Southeastern Pennsyl. Transp. Auth. v. Pennsyl. Pub. Util. Comm'n*, 826 F. Supp. 1506, 1518-22 (E.D. Pa. 1993) (federal statute exempting railroads from state taxation did not violate Tenth Amendment).

Placer seeks to sidestep these dispositive principles by asserting that FHFA's actions were *ultra vires* and therefore not a proper exercise of the federal commerce power. *See* Placer Compl. at ¶¶ 47-49. That is wrong. Congress's power to regulate interstate commerce encompasses supervision of the Enterprises, whose secondary mortgage market operations involve transactions throughout the United States. *See Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 39 (1980) (federal regulation of financial institutions "rest[s] primarily on Congress' powers under the Commerce Clause"); *McClain v. Real Estate Bd.*, 444 U.S. 232, 245 (1980) ("Mortgage obligations [are] traded as financial instruments in the interstate secondary mortgage market"). Here, Congress properly exercised its Commerce Clause power in enacting HERA, which not only requires FHFA (as regulator) to protect the safety and soundness of the Enterprises' operations, but also directs FHFA (as Conservator) to preserve and conserve the Enterprises' assets and property. And in acting to mitigate the financial risks PACE programs pose to the Enterprises (and taxpayers across the country who support the Enterprises in conservatorship), FHFA properly followed Congress's mandate. Accordingly, Placer's Tenth Amendment claim fails regardless of whether FHFA's actions somehow inhibited any state or local tax (or other) power.

Third, although a Tenth Amendment claim may lie where the federal government "'commandee[rs] the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program,'" *New York v. United States*, 505 U.S. 144, 162 (1992), Placer does not and could not allege that FHFA has done so here. FHFA's exercise of its regulatory supervision over the Enterprises requires nothing of the Plaintiffs with respect to enacting or enforcing a federal regulatory program.

2. Placer's Spending Clause Claim Fails

Placer's allegation that FHFA's issuance of the Statement violated the Constitution's Spending Clause fails because the Statement does not impose a "substantive condition or obligation on States they would not otherwise be required by law to observe." *See Winkelman ex rel. Winkelman v. Parma City Sch. Dist.*, 550 U.S. 516, 534 (2007); Placer Compl. at ¶¶ 52-58. Put simply, the Statement does not attach a condition or obligation to Placer's receipt of federal funds, and Placer does not and cannot make such an allegation.

The July 6 Statement does not impose any "obligation" on states or localities. It does not order them to eliminate first-lien priority for PACE loans or to take any other action. Rather, it directs the Enterprises, which are indisputably and exclusively within the jurisdiction of FHFA, to take certain prudential actions to mitigate the financial risks first-lien PACE obligations pose to the Enterprises as mortgage holders. The Enterprises have since announced that they will not purchase mortgages encumbered by first-lien PACE obligations. Although the removal of the Enterprises from the pool of potential mortgage buyers might increase the costs of operating a first-lien PACE program vis-à-vis other possible uses for the federal funds, higher costs do not amount to an "obligation" that would trigger the Spending Clause. *See Winkelman*, 550 U.S. at 534-35 (although the Court's ruling might, "as a practical matter, increase costs borne by the States, . . . [e]ffects such as these do not suffice to invoke the concerns under the Spending Clause."). Hence, even assuming that the Enterprises' decision not to purchase mortgages subject to first-lien PACE obligations could be attributed to FHFA, Placer's Spending Clause claim fails.

Moreover, to qualify as a "condition" for Spending Clause purposes, the purported condition must be one that the funding recipients "would not otherwise be required by law to observe." *See Winkelman*, 550 U.S. at 534. FHFA's Statement does not create any distinctions between localities that have accepted ARRA funding and those that have not. A county that has created a PACE program without using ARRA funding is in no different position than Placer to compel the Enterprises to purchase PACE loans with first liens. Thus, Placer cannot identify any "condition" created by FHFA in connection with its acceptance of funding that it would not "otherwise" be compelled to observe.

Because FHFA has not created a "substantive condition or obligation" that Placer "would not otherwise be required by law to observe," each ground Placer alleges in support of its Spending Clause claim is fatally undermined. *First,* Placer contends that "Congress did not delegate to the FHFA the power to fix terms regarding the dispersal of these ARRA funds and doing so would have been an improper delegation of authority." Placer Compl. at ¶ 54. Because FHFA did not "fix terms regarding the dispersal" of ARRA funds, the question of whether Congress delegated such authority to FHFA is irrelevant. *Second*, Placer alleges that "FHFA's directions and pronouncements are a post-acceptance or retroactive condition placed upon the receipt of ARRA energy project funds" and therefore a violation of the Spending Clause. *Id.* at ¶ 55. FHFA imposed no conditions, retroactive or otherwise, on the receipt of ARRA funds, but instead exercised its pre-existing statutory authority to regulate the Enterprises' safety and soundness.[11] *Third*, Placer alleges that if Congress did establish a condition that recipients of ARRA funds "waive their right to obtain a senior tax or assessment lien on property, Congress did not do so unambiguously in violation of the Spending Clause." *Id.* at ¶ 56. Because neither Congress nor FHFA imposed such a condition on the receipt of funds, it is unnecessary to consider the ambiguity issue. *Finally*, Placer alleges that if Congress established the alleged condition, doing so "induces the County of Placer to engage in unconstitutional conduct in impairing assessment and other contracts that the County had previously entered into." *Id.* at ¶ 57. Since there is no condition, there is no improper inducement.[12] Placer's Spending Clause violation claim therefore fails as a matter of law.

B. Placer's State Law Claims Fail

Placer alleges that the Enterprises intentionally and negligently interfered with a prospective economic advantage with respect to three sets of contracts to which Placer is a party. Placer Compl. at ¶¶ 64-78, Counts IV-VI. Placer's torts claims are similar to those asserted by Sonoma in its Complaint, Sonoma Compl. ¶¶ 64-67, and must be dismissed for the same reasons set forth in the Motion to Dismiss Sonoma's Claims. Mot. to Dismiss Sonoma's Claims at 27-36.

1. Placer's State Law Claims Are Preempted by HERA

As explained in the Motion to Dismiss Sonoma's Claims, HERA preempts Plaintiffs' state-law claims under the doctrines of conflict preemption and express preemption. *See* Mot. to Dismiss Sonoma's Claims at 27-31.

[11] Placer's reasoning implies that whenever a state receives federal funds to administer a program, any subsequent statement or action by any federal agency that affects the program is a "post-acceptance or retroactive condition placed upon the receipt" of the funding and thus "a violation of the Spending Clause." *See* Placer Compl. at ¶ 55. For example, if the Federal Trade Commission issued advertising guidelines to ensure that localities do not exaggerate the benefits of PACE programs to their residents, Placer's logic suggests that this would be a "post-acceptance or retroactive condition" placed on the receipt of federal funds rather than an exercise of the FTC's pre-existing statutory authority. Clearly, this is not so.

[12] Moreover, FHFA's July 6 Statement "direct[ed] Fannie Mae and Freddie Mac to waive their Uniform Security Instrument prohibitions against such senior liens" for any homeowner who obtained a PACE loan with a senior lien before July 6. Therefore, it is unclear how FHFA's statement could have induced Placer County to impair any existing assessment contracts.

2. <u>Placer's State Law Claims Fail as Matter of Law in Any Event</u>

Even if not preempted, Placer's state law claims against the Enterprises would fail as a matter of law. Placer alleges that the Enterprises, by issuing their May 5 Advisories, intentionally or negligently interfered with Placer's prospective economic advantages. Placer Compl. at ¶¶ 64-74, Counts IV-V. Placer also alleges that this same conduct by the Enterprises intentionally interfered with three types of contracts to which Placer is a party. Placer Compl. at ¶¶ 75-78, Count VI. Placer's state law claims fail for the same reasons Sonoma's fail. *See* Mot. to Dismiss at 27-31; Sonoma Compl. at ¶¶ 64-67. Placer's claims also fail as matter of law for the additional reasons set forth below.

a. <u>Placer's Claims for Interference with Prospective Economic Advantage and with Contractual Relations Fail</u>

To establish its claims against the Enterprises for intentional interference with a prospective economic advantage (Count V) and intentional interference with contractual relations (Count VI), Placer must plead and prove (1) the existence of an economic or contractual relationship between Placer and a third party, with the probability of a future economic benefit to Placer; (2) the Enterprises' knowledge of the relationship between Placer and the third party; (3) an intentional act on the part of the Enterprises designed to disrupt the relationship; (4) actual disruption of the relationship; and (5) economic harm to Placer proximately caused by the acts of the Enterprises. *Pacific Gas & Elec. Co. v. Bear Stearns & Co.*, 50 Cal. 3d 1118, 1126 (1990); *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 944 (2008). In the case of interference with prospective economic advantage, the defendant's disruptive acts must be independently wrongful. *See Pacific Gas*, 50 Cal. 3d at 1126. Other than the showing of requisite intent, the elements of a claim for negligent interference with prospective economic advantage (Count IV) are similar to those of intentional interference with prospective economic advantage. *See North Am. Chemical Co. v. Superior Ct.*, 59 Cal. App. 4th 764, 786 (1997). Importantly, "[a]s with claims for intentional interference, an essential element of the tort of negligent interference is an independently wrongful act." *Nat'l Medical Transp. Network v. Deloitte & Touche*, 62 Cal. App. 4th 412, 440 (1998).

Placer identifies the following purported prospective economic relationships between the County and third parties that the Enterprises allegedly interfered with, either intentionally or negligently:

1) A relationship between "the County of Placer and owners of real property located in Placer County who are interested in entering into an mPOWER assessment contract with the County." Placer Compl. ¶¶ 65, 70.[13]

2) A relationship between "the County of Placer and the Placer County Public Financing Authority … as part of the mPOWER Program." Placer Compl. ¶¶ 66, 71.[14]

3) A relationship between "the County of Placer and third-party investor bond purchasers … as part of the mPOWER Program." Placer Compl. ¶¶ 67, 72.

For all three purported prospective economic relationships, Placer alleges that "[d]efendants Fannie Mae and Freddie Mac each engaged in wrongful conduct as described above, which conduct amounted to misrepresentation, an unlawful business practice under California law (Cal. Business & Professions Code § 17200 et seq.), common law unfair competition, slander of title, a violation of the established standards in the mortgage lending and secondary market industry, and/or violation of California statutes regulating mortgage finance loans."[15] Placer Compl. ¶¶ 66-67, 70-72.[16] Placer fails to allege any "independently wrongful" action undertaken by the Enterprises and the common law claims are patently frivolous, as explained below.[17] *See Korea Supply Co. v.*

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[13] A speculative future relationship between Placer and unidentified residents "who are interested" in potentially participating in the County's PACE program does not satisfy the "existing relationship" requirement. *See* Mot. to Dismiss at 34-35.

[14] Placer provides no support for the claim that the relationships involved in funding Placer's revenue-neutral PACE Program are likely to endow Placer with any specific economic benefit. Placer Compl. ¶17; *see also* Mot. to Dismiss at 34-35.

[15] It is unclear what is meant by "and/or violation of California statutes regulating mortgage finance loans" but it bears noting that the Enterprises do not make mortgage finance loans. They only operate in the secondary mortgage market.

[16] Presumably, Placer also intended to include this sentence in Paragraph 65 of the Complaint.

[17] Placer alleges that the Enterprises engaged in unlawful business practices under California's Unfair Competition Law ("UCL"), but that law also requires Placer to show that the Enterprises have "violated another law" or engaged in an "unfair business practice," which it has failed to do. *See* Cal. Bus. & Prof. Code. § 17200 *et seq.*; FHFA discusses the UCL claims further in its discussion of Sonoma's identical UCL claims, *see* Mot. to Dismiss at 31-34.

Lockheed Martin Corp., 29 Cal. 4th 1134, 1159 (2003) ("[A]n act is independently wrongful if it is unlawful, that is, if it is proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard.").[18]

Placer also alleges two violations of the common law in support of its interference with prospective economic advantage claims. The first, "common law unfair competition," is inapplicable to the facts alleged by to Placer. As this Court has made clear, "[t]he tort of common law unfair competition is limited to instances of 'passing off,' or acts analogous to 'passing off,' one's goods as those of another." *Sigma Dynamics, Inc. v. E. Piphany, Inc.*, C 04-0569 MJJ, 2004 WL 2648370 at *5 (N.D. Cal. June 25, 2004) (citations omitted). Thus, "[where] Plaintiffs' allegations do not amount to 'passing off' or its equivalent, . . . [a] claim for [common-law] unfair competition [i]s properly dismissed." *Southland Sod Farms v. Stover Seed Co.*, 108 F.3d 1134, 1147 (9th Cir. 1997).

The second common law claim is for "slander of title." Slander of title "occurs when there is an unprivileged publication of a false statement that disparages title to property and causes pecuniary gain." *Stalberg v. Western Title Ins. Co.*, 27 Cal. App. 4th 925, 929 (1994). Placer has not and cannot allege that the Enterprises have disparaged any title held by the County. Further, even if Placer had standing to assert a slander of title claim on behalf of "owners of real property located in Placer County who are interested in entering into an mPOWER assessment contract with the County," "the Placer County Public Financing Authority," or "third-party investor bond purchasers," a point which FHFA does not concede, there has been and can be no allegation that the Enterprises have clouded any titles belonging to such persons and entities by virtue of issuing the May 5 Advisories.[19]

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[18] *See also Korea Supply Co.*, 29 Cal. 4th at 1159 n.11 ("[A]n act must be wrongful by some legal measure, rather than merely a product of an improper, but lawful, purpose or motive.").

[19] Indeed, it is the effect of PACE liens on titles that needs to be clarified. Letter from Kurt Pfotenhauer, Chief Executive Officer, American Land Title Association, to Alfred M. Pollard, General Counsel, Federal Housing Finance Agency (July 23, 2010), *available at* http://www.alta.org/advocacy/AdvocacyUpdate/attachments/10-07-23_Alfred_Pollard.pdf (Varma Decl. Ex. 8).

b. Placer's Claim for Interference with Contracts Also Fails

Placer also alleges the Enterprises intentionally interfered with existing contracts between Placer and (1) the Placer County Finance Authority and Placer County Treasurer-Tax Collector relating to the Bond Purchase Agreement, (2) the Placer County Finance Authority and Placer County Treasurer-Tax Collector relating to the Limited Obligation Loan Agreement, and (3) existing mPOWER assessment contracts with residents of Placer County. Placer Compl. at ¶¶ 75-78, Count VI. To sufficiently plead this claim, Placer must allege (1) a valid contract between Placer and a third party; (2) the Enterprises' knowledge of this contract; (3) intentional acts by the Enterprises designed to induce a breach or disruption of the contractual relationship; (4) actual breach or disruption of the contractual relationship; and (5) resulting damage to Placer. *Pacific Gas & Electric Co. v. Bear Stearns & Co.*, 50 Cal.3d 1118, 1126 (1990). Placer's complaint fails with respect to each of the three purported contracts.

First, the alleged "contracts" between the County and its Public Financing Authority and Treasurer-Tax Collector are not valid *third-party* contracts. Rather, these are intra-government agreements that appear to have been created solely to fund Placer's PACE Program. *See* Placer Compl. ¶ 29; *Pacific Gas*, 50 Cal. 3d at 1126 (existence of contract with third party necessary element of the claim). *Second*, as to the third class of alleged agreements— the eleven contractual assessment contracts in place when Placer suspended the mPOWER program in July 27, 2010— no harm could have resulted from any alleged acts by the Enterprises prior to that date, since FHFA's July 6 Statement expressly waived the conditions described in the Statement as to PACE-encumbered mortgages already in existence before July 6. *See* Placer Compl. at ¶ 34; *id*. at Exhibit C (July 6, 2010 FHFA Statement).[20] *Finally*, Placer's complaint fails regarding all three described contracts because the collateral, indirect effects of the Enterprises' business decisions were not

[20] Nor does the complaint allege that there were any contracts subsequent to July 6 that were purportedly interfered with. Moreover, Placer's allegation that the disruption purportedly caused by the August 31 Enterprise statements— an increased difficultly in the ability of homeowners to refinance— does not describe an interference with any *existing contract*. *See Pacific Gas*, 50 Cal. 3d at 1126.

intended or designed to disrupt these contracts as a matter of law. Placer's complaint fails to plead any facts to support its bald assertions that the Enterprises intended to disrupt the three contracts. Such allegations fail as a matter of law to establish a sufficient element of Placer's intentional interference claim. *Iqbal*, 129 S. Ct. at 1949 (a threadbare recital of the elements of a cause of action, supported by mere conclusory statements instead of facts, is insufficient to satisfy Rule 8). And while Placer may dispute whether Defendants are correct in their conclusion that PACE financing poses unacceptable safety and soundness risks to the mortgage market, that alone does not substitute for well pled facts demonstrating actual intent. In fact, the Complaint itself pleads facts demonstrating that the intent behind the Enterprises' issuance of the Advisories was driven by valid business decisions. Indeed, the Enterprises acted pursuant to their statutory purposes of ensuring stability in the secondary mortgage market, and in accordance with the safety and soundness policies and directives of its regulator, FHFA. *See Dollar Tree Stores Inc. v. Toyama Partners, LLC*, No. C 10-00325 SI, 2010 WL 1688583, *4 (N.D. Cal. Apr. 26, 2010) (plaintiff failed to state a claim for interference with existing contract because defendant acted for a legitimate business purpose, not with the intent to interfere with plaintiff's contract).

C. Plaintiffs' APA Claims Fail

1. Plaintiffs Lack Prudential Standing to Assert APA Claims

The APA provides that a "person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action *within the meaning of a relevant statute*, is entitled to judicial review thereof." 5 U.S.C. § 702 (emphasis added). In order to qualify under this provision and, thus, have prudential standing, a plaintiff must "fall[] within the 'zone of interests' sought to be protected by the statutory provision whose violation forms the legal basis for his complaint." *Lujan v. Nat'l Wildlife Federation*, 497 U.S. 871, 883 (1990) (quoting *Clarke v. Sec. Indus. Ass'n*, 479 U.S. 388 (1987)). In order to assert a claim under the APA, a plaintiff must demonstrate a "[c]ongruence of interests," because allowing suits by plaintiffs whose interests are incongruent with those of the statute would "[carry] a considerable potential for judicial intervention that would distort the regulatory process." *Amgen, Inc. v. Smith*, 357 F.3d 103, 109 (D.C. Cir. 2004). As such, plaintiffs can satisfy the "zone of interests" test only if they could be "expected to police the interests that the statute protects." *Id*. (quoting *Mova Pharma. Corp. v. Shalala*, 140 F.3d 1060, 1075 (D.C. Cir. 1998)). Here, the "relevant statute" on which Plaintiffs base their APA claim is HERA. In enacting HERA, Congress found that: "because the continued ability of the [Enterprises] to accomplish their public missions is important to providing housing in the United States and the health of the Nation's economy, *more effective Federal regulation is needed to reduce the risk of failure of the enterprises*." 12 U.S.C. § 4501(2) (emphasis added). Hence, Congress placed upon FHFA the duty "to ensure that each [Enterprise] operates in a safe and sound manner . . . ." 12 U.S.C. § 4613(d).

Plaintiffs do not fall within the zone of interests of HERA because their stated interests are, at best, "marginally related to" the statute's purposes or, more likely, "inconsistent with the purposes implicit in the statute[s]." *Clarke*, 479 U.S. at 399. Indeed, Plaintiffs' attempt to restrain the Enterprises' business activities and judgments plainly conflicts with the purposes—both implicit and explicit—of HERA and HERA's explicit direction to FHFA. HERA neither authorizes anyone other than FHFA (as regulator and Conservator) to supervise and direct the Enterprises[21] nor authorizes the subordination of the Enterprises' safety and soundness in order to promote Plaintiffs' interests. In any event, Plaintiffs cannot demonstrate any relationship between the interests they assert and the safe and sound operations of the Enterprises such that Plaintiffs could be "expected to police the interests that [HERA] protects." *See Mova Pharma.*, 140 F.3d at 1075. To the contrary, mPOWER and EIP are designed to shift default risk away from Plaintiffs and their residents and onto the Enterprises, thereby undermining the Enterprises' fiscal health and compromising their safety and soundness.

To the extent that Plaintiffs might argue that HERA's "public interest" clause could bring Plaintiffs within the "zone of interests" HERA protects (*see*, *e.g.*, Placer Compl. at ¶ 62), the "public interest" referred to in HERA is reflected in the Enterprises' missions as stated in their charters; not the local economic and environmental interests Plaintiffs assert. *See generally Nat'l*

[21] Indeed, Congress decreed that "When acting as conservator . . . , the Agency shall not be subject to the direction or supervision of any other Agency of the United States or any State in the exercise of the rights, powers, and privileges of the Agency." 12 U.S.C. § 4617(a)(7).

Ass'n for Advancement of Colored People v. Fed. Power Comm'n, 425 U.S. 662, 669 (1976) ("in order to give content and meaning to the words 'public interest' as used in the [] Acts, it is necessary to look to the purposes for which the Acts were adopted."). Otherwise, "any plaintiff claiming to sue in the public interest would have standing, thus depriving the zone of interests test of its meaning." *Farm Sanctuary, Inc. v. Veneman*, 212 F. Supp. 2d 280, 285 (S.D.N.Y. 2002) (*vacated in part not relevant here*) (interpreting the Federal Meat Inspection Act) (citation omitted). Hence, a plaintiff suing to protect the public interest has standing only when the plaintiff's purported public interest bears an "integral relationship" to the relevant statute. *See Air Courier Conference of Am. v. Am Postal Workers Union AFL-CIO*¸ 498 U.S. 517, 529-30 (1991). But here, Plaintiffs' asserted interests bear no relationship to HERA, "nor does the history of [HERA] . . . indicate that [its passage] was intended for the benefit" of local governments. *Id.* at 526. Rather, Congress enacted HERA to "ensure that the [Enterprises] operate in a safe and sound manner and *fulfill the missions assigned under their charters*, both through establishment of a strong, independent regulator and through enhancements to their mission responsibilities."[22] The Enterprises' charters—Congressionally enacted federal statutes—establish missions relating to housing finance, not local governments' economic interest. *See* 12 U.S.C. § 1716 *et seq*. (Fannie Mae charter); 12 U.S.C. § 1451 *et seq*. (Freddie Mac charter).

2. FHFA Has Not Taken Final Agency Action for APA Purposes

Under the APA, only "final agency action" is "subject to judicial review." 5 U.S.C. § 704. *See also Fairbanks North Star Borough v. U.S. Army Corps of Engineers*, 543 F.3d 586, 591 (9th Cir. 2008).[23] For an agency action to be final for APA purposes, it must be an action by which legal

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22 H.R. REP. 110-142, at 87 (2007) (emphasis added).

23 Moreover, the APA forecloses judicial review, separately from the jurisdictional withdrawal provisions discussed *supra*, where the challenged "agency action is committed to agency discretion by law." 5 U.S.C. § 701(a)(2). This exception applies where "the agency's action requires a complicated balancing of a number of factors which are peculiarly within [the agency's] expertise . . . ." *Center for Policy Analysis on Trade and Health v. Office of U.S. Trade Representative*, 540 F.3d 940, 944 (9th Cir. 2008) (internal quotation marks omitted) (brackets in original) (citation omitted). Here, Plaintiffs seek to challenge FHFA's determination that first-lien PACE programs present sufficiently significant "safety and soundness concerns" to support an FHFA "direct[ive]" that the Enterprises take certain "prudential actions." By enacting HERA, Congress authorized

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rights or obligations have been determined, or from which legal consequences flow. *Bennett v. Spear*, 520 U.S. 154, 177-78 (1997) (internal citations and quotations omitted). Practical consequences are not sufficient: "Not every agency decision that has immediate and financial impact or even profound economic consequences in the real world" is a reviewable final agency action under the APA. *Fairbanks North Star*, 543 F.3d at 596 (quotations omitted).

Here, whatever practical effects the Statement may have, it will not determine *legal* rights, *legal* obligations, or *legal* consequences. Nothing in the Statement even arguably purports to bind anyone other than the Enterprises and the Banks, and no statutory provision authorizes FHFA to treat disregard of the Statement as a *per se* safety-and-soundness violation. Rather, to support an enforcement action, FHFA must independently establish that an Enterprise "is engaging[,] . . . has engaged, or . . . is about to engage, in an unsafe or unsound practice . . . ." 12 U.S.C. § 4631(a)(1). *See Hindes v. FDIC*, 137 F.3d 148, 162 (3d Cir. 1998) (FDIC's "issuance of [a] Notification did not have the type of effect . . . required . . . [for it] to be a final, reviewable action, namely, that the agency action must be one that imposes an obligation, denies a right, or fixes some legal relationship as a consummation of the administrative process."); *Aerosource, Inc. v. Slater*, 142 F.3d 572, 575-82 (3d Cir. 1998) (FAA's issuance of statements court "recognize[d] [would have] severe adverse [practical] impact . . . on Aerosource's business" held not final agency action because "[n]either Aerosource nor any other entity suffered any *legal consequences* as a result of the issuance.") (emphasis added).

3. <u>Plaintiffs' Notice-and-Comment Claims Fail</u>

Palm Desert and Placer both argue that FHFA, in issuing the July 6 Statement without proceeding through a notice-and-comment rulemaking process, violated the APA. *See* Palm Desert Compl. at ¶¶ 44-45; Placer Compl. at ¶ 61. These claims fail because FHFA was not required to follow the APA's notice-and-comment procedure in issuing the Statement. HERA provides that the duties of the Director include the oversight of the Enterprises prudential operations. The Director

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FHFA to perform the discretionary balancing which led to that determination. Hence, § 701(a)(2) places the FHFA actions Plaintiffs challenge outside APA review.

can fulfill this duty by issuing guidelines or statements that do not require notice-and-comment rule making. *See* 12 U.S.C. § 4526.

a. <u>The Statement Is Not a Rule</u>

"The APA defines two, normally mutually exclusive categories of agency action—rules and orders." *Doe v. Rumsfeld*, 341 F. Supp. 2d 1, 10 (D.D.C. 2004). The notice and comment provisions of the APA apply to substantive rules, but not to orders. *Id*.

Justice Scalia's concurrence in *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204 (1988), highlights one controlling distinction between a "rule" and an "order" under the APA. *See Doe*, 341 F. Supp. 2d at 11 (citing *Bowen*). That distinction "is that rules have legal consequences only for the future" (*i.e.*, rules operate prospectively only), while orders may have "future as well as past legal consequences" (*i.e.*, orders can operate both retrospectively and prospectively). *Bowen*, 488 U.S. at 216 (Scalia, J., concurring). Other decisions highlight a second distinction: "Rulemaking is . . . directed to the implementation of *general* policy concerns into legal standards," while "adjudication" (*i.e.*, order-making) "is directed to the determination of the legal status of a *particular person or practice[]* through the application of preexisting legal standards." *Doe*, 341 F. Supp. 2d at 11-12 (citation omitted) (emphasis added).

Here, both distinctions establish that under the APA, FHFA's July 6 Statement was not a rule. *First*, the Statement is not exclusively prospective in operation. To the extent that the Statement creates legal consequences at all, those consequences flow from "future as well as past" conduct. Specifically, the Statement includes a separate directive regarding PACE-encumbered mortgages written "prior to this date." FHFA Statement at 2. *Second*, to the extent that the Statement addresses legal status at all, it addresses "the legal status of a particular . . . practice[] through the application of preexisting legal standards." *Doe* at 12. Specifically, the Statement addresses the particular practice of investing in mortgages subject to PACE liens, and prescribes "prudential actions" the Enterprises must undertake in order to fulfill their pre-existing legal obligation to maintain safe and sound operations. FHFA Statement at 2.

Because, as noted *supra*, the § 4635(b) jurisdictional bar applies if the Statement is deemed a final order, this case is akin to *Americopters, LLC v. F.A.A.*, in which the Ninth Circuit noted that:

> The issue of finality leaves [plaintiffs] somewhere between Scylla and Charybdis. The dilemma is this: if the [certain agency statements] are final orders . . . [then a jurisdiction-limiting statute] preempts the district court from considering these claims. But if they are not final, then [the APA] bars the district court from hearing the case for lack of jurisdiction. . . . As a result of the finality conundrum, the district court has no jurisdiction over the direct challenges to the [agency statements].

Americopters, LLC v. F.A.A., 441 F.3d 726, 735-36 (9th Cir. 2006).

b. <u>The Statement Is Not Legislative</u>

The APA does not subject every pronouncement of a federal agency to notice and comment rulemaking. Rather, "[i]nterpretive rules [and] general statements of policy are exempt" from such requirements. 5 U.S.C. § 553(b)(3); *Lincoln v. Vigil*, 508 U.S. 182, 196 (1993). This "allow[s] administrative officers the freedom to explain what they think a regulation or statute means without undertaking cumbersome proceedings." *Sentara-Hampton Gen. Hosp. v. Sullivan*, 980 F.2d 749, 759 (D.C. Cir. 1992). To the same effect, HERA expressly authorizes FHFA to issue "guidelines" that do not require the notice-and-comment process used in connection with regulations. *See* 12 U.S.C. § 4526. This is consistent with the common and accepted practice of all financial regulators, which routinely provide supervisory guidance to their regulated entities without issuing rules or applying notice-and-comment procedures.

As explained in the Motion to Dismiss Sonoma's Claims, the Statement is interpretive, not legislative, and therefore the APA did not require FHFA to issue it through a notice-and-comment process. *See* Mot. to Dismiss Sonoma's Claims at 42-45.

4. <u>Plaintiffs' Arbitrary-and-Capricious Action Claims Fail</u>

Palm Desert and Placer both also assert that FHFA acted arbitrarily and capriciously in issuing the Statement, and thereby violated the APA. *See* Palm Desert Compl. at ¶¶ 53-55; Placer Compl. at ¶ 62. Under the governing law, Plaintiffs' allegation are insufficient to support such a claim. Under the APA, the arbitrary-and-capricious standard applies only to actions that are not "committed to agency discretion by law." 5 U.S.C. § 701(a)(2). A plaintiff seeking to apply the standard "must specify some statute that would limit [the agency]'s discretion in th[e] matter" for which review is sought. *Lunney v. U.S.*, 319 F.3d 550, 558 (2d Cir. 2003). Plaintiffs identify none, and that failure alone is sufficient to doom the claims. *See* Palm Desert Compl. at ¶¶ 53-55; Placer Compl. at ¶ 62.

But even assuming that review under the arbitrary-and-capricious standard would be proper here, Plaintiffs could not establish that FHFA acted arbitrarily or capriciously. "Review under the arbitrary and capricious standard is narrow, and [courts do] not substitute [their] judgment for that of the agency." *The Lands Council v. McNair*, 537 F.3d 981, 987 (9th Cir. 2008) (quotation marks and citations omitted). "Rather, [courts] will reverse a decision as arbitrary and capricious only if the agency relied on factors Congress did not intend it to consider, entirely failed to consider an important aspect of the problem, or offered an explanation that runs counter to the evidence before the agency or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Id.* In particular, the reviewing court must defer to the agency's decision when the resolution of the dispute involves issues of fact or requires a high level of technical expertise. *Marsh v. Or. Natural Res. Council*, 490 U.S. 360, 377 (1989); *Cen. Ariz. Water Conservation Dist. v. EPA*, 990 F.2d 1531, 1539-40 (9th Cir. 1993).

Plaintiffs cannot establish that FHFA "relied on factors Congress did not intend it to consider." In issuing the Statement (and in all of the actions FHFA has taken regarding PACE programs), FHFA relied on the fact that the first-lien PACE loans necessarily shift default risk from PACE lenders to the holder of the mortgage. *See* FHFA Statement at 1. Because the Enterprises' portfolios consist almost exclusively of mortgages and mortgage-related assets, FHFA determined that PACE programs "present significant safety and soundness concerns" for the Enterprises. *Id.* Congress indisputably intended FHFA to consider financial risks and safety and soundness concerns in supervising the Enterprises (as their regulator) and managing their affairs (as Conservator); HERA includes a panoply of provisions directly on point. *See*, *e.g.*, 12 U.S.C. §§ 4511, 4513, 4517.

Likewise, Plaintiffs cannot establish that FHFA "entirely failed to consider an important aspect of the problem." Placer's claim that "FHFA has failed to examine relevant data," Placer Compl. at ¶ 62, is purely conclusory and unsupported by any factual allegations. Palm Desert asserts that FHFA purportedly "ignored" certain attributes of existing PACE programs, principally including a purportedly relevant distinction between PACE programs that "require acceleration of the assessment obligation in the event of default" and programs "that do not authorize acceleration of the assessment obligation." Palm Desert Compl. at ¶ 54(a). But as explained in the Motion to Dismiss Sonoma's Claims, PACE programs that do not accelerate upon default still shift material financial risk to mortgage holders including the Enterprises. *See* Mot. to Dismiss Sonoma's Claims at 14-15 & n.37. Hence, Palm Desert's distinction is irrelevant and does nothing to undermine FHFA's judgment that the financial risks first-lien PACE programs pose to mortgage holders present significant safety and soundness concerns regarding the Enterprises' portfolios. Palm Desert also claims that FHFA ignored purported "facts" that are really nothing more than Palm Desert's positions on certain legal issues, such as how PACE assessments are to be treated under the Enterprises Uniform Security Instruments. Palm Desert Compl. at ¶ 54(b). That FHFA's conclusion differs from Palm Desert's does not in any way imply that FHFA "ignored" the issue.

Finally, Plaintiffs cannot establish that FHFA "offered an explanation that runs counter to the evidence before the agency or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." In the Statement, FHFA explained that first-lien PACE programs "present significant safety and soundness concerns" because of the "difficult risk-management challenges" that the first-lien priority presents. FHFA Statement at 1. Placer acknowledges that the first-lien attribute of PACE obligations makes mortgage-related assets riskier and less valuable to entities (including the Enterprises) that hold such assets, although Placer claims that the "diminishment" will not be "significant." Placer Compl. at ¶ 32. As there is no dispute that PACE programs pose increased financial risk to holders of mortgage-related assets, which is exactly the explanation FHFA offered for its actions, FHFA's explanation cannot be regarded as running counter to the evidence—even the evidence Plaintiffs now purport to have mustered. Indeed, other financial institution regulators reached the same conclusion as FHFA.[24] Further, evaluation of the

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[24] *See* OCC Bulletin 2010-25, Property Assessed Clean Energy (PACE) Programs (July 6, 2010), *available at* http://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-25.html (Border Decl. Ex. 17); FDIC, Financial Institution Letter FIL-37-2010, Alert on FHFA Statement Relative to Concerns with Certain Energy Lending Programs (July 6, 2010), *available at* http://www.fdic.gov/news/news/financial/2010/fil10037.html (Border Decl. Ex. 18); National Credit Union Administration, Regulatory Alert No. 10-RA-10, Potential Risks of Property Assess

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nature and materiality of the risks that first-lien PACE programs like mPOWER and EIP pose to the Enterprises is surely within FHFA's expertise, and the actions FHFA has taken regarding those risks are therefore the product of agency expertise. Hence, Plaintiffs' allegations fail to state a plausible claim that FHFA's actions were arbitrary and capricious.

D. Palm Desert's NEPA Claim Fails

Palm Desert claims that FHFA ran afoul of the National Environmental Policy Act ("NEPA") by issuing the Statement without first having prepared an "environmental impact analysis or environmental impact statement." Palm Desert Compl. at ¶¶ 49-52. As explained in the Motion to Dismiss Sonoma's Claims, the NEPA claim fails for three reasons. *First*, the absence of APA Jurisdiction requires dismissal of the NEPA claim. *See* Mot. to Dismiss Sonoma's Claims at 45. *Second*, only "major federal action" can trigger NEPA's procedural requirements, and FHFA's issuance of the Statement does not constitute major federal action. *Id.* at 45-48. *Third*, NEPA's procedural requirements do not apply where an agency cannot base its decision on environmental factors, and given its statutory mandate, FHFA cannot subordinate financial safety and soundness concerns to environmental interests. *Id.* at 48-50.

E. Placer's Declaratory Judgment Claim Fails

Placer seeks declaratory judgments substantially similar to those sought by Sonoma and plaintiffs in the related cases. *Compare* Placer Compl. ¶ 80 *with, e.g.*, Sonoma Compl. ¶ 62. For the reasons set forth in the Motion to Dismiss Sonoma's Claims, these claims fail as a matter of law. *See* Mot. to Dismiss Sonoma's Claims at 36-41. Indeed, while Placer seeks a declaratory judgment that "the mPOWER program operates through legally valid assessments *and not loans*," Placer Compl. at Prayer ¶ 1 (emphasis added), Palm Desert's marketing materials candidly acknowledge that its analogous program involves loans:

> Since its launch in August 2008, the Energy Independence Program has made $5 million in <u>loans</u>, funded with $2.5 million each from the city's general fund and Redevelopment Agency. In February 2010, the City announced

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Clean Energy Loans (July 2010), *available at* http://www.ncua.gov/news/express/xfiles/10-RA-10.pdf (Border Decl. Ex. 19).

> the release of $6 million in new funding for the program. Half of the new funds will be dedicated to *loans* for energy efficiency improvements with the other half reserved for *loans* for solar projects.
>
> **NOTICE** - The City is once again accepting applications for its popular Energy Independence Program (EIP). Approximately $9 million is still available for EIP *loans* for qualifying energy efficiency upgrades and renewable energy projects, such as solar panels.

Palm Desert, Energy Independence Program website, available at http://www.cityofpalmdesert.org/Index.aspx?page=484 (last visited Nov. 5, 2010) (emphasis added) (Varma Decl. Ex. 3). Palm Desert provides not only a "Summary of [the] Loan Process" for EIP applicants, Palm Desert, Summary of Loan Process, *available at* http://www.cityofpalmdesert.org/Modules/ShowDocument.aspx?documentid=4820 (Varma Decl. Ex. 2), but also a "Draft Loan Agreement." Loan Agreement, City of Palm Desert Energy Independence Program, *available at* http://www.cityofpalmdesert.org/Modules/ShowDocument.aspx?documentid=4632 (Varma Decl. Ex. 4). Palm Desert even provides a report from the City's "Director, Office of Energy Management" that repeatedly and unabashedly refers to PACE programs generically (*i.e.*, to all "AB811 programs," not just Palm Desert's EIP) as involving "loans," stating, for example, that "[p]roperty owners *repay the loan* through a contractual assessment on their property." Palm Desert, Staff Report at 2 (Aug. 28, 2008), *available at* http://www.cityofpalmdesert.org/Modules/ShowDocument.aspx?documentid=2529 (emphasis added) (Varma Decl. 5).

CONCLUSION

For all the foregoing reasons, Defendants respectfully request that the Court dismiss all of Plaintiffs' claims with prejudice pursuant to Fed. R. Civ. P. 12(b)(1) and 12(b)(6).

Dated: November 5, 2010

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