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11 IN THE UNITED STATES DISTRICT COURT
 12 FOR THE NORTHERN DISTRICT OF CALIFORNIA

14 **PEOPLE OF THE STATE OF CALIFORNIA,**
 15 *ex rel. EDMUND G. BROWN JR.,*
 16 **ATTORNEY GENERAL,**

Plaintiff,

17 **v.**

18 **FEDERAL HOUSING FINANCE AGENCY;**
 19 **et al.,**

20 **Defendants.**

21 _____
 22 **– and related cases –**

Case No. 10-cv-03084 CW

Related Case Nos.:

10-cv-03270 CW
 10-cv-03317 CW
 10-cv-04482 CW

**PLAINTIFFS' JOINT
 MEMORANDUM OF POINTS AND
 AUTHORITIES IN OPPOSITION TO
 DEFENDANTS' MOTION TO
 DISMISS**

Date: December 2, 2010
 Time: 2:00 p.m.
 Dept: 2
 Judge: The Hon. Claudia Wilken

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INTRODUCTION¹

1
2 For well over a century, local governments have used their assessing and taxing powers to
3 finance improvements – such as sidewalks, roadway paving, and the undergrounding of utilities –
4 that benefit property owners and the larger community. Property Assessed Clean Energy (PACE)
5 programs use this same well-established mechanism to finance clean energy and water and energy
6 efficiency improvements for homes and businesses. Under PACE, local governments finance
7 qualifying improvements, allowing property owners to pay over time through regular assessments
8 that appear on the property tax bill. As with all assessments, the obligation “runs with the land,”
9 meaning that it passes to the new property owner on sale.

10 PACE has been endorsed at every level of government. In passing California’s PACE law,
11 the State legislature expressly determined that PACE provides public benefits and is essential to
12 achieving the State’s energy conservation and environmental objectives. The White House and
13 the Department of Energy (DOE) have supported PACE, and DOE awarded substantial federal
14 grant monies to California local governments to pursue PACE. Recognizing PACE’s benefits,
15 local governments across California have invested substantial time, money, and political capital
16 to develop efficient and successful PACE programs, delivering jobs to the local economy and
17 utility bill savings to their residents.

18 As set out in detail in plaintiffs’ complaints, by their actions, defendants Federal Housing
19 Finance Agency (FHFA, a federal agency), Federal National Mortgage Association (Fannie Mae,
20 a government-sponsored private enterprise), and the Federal Home Loan Mortgage Corporation
21 (Freddie Mac, also a government-sponsored private enterprise) have taken summary, decisive,
22 and unilateral action to shut down PACE programs across the nation and in California. Plaintiffs
23 allege that FHFA’s action violates the Administrative Procedures Act (APA) (5 U.S.C. §§ 500, *et*
24 *seq.*) because it is, among other things, arbitrary and capricious and not in accordance with law,
25 and because FHFA did not follow notice-and-comment requirements; the National Environmental
26

27 ¹ Plaintiffs file this brief jointly pursuant to the Court’s order; however, each plaintiff joins
28 and is responsible for only those arguments that pertain to the claims set forth in its complaint.

1 Policy Act (NEPA) (42 U.S.C. §§ 4321, *et seq.*);² and, in addition, the U.S. Constitution (Placer
 2 County and City of Palm Desert).³ Plaintiffs further allege that Fannie Mae's and Freddie Mac's
 3 actions violate California's Unfair Competition Law (Cal. Bus. & Prof. Code §§ 17200 *et seq.*)
 4 and state tort law.

5 Currently before this Court is defendants' Motion to Dismiss all complaints. While
 6 defendants make a number of arguments employing a variety of sometimes inconsistent theories,
 7 there is one overarching and recurring theme. FHFA contends that it can take whatever action it
 8 desires related to PACE and the mortgage market, without notice, without opportunity for public
 9 comment, and without support. According to the Agency, no Court has jurisdiction to review its
 10 action, and none of the plaintiffs – not even the State of California – has sufficient interest to
 11 challenge it. As set forth below, nothing in FHFA's governing statute or anywhere else in the law
 12 supports the Agency's assertion of such far reaching and supreme power. Defendants' Motion to
 13 Dismiss should be denied.

14 SUMMARY OF ARGUMENT⁴

15 FHFA first argues that this Court has no jurisdiction over plaintiffs' APA and NEPA claims
 16 because certain statutory provisions in the Agency's authorizing statute, the Safety and Soundness
 17 Act (Title 12, Chapter 46), limit or withdraw review. Read in full and in context, none of the
 18 three statutory provisions that FHFA cites applies to FHFA's July 6, 2010 anti-PACE Statement.

19 The first provision cited by FHFA, 12 U.S.C. section 4617(f), limits review where FHFA is
 20 acting in its capacity as the conservator of a regulated entity. Considering the content of the
 21 Statement, taking the facts as alleged by plaintiffs as true, and rejecting the Agency's *post hoc*
 22 assertions, there is nothing to indicate that FHFA was acting as the conservator of Fannie Mae
 23 and Freddie Mac (the Enterprises) when it issued its Statement. Rather, FHFA was acting in its
 24 general supervisory and regulatory capacity as evidenced by, for example, the fact that the

25 ² All plaintiffs except Placer County allege violation of NEPA.

26 ³ FHFA's Motion to Dismiss does not address Palm Desert's claim under the Fourteenth
 Amendment (Palm Desert Compl. ¶¶ 53-55) and, therefore, this brief does not address that claim.

27 ⁴ Defendants filed their Motion to Dismiss in two parts: the first filed on October 14,
 28 2010, and the second filed on November 5, 2010. For ease of reference, in citing to defendants'
 briefs, plaintiffs will refer to these filings as "Motion 1" and "Motion 2."

1 Statement was issued to all regulated entities and not just those for which FHFA is conservator.
2 The second provision FHFA cites, 12 U.S.C. section 4635(b), addresses FHFA's control over the
3 Enterprises' "portfolio holdings." Nothing in FHFA's Statement suggests that it has anything to
4 do with such holdings. Finally, FHFA cites 12 U.S.C. section 4623(d), which relates to FHFA
5 orders to regulated entities that have been classified as "significantly undercapitalized." Again,
6 nothing in the Statement suggests that it was issued by FHFA under this authority. Applying the
7 presumption in favor of judicial review, the Court has jurisdiction over plaintiffs' APA and
8 NEPA claims. Defendants' Motion, to the extent it is grounded in Rule 12(b)(1), should be
9 denied.

10 Plaintiffs have adequately pleaded all claims, and, therefore defendants' Rule 12(b)(6)
11 arguments also fail. FHFA attacks plaintiffs' APA and NEPA claims on a variety of fronts, none
12 of which have merit. Plaintiffs have prudential standing to pursue their APA claims. Contrary to
13 FHFA's crabbed reading of the Safety and Soundness Act, plaintiffs are within the Act's "zone of
14 interest" because all have interests related to the proper functioning of the residential home
15 mortgage market and all are directly affected by FHFA's anti-PACE action. Moreover, plaintiffs
16 clearly are within the "zone of interest" of NEPA; all have an interest in obtaining the
17 conservation and environmental benefits of PACE that have been thwarted by FHFA's action.

18 While FHFA certainly has discretion to issue regulations related to PACE, contrary to
19 FHFA's argument, its discretion is not so ill-defined and unbounded as to be "committed to
20 agency discretion by law" (5 U.S.C. § 701(a)(2)) and therefore unreviewable under the APA.
21 Reviewing agency rules to ensure that they are not arbitrary, capricious or an abuse of discretion,
22 and that they are in accordance with law and with constitutional requirements (5 U.S.C. § 706) is
23 squarely within the courts' expertise.

24 Whether FHFA was required to comply with notice and comment requirements depends on
25 whether the Agency's July 6, 2010 Statement constitutes a substantive rule. The facts as pleaded
26 by plaintiffs, taken as true, establish that FHFA's Statement is a quasi-legislative *rule*
27 (prospective and of broad application) and not a quasi-judicial order (fact specific and
28 situational). Further, the Statement is a *substantive* rule, as it is not merely discretionary fine-

1 tuning. For these reasons, FHFA's failure to give notice and provide opportunity for comment,
2 standing alone, violates the APA.

3 Contrary to FHFA's assertions, plaintiffs have sufficiently pleaded that the FHFA's July 6,
4 2010 Statement is a major federal action as defined in NEPA. FHFA's action was specifically
5 intended to – and did – cause a “pause” in state-law based programs that are specifically designed
6 to reduce greenhouse gas pollution. FHFA's contention that it is precluded from considering the
7 environment in taking actions under the Safety and Soundness Act must be rejected. Nothing in
8 the Act creates an irreconcilable conflict with the requirements of NEPA, and, accordingly, there
9 is no basis for a special exemption for FHFA.

10 California and the Counties' state law-based claims against Fannie Mae and Freddie Mac
11 are not preempted by the Safety and Soundness Act, either expressly or by conflict. The limits of
12 12 U.S.C. § 4617 apply only to *FHFA* in its capacity as conservator, not to the Enterprises. Even
13 as to FHFA, the provision at most prevents state administrative oversight of FHFA's conservator
14 actions, not traditional tort and law enforcement claims under state law. As for conflict
15 preemption, the facts as pleaded by plaintiffs do not show any irreconcilable conflict with the
16 Safety and Soundness Act, or that such claims stand as an obstacle to the purposes of that Act.
17 Indeed, until Fannie Mae and Freddie Mac issued their anti-PACE lender letters on May 5, 2010,
18 the purposes of the Act and state law were both being served. In any event, it is premature to
19 reach conflict preemption – an affirmative defense based on disputed facts and a constitutional
20 doctrine – at the pleading stage.

21 Defendants' remaining arguments (FHFA's challenge to Placer County's Tenth
22 Amendment and Spending Clause claims; Fannie Mae's and Freddie Mac's challenge to the
23 elements of the State's Unfair Competition Law and the Counties' tort claims; and defendants'
24 challenge to declaratory relief claims) all are based on disputed facts and, accordingly, cannot
25 provide a basis for dismissal of plaintiffs' claims at this stage of the litigation. For these reasons,
26 and as set forth in greater detail below, the Court should deny defendants' Motion to Dismiss.

1 **SUMMARY OF FACTS ALLEGED**

2 The facts as alleged by plaintiffs California, County of Sonoma, intervenor County of
3 Placer, City of Palm Desert, and Sierra Club are set forth in their complaints and in the documents
4 referenced in, and attached to, those complaints. By way of background, plaintiffs will
5 summarize the primary actions of FHFA, Fannie Mae, and Freddie Mac that give rise to these
6 lawsuits.

7 Fannie Mae and Freddie Mac are federally chartered, private corporations that facilitate the
8 secondary market in residential mortgages. (California First Amended Complaint (Cal. FAC) ¶¶
9 10, 12.) Together, the Enterprises own or guarantee approximately one-half of the home loans in
10 the U.S. and California. (Cal. FAC ¶ 12.) The Enterprises effectively control the mortgage resale
11 market and, because of this power, lenders will not issue mortgages that are inconsistent with
12 Fannie Mae's and Freddie Mac's stated requirements and expectations. (Cal. FAC ¶ 3.)

13 Defendant FHFA is the federal government agency that regulates and supervises Fannie
14 Mae, Freddie Mac, and the Federal Home Loan Banks. (Cal. FAC ¶ 14.)⁵ Defendants request
15 that the Court judicially notice that as of September 6, 2008, FHFA has also acted as the
16 conservator of Fannie Mae and Freddie Mac.⁶ (*See* Motion 1 at pp. 2, 6-7.) Since that date,
17 Treasury has infused substantial funds into Fannie Mae and Freddie Mac. (Motion 1 at pp. 6-7.)

18 For well over 100 years, local governments in California have used their assessment powers
19 to finance improvements that serve a public purpose, such as the paving of roads, sidewalk
20 improvements, and the undergrounding of utilities. (Cal. FAC ¶ 18.) Assessments are paid over
21 time through charges that appear on the property tax bill, and the obligation to pay runs with the
22 land, meaning that it passes to the new owner on sale. (Sonoma Compl. ¶ 16.) Under
23 longstanding California law, assessments create liens that have priority over private mortgages.
24 (Cal. FAC ¶ 19.) Plaintiffs allege that the Enterprises' longstanding business practices reflect

25 _____
26 ⁵ For a summary of FHFA's creation through the Housing and Economic Recovery Act of
2008 and a history of FHFA's predecessor agencies, *see* 75 Fed. Reg. 39462-64 (July 9, 2010).

27 ⁶ While the statutory basis for Fannie Mae's and Freddie Mac's conservatorship is not
28 clear from defendants' submissions, it appears that it was effected by consent. 74 Fed. Reg. 5609,
5610 (Jan. 30, 2009).

1 their interpretation that assessments constitute priority liens that are not prohibited by their form
2 mortgage documents (called Uniform Security Instruments). (Cal. FAC ¶¶ 20, 34.)

3 Under California law, local governments may finance the installation on private property of
4 various energy- and water-saving improvements using the same, traditional assessment
5 mechanism.⁷ (Cal. FAC ¶ 21.) Under the plain language of California law, any liens that result
6 from PACE assessments have priority over mortgages, operating in the same way as other
7 assessments. (Cal. FAC ¶ 21.) Thus, in the event of a mortgage default, any delinquent PACE
8 assessments (not the entire amount financed) are paid ahead of the mortgage. (Cal. FAC ¶ 41.)

9 In passing its PACE law (California Assembly Bill 811 (Cal. Stats. 2008, ch. 159), Cal.
10 Streets & Hwys. Code § 5898.12), the California legislature made the following findings:

11 Energy conservation efforts, including the promotion of energy efficiency improvements to
12 residential, commercial, industrial, or other real property are necessary to address the issue
13 of global climate change

14 The upfront cost of making residential, commercial, industrial, or other real property more
15 energy efficient prevents many property owners from making those improvements.... [I]t
16 is necessary to authorize an alternative procedure for authorizing assessments to finance the
17 cost of energy efficiency improvements.

18 [A] public purpose will be served by a contractual assessment program that provides the
19 legislative body of any city with the authority to finance the installation of distributed
20 generation renewable energy sources and energy efficiency improvements that are
21 permanently fixed to residential, commercial, industrial, or other real property.

22 (Cal. FAC ¶ 43 (quoting Cal. Streets & Hwys. Code § 5898.14).)

23 The passage of California's PACE law spurred the development of PACE programs across
24 the State. (Cal. FAC ¶ 22.) The City of Palm Desert established its Energy Independence
25 Program by a resolution adopted on August 28, 2008. (Palm Desert Compl., ¶ 13). Sonoma
26 County launched its Energy Independence Program in March 2009. Sonoma County's PACE
27 program has now financed over 1,000 water- and energy-saving projects totaling over \$34.5
28 million. (Sonoma Compl. ¶¶ 25 and 28.) Placer County established the "money for Property

⁷ Cal. Gov. Code § 53311 *et seq.*; Cal. Streets & Hwys. Code §§ 5898.12, 5898.14, 5898.20, 5898.21, 5898.22, and 5898.30

1 Owner Water & Energy Efficiency Retrofitting” program (or “mPOWER Program”) in May
2 2010. (Placer Compl. ¶¶ 17, 26).

3 The federal government, including the White House and DOE, supported development of
4 PACE. (Cal. FAC ¶ 25.) Among other things, DOE expressly supported the use of hundreds of
5 millions of dollars of federal Recovery Act funds for PACE programs. (Cal. FAC ¶¶ 25, 26.)
6 Dozens of counties and cities across California were poised to launch their own PACE programs
7 in part with federal dollars. (Cal. FAC ¶ 26.)

8 In its September 18, 2009, lender letter, interpreting the Enterprises’ Uniform Security
9 Instruments, Fannie Mae stated that until further guidelines are issued, “lenders should treat
10 [PACE] payments as a special assessment in underwriting a borrower where the security property
11 is subject to an existing [PACE] loan.” (Cal. FAC ¶ 24, Ex. A (Letter at p. 2).) The letter further
12 stated that mortgage “[s]ervicers should treat [PACE] as any tax or assessment that may take
13 priority over Fannie Mae’s lien.” (*Id.*) On May 5, 2010, Fannie Mae and Freddie Mac each
14 unexpectedly issued a letter to the mortgage industry concerning PACE taking a contrary
15 position. (Cal. FAC ¶¶ 27-28 and Ex. B.) In the letters, Fannie Mae and Freddie Mac both
16 referred to PACE “loans”; the word “assessment” does not appear in either letter. (*Id.*) Fannie
17 Mae’s letter further stated that “[t]he terms of Fannie Mae/Freddie Mac Uniform Security
18 Instruments prohibit loans that have senior lien status to a mortgage.” (*Id.*)

19 The California Attorney General believed, and sought confirmation from FHFA, that
20 Fannie Mae’s and Freddie Mac’s May 5, 2010 lender letters did not apply in California – where
21 PACE operates not through loans in a traditional sense, but rather through assessments. (Cal.
22 FAC ¶ 47, Ex. D (letter from Attorney General to FHFA).) On July 6, 2010, FHFA responded
23 with a cover letter to the Attorney General and a definitive Statement that ends the effective
24 operation of PACE in California. (Cal. FAC ¶ 48, Ex. C.) The cover letter and the Statement set
25 forth FHFA’s intent to create a “pause” in PACE programs. (Cal. FAC, Ex. C.)

26 FHFA’s July 6, 2010 Statement contains three elements. First, FHFA makes several
27 summary and general assertions about the risks purportedly posed by PACE. For example, FHFA
28 asserts: “First liens established by PACE loans are unlike routine tax assessments and pose

1 unusual and difficult risk management challenges for lenders, servicers and mortgage securities
2 investors”; PACE programs “present significant risk to lenders and secondary market entities,
3 may alter valuations for mortgage-backed securities and are not essential for successful programs
4 to spur energy conservation” and “disrupt a fragile housing finance market and long-standing
5 lending priorities”; and “the absence of robust underwriting standards to protect homeowners and
6 the lack of energy retrofit standards to assist homeowners, appraisers, inspectors and lenders
7 determine the value of retrofit products combine to raise safety and soundness concerns.” (Cal.
8 FAC, Ex. C.) Second, FHFA affirms the assertion in the May 5, 2010 lender letters that
9 “programs with first liens run contrary to the Fannie Mae-Freddie Mac Uniform Security
10 Instrument,” and further states that without exception or caveat, “[t]hose lender letters remain in
11 effect.” Lastly, FHFA directs Fannie Mae, Freddie Mac, and the Federal Home Loan Banks to
12 undertake what it calls “prudential actions.” (*Id.*) These include, for example, “[e]nsuring that
13 loan covenants require approval/consent for any PACE loan.” (*Id.*)

14 Plaintiffs agree that, as requested by defendants, the Court can take judicial notice of further
15 action taken by Fannie Mae and Freddie Mac on August 31, 2010, which occurred after the filing
16 of plaintiffs’ original complaints, without converting this motion into a motion for summary
17 judgment.⁸ On August 31, 2010, Fannie Mae and Freddie Mac each issued a new lender letter
18 addressing PACE. (Declaration of Scott M. Border in Support of Motion to Dismiss (Border
19 Decl.), Exs. 20, 21.) Both letters indicate that they are issued in response to FHFA’s July 6, 2010
20 Statement. (*Id.*) The Fannie Mae letter states that for PACE “loans” originated on or after July 6,
21 2010, the Enterprise “will not purchase mortgage loans secured by properties with an outstanding
22 PACE obligation unless the terms of the PACE program do not permit priority over first
23 mortgage liens.” (Border Decl. Ex. 20 at p. 2.) (In California, by operation of law, PACE
24 assessments have priority over private mortgages.) The Freddie Mac letter contains a similar
25 prohibition. (Border Decl. Ex. 21 at p. 1.)

26
27 ⁸ Placer County’s Complaint in Intervention, filed November 3, 2010, includes allegations
28 concerning the Enterprises’ actions on this date. (Placer Compl. ¶ 39.)

1 Defendants' actions have harmed local PACE programs in California. For example, more
2 than 20 Sonoma County property owners who were in the process of entering the PACE program
3 for various energy improvements have withdrawn their applications. (Sonoma Comp. ¶ 46.) The
4 City of Palm Desert's PACE program has been adversely affected by "discriminating acts by
5 lenders." (Palm Desert Compl. ¶ 47.) Placer County was forced to indefinitely suspend its
6 Residential PACE program in July 2010. (Placer Comp. ¶ 34.) Before suspension, Placer County
7 had committed to 11 contractual assessments. (*Id.*)

8 SUMMARY OF THE SAFETY AND SOUNDNESS ACT

9 Following introductory provisions and definitions (12 U.S.C. §§ 4501-4503), the Safety and
10 Soundness Act, Chapter 46 of Title 12, is divided into three subchapters: subchapter I,
11 "Supervision and Regulation of Enterprises" (12 U.S.C. §§ 4511-4603); subchapter II, "Required
12 Capital Levels for Regulated Entities, Special Enforcement Powers, and Reviews of Assets and
13 Liabilities" (12 U.S.C. §§ 4611-4624); and subchapter III, "Enforcement Provisions" (12 U.S.C.
14 §§ 4631-4642).

15 While the categories are not entirely discrete, generally speaking, the Act defines three
16 areas of agency authority. As set forth in subchapter I, FHFA has "general regulatory authority"
17 over Fannie Mae, Freddie Mac, and the Federal Home Loan Banks – the "regulated entities." 12
18 U.S.C. §§ 4511(b), 4502(20). This "general regulatory authority" includes exercising the "duties
19 and authorities set forth under section 4513[.]" 12 U.S.C. § 4511(b)(2). The duties and
20 authorities listed in 12 U.S.C. section 4513 include, for example, "oversee[ing] the prudential
21 operations of each regulated entity"; and ensuring that they operate in a "safe and sound
22 manner[.]" act "only through activities that are authorized under and consistent with" Chapter 46,
23 and act "consistent with the public interest." 12 U.S.C. § 4513(a)(1)(A)-(B). As FHFA itself
24 acknowledges, its general regulatory authority is broad. *See* 75 Fed. Reg. 39462, 39463 (July 9,
25 2010). Moreover, the Act makes clear that FHFA's authorities "under subchapters II and III of
26 this chapter[.]" described below, do "not in any way limit the general supervisory and regulatory
27 authority" granted under section 4511(b). 12 U.S.C. § 4511(c).

28

1 Under subchapter II, FHFA is authorized and in some cases required to take more specific
2 actions to ensure that Fannie Mae, Freddie Mac, and the Federal Home Loan Banks have
3 sufficient capital and reserves. For example, FHFA must issue regulations establishing capital
4 requirements for the regulated entities (12 U.S.C. § 4611(a)(1)) and must periodically classify
5 each regulated entity based on the adequacy of its capitalization (12 U.S.C. § 4614). In addition,
6 under subchapter II, the Director may appoint FHFA as conservator or receiver of a regulated
7 entity for a variety of reasons, including where there has been substantial dissipation of assets due
8 to any unsafe or unsound practice (12 U.S.C. § 4617(a)(3)(B)(ii)); where the entity is
9 “undercapitalized” as defined in the act (12 U.S.C. § 4617(a)(3)(J)); or where the entity consents
10 to appointment (12 U.S.C. § 4617(a)(3)(I)). As conservator, FHFA succeeds to all the “rights,
11 titles, powers, and privileges” of the shareholders, directors, and officers of the regulated entity
12 under conservatorship. 12 U.S.C. § 4617(b)(2)(A)(i).

13 The Act also provides FHFA, acting as conservator, with a number of additional powers to
14 conserve the assets of a regulated entity under conservatorship, including, for example, the
15 authority to take over the assets of and operate the regulated entity (12 U.S.C. §
16 4617(b)(2)(B)(i)); collect all obligations and money due the regulated entity (12 U.S.C. §
17 4617(b)(2)(B)(ii)); preserve and conserve the assets and property of the regulated entity (12
18 U.S.C. § 4617(b)(2)(B)(iv)); and transfer or sell any asset or liability in default (12 U.S.C. §
19 4617(b)(2)(G)). FHFA’s power as conservator or receiver includes taking actions that are
20 necessary to put the regulated entity into a “sound and solvent condition,” and that are appropriate
21 to carry on the business of the regulated entity and preserve the assets and property of the
22 regulated entity. 12 U.S.C. § 4617(b)(2)(D).

23 Finally, under subchapter III, FHFA is empowered to take certain enforcement actions
24 against the regulated entities. Among other things, the Agency can issue notice of charges and
25 “cease and desist” orders to regulated entities to prohibit unsafe or unsound practices or violations
26 of law (12 U.S.C. §§ 4631(a),(c), 4632(a)); impose monetary penalties on regulated entities (12
27 U.S.C. § 4636(a)); and remove officers and directors of regulated entities (12 U.S.C. § 4636a(a)).
28 Subchapter III also contains a provision governing the procedural requirements for parties to an

1 FHFA quasi-judicial proceeding that wish to challenge the Agency's resulting enforcement order,
2 whether issued under Subchapter III or pursuant to the agency's general supervisory authority. 12
3 U.S.C. § 4634.

4 ARGUMENT

5 I. Legal Standard – Motion to Dismiss

6 Defendants bring their motion to dismiss on two grounds: lack of subject matter jurisdiction
7 (Fed. Rule Civ. P. 12(b)(1)) and failure to state a claim upon which relief can be granted (Fed.
8 Rule Civ. P. 12 (b)(6)).

9 A motion to dismiss under Rule 12(b)(1) for lack of subject matter jurisdiction may be
10 facial or factual. *Safe Air for Everyone v. Meyer*, 373 F.3d 1035, 1039 (9th Cir. 2004). FHFA's
11 jurisdictional arguments rely on specific provisions of the Safety and Soundness Act. These
12 arguments rise or fall on the statutory language and thus are facial challenges to this Court's
13 jurisdiction. In ruling on a facial Rule 12(b)(1) motion, a court must accept the complaint's
14 factual allegations as true and construe them in the light most favorable to the plaintiffs. *Carson*
15 *Harbor Village, Ltd. v. City of Carson*, 353 F.3d 824, 826 (9th Cir. 2004).

16 All of defendants' remaining arguments would appear to be made under the authority of
17 Rule 12(b)(6). To survive a Rule 12(b)(6) motion to dismiss, a complaint must contain sufficient
18 facts "to state a claim to relief that is plausible on its face." *Caviness v. Horizon Comty. Learning*
19 *Ctr., Inc.*, 590 F.3d 806, 812 (9th Cir. 2010) (citation omitted). All allegations of material fact in
20 the complaint are taken as true and construed in the light most favorable to the plaintiff. *Cousins*
21 *v. Lockyer*, 568 F.3d 1063, 1067 (9th Cir. 2009).

22 In general, in ruling on a motion to dismiss, a court is limited to the four corners of the
23 complaint. *Hal Roach Studios, Inc. v. Richard Feiner and Co., Inc.*, 896 F.2d 1542, 1555 n.19
24 (9th Cir. 1990). This rule is subject to limited exceptions. A court may consider documents that
25 are referenced in the plaintiff's complaint, the authenticity of which is not disputed, without
26 converting a motion to dismiss into a motion for summary judgment. *Branch v. Tunnel*, 14 F.3d
27 449, 453-54 (9th Cir. 1994), *overruled on other grounds by Galbraith v. County of Santa Clara*,
28 307 F.3d 1119, 1121 (9th Cir. 2002). Moreover, a court may consider facts that are subject to

1 judicial notice (*i.e.*, facts not reasonably subject to dispute), and notice public records and reports
2 of administrative bodies, provided they are not presented to prove the truth of their disputed
3 factual contents. *Mack v. South Bay Beer Distrib., Inc.*, 798 F.2d 1279, 1282 (9th Cir. 1986),
4 *overruled on other grounds by Astoria Federal Sav. and Loan Ass'n v. Solimino*, 501 U.S. 104,
5 107, 114 (1991); *see also Watterson v. Page*, 987 F.2d 1, 3 (1st Cir. 1993) (“courts have made
6 narrow exceptions for documents the authenticity of which are not disputed by the parties; for
7 official public records; for documents central to plaintiffs’ claim; or for documents sufficiently
8 referred to in the complaint”).

9 As set forth below, applying these standards, defendants’ motion must fail.

10 **II. The Court has Jurisdiction Over Plaintiffs’ APA and NEPA Claims Against FHFA**

11 Under the APA, a “final agency action for which there is no other adequate remedy in a
12 court” is “subject to judicial review.” 5 U.S.C. § 704. The scope of review is set forth in 5
13 U.S.C. section 706. Section 706 provides that a reviewing court “shall” hold unlawful and set
14 aside agency action, findings, and conclusions” that are procedurally deficient – “without
15 observance of procedure required by law.” 5 U.S.C. § 706(2)(D). This is the jurisdictional basis
16 of plaintiffs’ claims that FHFA failed to engage in notice and comment rulemaking as required by
17 5 U.S.C. § 553. Section 706 also provides that a court shall set aside agency actions that are
18 “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law” or
19 “contrary to constitutional right, power, privilege, or immunity[.]” 5 U.S.C. § 706(2)(A), (B).
20 These provisions provide the jurisdictional basis for plaintiffs’ claims that FHFA’s decision to
21 stop PACE is unsupported by facts or logic (all plaintiffs) and that in making such decision,
22 FHFA violated NEPA (all plaintiffs except Placer County) and the constitution (Sonoma and
23 Placer Counties and Palm Desert). FHFA argues that there is no final agency action, that agency
24 action has been committed to its discretion and therefore is unreviewable, and that various
25 provisions of the Safety and Soundness Act take back the grant of review provided by the APA.
26 As discussed below, none of these arguments survives examination.

1 **A. FHFA’s July 6, 2010 Statement constitutes a final agency action reviewable**
2 **under the APA**

3 In its second brief, FHFA for the first time contends that its July 6, 2010 Statement does not
4 constitute a “final agency action.” (Motion 2 at pp. 18-19.) To determine whether an agency’s
5 action is final, courts “look to whether the action amounts to a definitive statement of the
6 agency’s position or has a direct and immediate effect on the day-to-day operations of the subject
7 party, or if immediate compliance [with the terms] is expected.” *Oregon Natural Desert Ass’n v.*
8 *U.S. Forest Service*, 465 F.3d 977, 982, (9th Cir. 2006) (internal quotations omitted; alteration in
9 original). In this Circuit, courts must “focus on the practical and legal effects of the agency
10 action: [T]he finality element must be interpreted in a pragmatic and flexible manner.” *Id.*
11 (quotations, citations omitted; alteration in original).

12 Under the facts alleged by plaintiffs, and pursuant to the face of the document, FHFA’s July
13 6, 2010 Statement is a final agency action under all three of the disjunctive tests set forth in
14 *Oregon Natural Desert Ass’n*. As set forth in the Summary of Facts, above, the Statement
15 announces definitively that the FHFA has “determined that certain energy retrofit lending
16 programs” – PACE programs – “present significant safety and soundness concerns that must be
17 addressed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks.” In response to the
18 inquiry from the California Attorney General, the Agency unequivocally stated its intent to effect
19 a nationwide “pause” in PACE. Further, the Statement had a direct and immediate effect on the
20 regulated entities’ operations – FHFA directed all three to take specific anti-PACE actions.

21 Specifically, it directed Fannie Mae and Freddie Mac to:

- 22 • Adjust loan-to-value ratio to reflect the maximum permissible PACE loan amount
- 23 • Ensure that loan covenants require approval/consent for any PACE loan;
- 24 • Tighten borrower debt-to-income ratios to account for additional obligations
- 25 • Ensure that mortgages on properties in a jurisdiction offering PACE-like programs
- 26 • Issue additional guidance as needed.

27 (Cal. FAC, Ex. C.)
28

1 In addition, the Statement directed the Federal Home Loan Banks to review their collateral
2 policies in order to assure that pledged collateral is not adversely affected by energy retrofit
3 programs that include first liens. (*Id.*). The fact that FHFA required immediate compliance is
4 implied by its repeated references to PACE’s asserted risks, and confirmed by the fact that Fannie
5 Mae and Freddie took decisive anti-PACE action in response to the Statement on August 31,
6 2010. The Statement thus is a final agency action.

7 **B. Nothing in the Safety and Soundness Act withdraws this Court’s jurisdiction**

8 Defendants contend that three statutory provisions in the Safety and Soundness Act – 12
9 U.S.C. § 4617(f), 12 U.S.C. § 4635(b) and 12 U.S.C. § 4623(d) – prevent this Court from hearing
10 plaintiffs’ APA and NEPA claims. These contentions are without merit.

11 As a threshold matter, FHFA did not set out the authority for its July 6, 2010 Statement at
12 the time of issuance. The Agency in this Motion now offers a variety of novel and mutually
13 exclusive statutory provisions under which, it contends, it could have been acting – all of which,
14 the Agency asserts, allow it to evade judicial review and preclude it having to explain and justify
15 its actions in a public process. “The short – and sufficient – answer” to this attempt to recast
16 FHFA’s action “is that the courts may not accept [trial] counsel’s *post hoc* rationalizations for
17 agency action.” *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto.*, 463 U.S. 29, 50
18 (1983). “It is well-established that an agency’s action must be upheld, if at all, on the basis
19 articulated by the agency itself.” *Id.*

20 Even if the *post hoc* assertions of FHFA’s counsel were relevant, FHFA has failed to
21 establish that any of the limited provisions cited apply to the facts of this case. As set forth
22 below, section 4617(f), which precludes courts from taking actions that “restrain or affect”
23 FHFA’s actions as conservator, has no application in this case where FHFA, in issuing the July 6,
24 2010 Statement, acted not as conservator for Fannie Mae and Freddie Mac, but rather in its
25 capacity as regulator of the Enterprises and the Federal Home Loan Banks. Similarly, sections
26 4623(d) and 4635(b), which prohibit a court from affecting or enjoining specifically defined types
27 of FHFA actions (*i.e.*, FHFA classification of the regulated entities’ capitalization, and FHFA
28

1 “notice[s] or order[s]” issued under the subchapter governing conservatorships and receiverships),
 2 have no application to plaintiffs’ claims challenging FHFA’s Statement.

3 **1. There is a presumption in favor of judicial review; statutory exceptions are**
 4 **narrowly construed**

5 The effect of the cited provisions on this Court’s jurisdiction, if any, must be decided
 6 without giving weight or deference to FHFA’s proffered interpretations. While courts “ordinarily
 7 give great weight” to the statutory interpretation of the agency charged with enforcement of that
 8 statute, “that deference does not extend to the question of judicial review, a matter within the
 9 peculiar expertise of the courts.” *Love v. Thomas*, 858 F.2d 1347, 1352, n.9 (9th Cir. 1988).

10 A court begins its analysis with the “presumption in favor of judicial review of
 11 administrative actions.” *Id.* at 1356. Even where a statute contains some prohibitions against
 12 judicial review, they must be construed narrowly. *Desta v. Ashcroft*, 365 F.3d 741, 746 (9th Cir.
 13 2004). Courts should not construe a statute to prohibit judicial review “absent the clearest
 14 command or an inescapable inference to the contrary.” *Id.* (quotation omitted).

15 **2. On its face, FHFA’s July 6, 2010 Statement was issued under the Agency’s**
 16 **general supervisory and regulatory authority and therefore is reviewable**

17 FHFA in its July 6, 2010 Statement does not cite any statutory authority for its action. The
 18 Statement’s language and content, however, establish that it was issued under the Agency’s
 19 general supervisory and regulatory authority, which continues to exist despite the conservatorship
 20 of Fannie Mae and Freddie Mac.

21 As discussed, FHFA is empowered to “issue any regulations, guidelines, or orders
 22 necessary to carry out the duties” assigned to the Agency “under this chapter [Chapter 46] or the
 23 authorizing statutes [creating Fannie Mae, Freddie Mac, and the Federal Home Loan Banks], and
 24 to ensure that the purposes of this chapter and the authorizing statutes are accomplished.” 12
 25 U.S.C. § 4526(a); *see also* 12 U.S.C. § 4511(b); 12 U.S.C. § 4513(a)(1)(A)-(B) (discussed in the
 26 legal summary section, above).

27 In this case, all relevant facts indicate that the Statement was issued by FHFA acting in its
 28 capacity as a regulatory agency under the authority of 12 U.S.C. section 4526. FHFA’s July 6,

1 2010 Statement was directed to all three regulated entities – not just to Fannie Mae and Freddie
2 Mac (for which it is conservator), but also to the Federal Home Loan Banks (for which it is not).
3 In addition, the Statement directs the regulated entities to undertake what it deems “prudential
4 actions” and characterizes its direction to Fannie Mae and Freddie Mac as “actions that protect
5 their safe and sound operations.” This tracks the language in section 4513(a)(1)(A) and (B)(i)
6 describing FHFA’s general regulatory powers. In addition, the Statement sets out various factual
7 assertions about PACE, *e.g.*, that such programs “do not have the traditional community benefits
8 associated with taxing initiatives”; are “not essential for successful programs to spur energy
9 conservation”; and do not have sufficient underwriting standards to “protect homeowners.” (Cal.
10 FAC, Ex. C (Statement at p. 1).) Making these types of general pronouncements, FHFA would
11 appear to be stating its view of the general “public interest.” *See* 12 U.S.C. § 4513(a)(1)(B)(v).

12 The Act expressly provides that “any regulations issued by the Director under this section
13 [section 4526] shall be issued after notice and opportunity for public comment pursuant to the
14 provisions of section 553 of Title 5” – the notice and comment provisions of the APA. 12 U.S.C.
15 § 4526(b). The APA, in turn, provides that “[a] person suffering legal wrong because of agency
16 action, or adversely affected or aggrieved by agency action within the meaning of a relevant
17 statute, is entitled to judicial review thereof.” 5 U.S.C. § 702. Given the Safety and Soundness
18 Act’s express incorporation of the APA and the presumption in favor of judicial review, section
19 4526 provides for review unless a more specific provision limiting review controls.

20
21 **3. The facts as pleaded do not suggest that, in issuing the July 6, 2010 Statement,**
22 **FHFA was acting in its capacity as conservator; 12 U.S.C. § 4617(f) does not**
23 **apply**

24 In arguing that judicial review is precluded, FHFA first cites 12 U.S.C. § 4617(f), which
25 appears in subchapter II (Required Capital Levels for Regulated Entities). As discussed above,
26 section 4617 authorizes FHFA’s Director to appoint the Agency as conservator for a regulated
27 entity for a number of reasons. 12 U.S.C. § 4617(a); *see also* 75 Fed. Reg. 39462 (summarizing
28 the conservator appointment process). Subsection (f) of 4617 provides in full: “Except as

1 provided in this section or at the request of the Director, no court may take any action to restrain
2 or affect the exercise of powers or functions of the Agency as a conservator or a receiver.”

3 Section 4617 must be interpreted consistent with the presumption in favor of judicial
4 review.⁹ By its plain terms, section 4617(f) applies only to FHFA’s actions taken as a
5 conservator or receiver. In reviewing a similar “restrain or affect” limiting provision that applies
6 to the Federal Deposit Insurance Company (FDIC), 12 U.S.C. § 1821(j),¹⁰ the Ninth Circuit has
7 noted the protection for FDIC exists only “when it acts as receiver” or conservator. *Sahni v.*
8 *American Diversified Partners*, 83 F.3d 1054, 1058, 1059 (9th Cir. 1996) (holding that FDIC, in
9 selling of certain assets of failed bank, acted in its capacity as receiver of failed bank and not as a
10 general partner of the failed bank’s subsidiary; section 1821(j) barred review). “The bar imposed
11 by section 1821(j) does not extend to situations in which the FDIC as receiver asserts authority
12 beyond that granted to it as receiver.” *Sharpe v. FDIC*, 126 F.3d 1147, 1155 (9th Cir. 1997)
13 (holding that FDIC, in breaching contract, did not act within statutorily defined receiver powers
14 to disaffirm or repudiate contracts; FDIC was not immune from judicial review of breach of
15 contract claim).

16 **a. The facts viewed in the light most favorable to plaintiffs do not**
17 **establish that FHFA was acting in its capacity as conservator**

18 Nothing in plaintiffs’ complaints or in the matters that this Court may judicially notice,
19 viewed in the light most favorable to plaintiffs, establishes that in issuing its July 6, 2010
20 Statement, FHFA was exercising its powers as conservator of Fannie Mae or Freddie Mac.

21 As discussed above, the content of the Statement, and the fact that it was issued to the
22 Federal Home Loan Banks which are not in FHFA conservatorship, evidences that FHFA was
23 acting in its general regulatory capacity. There are no indicia that the Agency was in any way
24

25 ⁹ As the D.C. Circuit noted in construing a similar provision, even where there is no
26 affirmative provision authorizing review, courts “do not presume . . . that Congress intended to
preclude judicial review” but rather “assume just the opposite . . .” *James Madison Ltd. v.*
Ludwig, 82 F.3d 1085, 1092 (D.C. Cir. 1996) (internal quotations and citations omitted).

27 ¹⁰ 12 U.S.C. § 1821(j) provides: “Except as provided in this section, no court may take
28 any action, except at the request of the Board of Directors by regulation or order, to restrain or
affect the exercise of powers or functions of the Corporation as a conservator or a receiver.”

1 acting in its capacity as conservator. The Statement does not, for example, invoke section 4617
2 (setting out the Agency’s powers as conservator) or even mention the Fannie Mae and Freddie
3 Mac conservatorships. The Statement does not announce actions that FHFA has taken or will
4 take, standing in the shoes of the Enterprises’ officers and directors. There is no suggestion that
5 if, tomorrow, the conservatorship ended, the new officers, directors or shareholders of Fannie
6 Mae and Freddie Mac would be free to ignore, violate, or rescind the July 6, 2010 Statement.
7 FHFA stated that it issued the Statement after “over a year of working with federal and state
8 government agencies” (Cal. FAC, Ex. C. (Statement at p. 1)) – agencies that have no role in
9 administering the conservatorships. Taking the facts as alleged by plaintiffs as true, FHFA was
10 acting solely in its capacity as regulatory agency over all regulated entities. At the pleadings
11 stage, therefore, section 4617(f) as a matter of law presents no bar to review.

12 **b. At a later stage, FHFA can attempt to establish that its Statement is a**
13 **conservator act, and argue that out-of-circuit case law interpreting a**
14 **different statute bars review under section 12 U.S.C. § 4617(f);**
addressing these issues now is premature

15 FHFA argues that even if it was acting in its capacity as regulatory agency when it issued
16 the July 6, 2010 Statement, it was also acting as conservator of Fannie Mae and Freddie Mac and
17 thus is entitled to the protections against judicial review set forth in 12 U.S.C. § 4617(f). (Motion
18 1 at p. 18.) As discussed above, this assertion is not supported by the facts as alleged by plaintiffs
19 or that can be judicially noticed and, accordingly, on this Motion to Dismiss, the Court need not
20 consider this argument further.

21 To the extent that FHFA’s argument is that, under section 4617(f), once it has been
22 appointed conservator for any regulated entity, nothing that it does in any capacity can be
23 reviewed, its argument must be rejected. Such a sweeping reading of section 4617(f) is not
24 supported by its plain language. Had Congress intended such a result, it would have written
25 section 4617(f) to provide, for example, that “no court may take any action to restrain or affect
26 the exercise of powers or functions of the Agency *under this Chapter* once it has been appointed a
27 conservator or a receiver.” The section is not so worded.
28

1 Neither is such a broad view of section 4617(f) supported by the case law. The precedent
 2 on section 4617(f) is limited.¹¹ Plaintiffs agree that case law construing other, similar “restrain or
 3 affect” provisions applying to federal agency conservators and receivers may provide some
 4 guidance on the interpretation of section 4617(f), though the cases must be read with a view to the
 5 different statute and different agency functions.

6 In its brief, FHFA extracts quotes from several out-of-circuit FDIC cases to imply that
 7 “restrain or affect” provisions will bar virtually any case where the agency has been appointed
 8 receiver or conservator. *See, e.g., Nat’l Trust for Historic Preservation in U.S. v. FDIC*, 21 F.3d
 9 469, 471 (D.C. Cir. 1994) (*per curiam*) (declining to enjoin FDIC, acting as liquidator and in its
 10 corporate capacity, from selling historic building as part of failed bank’s assets, on theory that
 11 contemplated sale would violate National Historic Preservation Act; refusing to recognize
 12 exception for receiver acts that are also “corporate”); *Freeman v. FDIC*, 56 F.3d 1394, 1398-99
 13 (D.C. Cir. 1995) (declining to enjoin FDIC, acting as receiver for failed bank, from foreclosing on
 14 property of debtor held by failed bank as collateral); *Bank of Am. Nat’l Ass’n v. Colonial Bank*,
 15 604 F.3d 1239, 1244 (11th Cir. 2010) (declining to enjoin FDIC, acting as receiver for possessed
 16 bank, controlling and disposing of loans and proceeds). In the main, these cases involve direct
 17 challenges to the FDIC’s exercise of powers that fall squarely within the ordinary functions of a
 18 receiver, such as the control and disposal of specific assets of the failed institution. They do not
 19 involve exercise of FDIC’s non-conservator/receiver duties.¹² Here, in contrast, plaintiffs do not

20 ¹¹ FHFA mentions in passing only two cases that discuss 12 U.S.C. § 4617(f): *In re*
 21 *Federal Home Loan Mortg. Corp. (Freddie Mac) Derivative Litig.*, 643 F.Supp.2d 790 (E.D. Va.
 22 2009) (Motion at pp. 19, 46) and *Kuriakose v. Federal Home Loan Mortgage Corporation*, 674 F.
 23 Supp. 2d 483 (S.D.N.Y. 2009) (Motion at p. 20). Neither is apposite. The district court in *In re*
 24 *Freddie Mac* held that once FHFA was appointed conservator, it steps into the shoes of the pre-
 25 receiver shareholders; those shareholders thus no longer have standing to pursue a derivative
 26 action on behalf of Freddie Mac. 643 F.Supp.2d at 797. In *Kuriakose*, plaintiff investors in a
 27 securities fraud action moved for the court to invalidate severance contracts between Freddie Mac
 28 and its former employees that, plaintiffs contended, prevented them from interviewing the former
 employees. 674 F.Supp.2d at 485-87. The district court held that the plaintiffs did not have
 standing to challenge the contracts to which they were not parties. *Id.* at 492. Alternatively, the
 court held that section 4617(f) bars review because FHFA had express statutory power as
 conservator “to enforce the contracts of Freddie Mac” and the relief requested would “restrain[]
 FHFA from enforcing this contractual provision in the future” *Id.* at 494.

¹² In these cases, the FDIC’s non-conservator/receiver capacity is called its “corporate”
 capacity since the FDIC’s function outside of the conservator/receiver context is that of corporate
 (continued...)

1 challenge FHFA decisions relating to the sale of properties, collection of debts, disposition of
 2 loans and proceeds, or the control or disposal of any other specific assets at issue in the Fannie
 3 Mae or Freddie Mac conservatorships. These cases thus provide little helpful guidance in the
 4 matters before this Court.

5 Further, even if FHFA's exercise of traditional receiver and conservator powers were at
 6 issue, which it is not, the case law is not as clear FHFA's briefing might suggest.¹³ In cases not
 7 cited by FHFA, the Ninth Circuit has rejected arguments that judicial review that relates to
 8 conservator or receivership functions automatically runs afoul of "restrain or affect" provisions.
 9 In *Morrison-Knudsen Co., Inc. v. CHG International*, 811 F.2d 1209, 1216-17 (9th Cir. 1987),
 10 the Court interpreted section 1821(j)'s predecessor, 12 U.S.C. § 1464(d)(6)(C), as applied to
 11 FDIC's predecessor the Federal Savings and Loan Insurance Corporation (FSLIC). *See Abbott*
 12 *Building Corporation, Inc., v. United States*, 951 F.2d 191, 195 (9th Cir. 1991). The Court held
 13 that *de novo* judicial adjudication of the agency's allowance or disallowance of creditors' claims
 14 against the failed institution does not restrain or affect a receivership because the statute did not
 15 clearly confer on FSLIC as receiver the power to adjudicate claims. *Morrison-Knudsen*, 811 F.2d
 16 at 1217; *accord Coit Independence Joint Venture v. FSLIC*, 489 U.S. 561, 572 (1989). In *Abbott*
 17 *Building Corp., Inc. v. U.S.*, 951 F.2d 191 (9th Cir. 1991), the Court held that it had jurisdiction to
 18 determine whether a foreclosure sale of a piece of property to FSLIC as receiver should be set
 19 aside for failure to comply with state law. *Id.* at 195. These cases strongly suggest that judicial
 20 review of FHFA's Statement for compliance with the APA, even if issued in FHFA's
 21 conservatorship capacity, would not contravene section 4617(f).¹⁴

22 (...continued)

23 insurer. *See Nat'l Trust for Historic Preservation*, 21 F.3d at 471. In this case, FHFA's non-
 24 conservator/receiver function is to supervise and regulate of Fannie Mae, Freddie Mac and the
 25 Federal Home Loan Banks.

26 ¹³ For example, FHFA cites a D.C. Circuit case, *In Nat'l Trust for Historic Preservation*,
 27 21 F.3d at 470, but fails to note that in that case, the court expressed its disagreement with the
 28 Fifth Circuit's interpretation of section 1821(j) in *Sierra Club, Lone Star Chapter v. FDIC*, 992
 F.2d 545 (5th Cir. 1993)). In that case, the Fifth Circuit held that the district court had
 jurisdiction to enjoin the FDIC from approving the sale of environmentally sensitive property,
 reasoning that although the FDIC acquired interest in the land when it became receiver, it was
 acting in its corporate capacity at the time it approved the sale. *Id.* at 550-551.

¹⁴ Palm Desert's complaint is not barred from judicial review for additional reasons: it

(continued...)

1 The Court need not, however, resolve the nuances in application of the Safety and
 2 Soundness Act’s “restrain or affect” provision in ruling on this motion, as it must take the facts as
 3 pleaded by plaintiffs as true. Under the facts as pleaded, FHFA was acting in its regulatory
 4 capacity and not as conservator in issuing the July 6, 2010 Statement. FHFA’s motion to dismiss
 5 based on section 4617(f) should be denied.

6
 7 **4. The July 6, 2010 Statement is not an FHFA order temporarily adjusting**
 8 **“portfolio holdings” standards or ordering Fannie Mae and Freddie Mac to**
 9 **divest or acquire specific assets; 12 U.S.C. § 4635(b) does not apply**

10 To avoid review, FHFA argues, again *post hoc*, that it could have issued the Statement as a
 11 “notice or order” to the Enterprises under still another provision, this one governing the
 12 Enterprises’ portfolio holdings.¹⁵ Under 12 U.S.C. § 4635(b) (contained in subchapter III
 13 (Enforcement Provisions)), FHFA argues, the Court is divested of jurisdiction. FHFA’s strained
 14 reading of the statute becomes apparent on review of the provision.

15 Section 4635 provides in full:

16 (a) Enforcement

17 The Director may, in the discretion of the Director, apply to the United States District Court
 18 for the District of Columbia, or the United States district court within the jurisdiction of
 19 which the headquarters of the regulated entity is located, for the enforcement of any
 20 effective and outstanding notice or order issued under this subchapter or subchapter II of

21 (...continued)

22 alleges that FHFA’s July 6, 2010 Statement is an act clearly outside of the Agency’s statutory
 23 powers and is unconstitutional. (Palm Desert Compl. ¶¶ 53-55.) 12 U.S.C. sections 4617(f),
 24 4635(b), and 4623(d), by their own terms, only apply when FHFA acts within its enumerated
 25 powers. But Palm Desert alleges the Statement jeopardizes the soundness of mortgage loans (and
 26 therefore the assets of the regulated entities), in contradiction to FHFA’s statutory authority. *See*
 27 12 U.S.C. § 4617(b)(2)(B)(iv). (Palm Desert Compl. ¶¶ 54-55.) Palm Desert also alleges the
 28 Statement is unconstitutional. (*Id.*) Accordingly, judicial review is not precluded. *See Elmco*
Properties, Inc. v. Second Nat’l Fed. Sav. Ass’n, 94 F.3d 914, 923 (4th Cir. 1996) (holding
 section 1821(j) did not prohibit enjoining the Resolution Trust Company, reasoning “[b]ecause
 Congress could not authorize the RTC to act unconstitutionally, enjoining the RTC from doing so
 cannot infringe on its statutorily granted powers”); *Nat’l Trust for Historic Pres. v. FDIC*, 995
 F.2d 238, 240 (D.C. Cir. 1993) (declaring section 1821(j) “does not bar injunctive relief when the
 FDIC has acted or proposes to act beyond, or contrary to, its statutorily prescribed,
 constitutionally permitted, powers or functions”), *vacated by* 5 F.3d 567 (D.C. Cir. 1993),
restored in relevant part by 21 F.3d 469 (D.C. Cir. 1994) (*en banc*).

¹⁵ As discussed in Section III.A.3, below, the Statement constitutes a substantive rule,
 which means necessarily that it is not a quasi-judicial notice or order.

1 this chapter, or request that the Attorney General of the United States bring such an action.
2 Such court shall have jurisdiction and power to order and require compliance with such
3 notice or order.

4 (b) Limitation on jurisdiction

5 Except as otherwise provided in this subchapter [subchapter III] and sections 4619
6 [repealed] and 4623 [allowing for regulated entity to challenge certain actions taken against
7 it by FHFA] of this title, no court shall have jurisdiction to affect, by injunction or
8 otherwise, the issuance or enforcement of any notice or order under [12 U.S.C.] section
9 4631, 4632, 4513b, 4636 or 4637 of this title, or subchapter II of this chapter, or to review,
10 modify, suspend, terminate, or set aside any such notice or order.

11 FHFA argues that the Statement should be reinterpreted as a notice or order issued under
12 “subchapter II of this chapter,” specifically 12 U.S.C. section 4624(c) or alternatively section
13 4624(b), or that it “presages” such a notice or order (Motion 1 at pp. 22-25), and that, therefore,
14 the Statement falls under section 4635(b) and is unreviewable.¹⁶

15 Section 4624 provides:

16 (a) In general

17 The Director shall, by *regulation*, establish criteria governing the portfolio holdings of the
18 enterprises, to ensure that the holdings are backed by sufficient capital and consistent with
19 the mission and the safe and sound operations of the enterprises. In establishing such
20 criteria, the Director shall consider the ability of the enterprises to provide a liquid
21 secondary market through securitization activities, the portfolio holdings in relation to the
22 overall mortgage market, and adherence to the standards specified in section 4513b of this
23 title.

24 (b) Temporary adjustments

25 The Director may, by *order*, make temporary adjustments to the established standards for
26 an enterprise or both enterprises, such as during times of economic distress or market
27 disruption.

28 (c) Authority to require disposition or acquisition

The Director shall monitor the portfolio of each enterprise. Pursuant to subsection (a) and
notwithstanding the capital classifications of the enterprises, the Director may, by *order*,
require an enterprise, under such terms and conditions as the Director determines to be

¹⁶ The other types of notices and orders listed in section 4635 are clearly inapplicable; FHFA did not attempt to argue otherwise.

1 appropriate, to dispose of or acquire any asset, if the Director determines that such action is
2 consistent with the purposes of this Act or any of the authorizing statutes.

3 12 U.S.C. § 4635 (emphasis added).

4 Assuming for the sake of argument that FHFA could invoke section 4624 *post hoc* as a
5 source of authority for the Statement, the only subsection most on point would appear to be
6 subsection (a), authorizing regulations setting forth the criteria for portfolio holdings. FHFA has,
7 however, already promulgated such regulations, 12 C.F.R. pt. 1252, after giving notice and
8 requesting comments. 74 Fed. Reg. 5609 (Jan. 30, 2009). Moreover, reliance on section 4624(a)
9 is not helpful to FHFA's current litigation position, as *regulations* are not protected from judicial
10 review under section 4635(b). Turning to 12 U.S.C. section 4624's remaining subsections, there
11 is no suggestion in the Statement that it constitutes a temporary adjustment of the standards set
12 forth in 12 C.F.R. pt. 1252. The Statement does not direct Fannie Mae or Freddie Mac to dispose
13 of or acquire any specific assets. Rather, at most, the Statement directs Fannie Mae and Freddie
14 Mac to make certain determinations that resulted in the Enterprises' August 31, 2010
15 announcements that, going forward, they will not acquire a class of assets (namely, mortgage
16 loans secured by properties with an outstanding PACE obligation). In sum, there is no indication
17 that the Statement is a notice or order issued pursuant to section 4624, and section 4635(b) thus
18 does not limit this Court's jurisdiction.

19 **5. The July 6, 2010 Statement does not pertain to required capital levels for the
20 regulated entities; 12 U.S.C. § 4623(d) does not apply**

21 Finally, FHFA cites 12 U.S.C. § 4623(d), which appears in subchapter II (Required Capital
22 Levels for Regulated Entities). Section 4623 authorizes a regulated entity in certain instances to
23 file a petition seeking review of its capitalization classification by FHFA or other action taken
24 against it by FHFA under subchapter II. Section 4623, subsection (d) provides in full:

25 (d) Limitation on jurisdiction

26 Except as provided in this section, no court shall have jurisdiction to affect, by injunction or
27 otherwise, the issuance or effectiveness of any classification or action of the Director under
28 this subchapter (other than appointment of a conservator under section 4616 or 4617 of this
title or action under section 4619 of this title) or to review, modify, suspend, terminate, or
set aside such classification or action.

1 FHFA now contends that it issued (or, more precisely, could have issued) the Statement
2 under 12 U.S.C. § 4616(b)(4) and therefore the protection of section 4623(d) applies. Read in
3 context, section 4616 has no application to FHFA's July 6, 2010 Statement.

4 Section 4616 authorizes and in some instances requires FHFA to take certain supervisory
5 actions applicable to a "regulated entity that is classified as significantly undercapitalized." 12
6 U.S.C. § 4616(a),(b). FHFA must approve (or disapprove) a "capital restoration plan[,]" 12
7 U.S.C. § 4616(a)(1), and certain types of capital distributions. 12 U.S.C. § 4616(a)(2). In
8 addition, FHFA is required to take "1 or more" of a list of actions against the significantly
9 undercapitalized regulated entity. These include actions to "limit or prohibit the growth of assets
10 ... or require contraction of the assets of the regulated entity," 12 U.S.C. § 4616(b)(2); "[r]equire
11 the regulated entity to acquire new capital[,]" 12 U.S.C. § 4616(b)(3); and the action that FHFA
12 now relies on, 12 U.S.C. § 4616(b)(4), "[r]equire the regulated entity to terminate, reduce, or
13 modify any activity that the Director determines creates excessive risk to the regulated entity."

14 Nothing in the pleadings or matters that this Court may judicially notice establishes that
15 FHFA issued the Statement under the authority of section 4616. The Statement does not mention
16 this section or make any reference to capitalization. The pleadings and matters judicially noticed
17 do not address whether, on July 6, 2010, Fannie Mae, Freddie Mac, and the Federal Home Loan
18 Banks were classified as "significantly undercapitalized," thereby authorizing and requiring the
19 actions set forth in 4616. *See* 12 U.S.C. § 4614(a), (b) (defining classifications for Fannie Mae,
20 Freddie Mac and the Federal Home Loan Banks and requiring such classifications); *id.* at §
21 4614(d) (requiring FHFA to make capital classification on a quarterly basis). Instead, as
22 discussed above, FHFA's use of the phrases "prudential actions" and "safe and sound operations"
23 indicates that FHFA issued the Statement under its general regulatory and supervisory authority,
24 set forth in section 4511(b)(2). The Court should reject FHFA's *post hoc* invocation of section
25 4616, *see State Farm*, 463 U.S. at 50. Section 4623(d) thus provides no basis to dismiss
26 plaintiffs' complaints.

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6. The Court should reject FHFA's attempt to re-write the Safety and Soundness Act

The sum effect of FHFA's proffered interpretations of 12 U.S.C. sections 4617(f), 4635(b) and 4623(d) is that virtually no action taken by FHFA would ever be subject to judicial review once it is appointed conservator. There is no indication, however, that Congress intended that the Act's narrowly crafted exemptions would swallow up the general presumption in favor of judicial review. Moreover, FHFA's broad reading would, in effect, write section 4526 – requiring compliance with the APA's notice and comment requirements – out of the statute. This result is at odds with accepted rules of statutory interpretation. *Corley v. United States*, 129 S.Ct. 1558, 1566 (2009) (holding that statute should be construed to give effect to all its provisions, so that no part will be inoperative or superfluous, void or insignificant). FHFA's Motion to Dismiss plaintiff's APA and NEPA claims against FHFA on jurisdictional grounds should be denied.

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III. Plaintiffs Have Alleged Sufficient Facts to Support Each of Their Claims

A. **Plaintiffs adequately have alleged violations of the APA's notice-and-comment requirement and its prohibition against agency actions that are arbitrary, capricious, unlawful, or unconstitutional**

Plaintiffs allege two separate types of claims against FHFA, jurisdiction over which is grounded in the APA. First, plaintiffs allege that FHFA in issuing its July 6, 2010 Statement failed to comply with the APA's notice and comment requirements (5 U.S.C. §§ 553, 706(2)(D)). This claim requires that the Statement constitute a substantive rule, as only such rules are subject to section 553. Second, plaintiffs allege that the Statement, whether it is a rule or some other type of agency action, is arbitrary, capricious, or an abuse of discretion; "not in accordance with law" and the "procedure required by law" (including NEPA); and/or is unconstitutional, in violation of section 706(2).¹⁷

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¹⁷ Defendants' request to dismiss Palm Desert's and Placer County's claims that the Statement is arbitrary and capricious (Motion 2 at pp. 21-24) is based on facts that are disputed and do not appear in plaintiffs' complaints; it is therefore without merit. Both complaints allege sufficient facts to state a claim under 5 U.S.C. section 706 (Palm Desert Compl. ¶¶ 53-55; Placer Compl. ¶¶ 59-63), and the administrative record has not been filed yet. *See Miccosukee Tribe of Indians of Florida v. U.S.*, 574 F. Supp. 2d 1360, 1367 n.5 (S.D. Fla. 2008).

1 FHFA contends that as to all of plaintiffs' APA-based claims, plaintiffs lack prudential
 2 standing. In addition, FHFA claims that plaintiffs' section 706(2) APA claims are barred because
 3 the FHFA's action on July 6, 2010 is "committed to agency discretion by law" (5 U.S.C. §
 4 701(a)(2)) and their notice and comment APA claims are barred because the Statement is merely
 5 an interpretive rule and not a substantive rule, and therefore not subject to the APA's notice and
 6 comment requirements. As set forth below, none of these arguments has merit.

7
 8 **1. Plaintiffs' complaints establish that they have prudential standing under the
 relevant statutes**

9 Prudential standing under the APA requires that plaintiff's interests must be "*arguably*
 10 within the zone of interests to be protected or regulated by the statute ... in question." *Nat'l*
 11 *Credit Union Admin. v. First Nat. Bank & Trust Co.*, 522 U.S. 479, 488 (1998) (*NCUA*) (quoting
 12 *Ass'n of Data Processing Service Org. v. Camp*, 397 U.S. 150, 152 (1970) (emphasis added)).
 13 FHFA summarily contends that none of the plaintiffs – not even the State of California – has
 14 prudential standing to challenge the Agency's pointed attempt to shut down PACE in California
 15 or to counter its findings that PACE programs are risky, unnecessary, and "do not have the
 16 traditional community benefits associated with taxing initiatives." (Cal. FAC Ex. C (Statement p.
 17 1).) According to FHFA, no plaintiff is entitled to review because the missions of Fannie Mae
 18 and Freddie Mac "relat[e] to housing finance, not environmentalism." (Motion 1 at p. 42.)

19 FHFA's contention is inconsistent with the legal standard, which FHFA fails to set forth in
 20 its Motion. Under the Agency's reasoning, it is difficult to imagine any person or entity
 21 adversely affected by its anti-PACE rule with prudential standing to challenge it. The test,
 22 however, is not intended to be "especially demanding." *Clarke v. Securities Indus. Ass'n*, 479
 23 U.S. 388, 399-400 (1987). In the words of the Supreme Court:

24 The "zone of interest" test is a guide for deciding whether, in view of Congress' evident
 25 intent to make agency action presumptively reviewable, a particular plaintiff should be
 26 heard to complain of a particular agency decision. In cases where the plaintiff is not itself
 27 the subject of the contested regulatory action, the test denies a right of review if the
 plaintiff's interests are so *marginally related* to or *inconsistent* with the purposes implicit in
 the statute that it cannot reasonably be assumed that Congress intended to permit the suit.

28 *Id.* (emphasis added).

1 As the Supreme Court noted in *Clarke*, “there need be no indication of congressional
 2 purpose to benefit the would-be plaintiff.” *Id.* Moreover, a plaintiff need not be directly
 3 regulated to have prudential standing; even the competitors of entities that are regulated and
 4 benefited by the statute in question can be within the “zone of interest” for purposes of prudential
 5 standing. *See NCUA*, 522 U.S. 479, 498 (holding that non credit-union banks had prudential
 6 standing to challenge interpretation of federal credit union statute that permitted federal credit
 7 unions to increase their memberships); *see also id.* at 495-98 (citing cases in accord). Plaintiffs
 8 proceeding under the APA “need only show that their interests fall within the ‘general policy’ of
 9 the underlying statute, such that interpretations of the statute’s provisions or scope could directly
 10 affect them.” *Graham v. Fed. Emergency Mgmt. Agency*, 149 F.3d 997, 1004 (9th Cir. 1998)
 11 (quoting *NCUA*, 522 U.S. at 489).

12
 13 **a. Plaintiffs are within the zone of interest of the Safety and Soundness**
 14 **Act; FHFA’s interpretation of that Act directly affects their interests**
 15 **in the operation of the housing mortgage market**

16 Subchapter I of the Safety and Soundness Act requires FHFA to supervise and regulate
 17 Fannie Mae and Freddie Mac by, among other things, ensuring that each entity operates in a “safe
 18 and sound manner” and carries out its mission consistent not only with the Act, but also
 19 “consistent with the public interest.” 12 U.S.C. § 4513(a)(1)(B)(i), (iv), (v). “[T]he continued
 20 ability of [Fannie Mae] and [Freddie Mac] to accomplish their public missions is important to
 21 providing housing in the United States and the health of the Nation’s economy....” 12 U.S.C. §
 22 4501(2). Thus, the ultimate goal of the Safeness and Soundness Act is to protect the operation
 23 and liquidity of the housing mortgage market.

24 As set forth in the pleadings, in California, the housing mortgage market operates within a
 25 system that includes state laws and local taxes and assessments. Plaintiffs allege that the housing
 26 mortgage market from its beginning has accepted lien priority for taxes and assessments.
 27 California, in passing its PACE law, local governments in instituting PACE programs, and
 28 homeowners in choosing to participate in PACE, fully expected and relied on the fact that the
 operation of housing mortgage markets would continue as it had historically, and that

1 homeowners with mortgages could participate in PACE without any adverse effects on their
2 ability to refinance or sell their property. FHFA’s Statement, which upends decades of precedent
3 for how taxes and assessments must be treated in the home mortgage market, “directly affect[s]”
4 plaintiffs. *See Graham*, 149 F.3d at 1004. The interests of the plaintiffs affected by FHFA’s
5 Statement include the interest of PACE participants’ in access to the home mortgage market (who
6 now must face additional hurdles on refinancing and transfer); the interest of all citizens in the
7 counties and cities where there are PACE programs in access to the home mortgage market (who
8 are now chilled or preventing from participating);¹⁸ and the interests of California and its local
9 governments in ensuring that their citizens and residents have adequate access to mortgages and
10 housing, and that state laws and local taxes and assessments operate as intended. (*See* Cal. FAC
11 ¶¶ 3-4; *Sonoma Compl.* ¶¶ 46-50; *Sierra Club Compl.* ¶¶ 16-17.) All of these interests are within
12 the general “zone of interest” of the Safety and Soundness Act in the operation of the home
13 mortgage market.

14 This reading of the Safety and Soundness Act’s “zone of interest” is consistent with
15 Congressional intent. The statute requires FHFA to consider the “public interest” (12 U.S.C. §
16 4513(a)(1)(B)(v)). In addition, the Safety and Soundness Act expressly incorporates the APA’s
17 notice and comment requirements, *see* Section II.B.2, above, underscoring the importance of
18 public participation and transparent, informed FHFA decision making for action that will affect
19 the entire mortgage market. Because the interests asserted by plaintiffs in their respective
20 pleadings are related to and consistent with the purposes implicit in the Safety and Soundness
21 Act, and because FHFA’s regulation at issue in this case directly affects them, Congress intended
22 to permit the challenges before this Court.

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27 ¹⁸ The Statement directs Fannie Mae and Freddie Mac to tighten mortgage requirements
28 for all mortgages in PACE jurisdictions and not just for properties with PACE assessments.

1 **b. Plaintiffs' interests in requiring FHFA to consider the environmental**
2 **effects of its actions place them squarely within NEPA's zone of**
3 **interest**

4 The same "zone of interest" prudential standing requirement applies for APA claims that
5 allege violation of NEPA. *Citizens for Better Forestry v. U.S. Dept. of Agric.*, 341 F.3d 961, 976
6 (9th Cir. 2003). "As might be expected, NEPA's purpose is to protect the environment." *Id.*
7 (internal quotations and citations omitted). NEPA's twin aims place upon an agency the
8 obligation to (1) consider every significant aspect of the environmental impact of a proposed
9 action and (2) ensure that the agency will inform the public that it has indeed considered
10 environmental concerns in its decision-making process. *San Luis Obispo Mothers for Peace v.*
11 *Nuclear Regulatory Comm'n*, 449 F.3d 1016, 1020 (9th Cir. 2006). Plaintiffs seek to obtain the
12 environmental benefits that flow from the successful implementation of PACE programs.
13 "[PACE] programs reduce energy and water use, provide clean power, and are part of
14 California's efforts to promote clean energy and green jobs." (Cal. FAC ¶¶ 1, 43.) "The goal of
15 [Sonoma County's PACE program] is to help property owners of improved real property make
16 principled investments in...[the] global environment." (Sonoma Compl. ¶ 26.) "PACE programs
17 further benefit Sierra Club members by reducing the detrimental impacts from climate change and
18 other air pollutants that result from the reliance on fossil fuel energy sources that produce carbon
19 emissions and other harmful air pollutants." (Sierra Club Compl. ¶ 4.) Plaintiffs' environmental
20 concerns therefore lie well within NEPA's zone of interests. *See Citizens for Better Forestry*, 341
21 F.3d at 976. Furthermore, plaintiffs allege that FHFA's failure to follow NEPA's procedure
22 deprived them of an opportunity to address substantial and detrimental environmental impacts of
23 the July 6, 2010 Statement, thereby precluding FHFA from engaging in a fully informed decision-
24 making process. (See, e.g., Cal. FAC ¶¶ 31, 55; Sierra Club ¶ 13.) Plaintiffs are within NEPA's
25 zone of interest.

1
2 **2. There is no indication that FHFA's action on July 6, 2010, is committed to**
3 **agency discretion and therefore cannot be reviewed for an abuse of discretion or**
4 **violation of law**

5 In a footnote in its second Motion, FHFA states summarily that its action on July 6, 2010,
6 effecting a pause in PACE programs nationwide, was "committed to agency discretion by law" (5
7 U.S.C. § 701(a)(2)) and therefore it is "outside APA review." (Motion 2 at p. 18, n.23.) Section
8 701(a)(2) does not apply to this case.

9 FHFA's cite to *Ctr. for Policy Analysis on Trade and Health v. Office of U.S. Trade*
10 *Representative*, 540 F.3d 940, 944 (9th Cir. 2008), out-of-context, suggests that there can be no
11 review under section 706 whenever an agency must make a decision based on "a complicated
12 balancing of a number of factors[.]" (Motion at p. 18, n.23.) In fact, "[t]he operation of §
13 701(a)(2) of the APA is narrowly limited to "those rare instances where statutes are drawn in
14 such broad terms that in a given case there is no law to apply.'" *Ctr. for Policy Analysis*, 540
15 F.3d at 944 (quoting *Heckler v. Chaney*, 470 U.S. 821 (1985)). In *Ctr. for Policy Analysis*, for
16 example, the Court held that while federal statutes required the U.S. Trade Representative and the
17 U.S. Department of Commerce to ensure that membership of certain advisory committees are
18 "fairly balanced," the law provided no "meaningful standards" for a court to apply in reviewing
19 committee composition. *Id.* at 945; *see also id.* at 947. The composition of the committees was
20 thus in the nature of a "political question" that is "best left to the executive and legislative
21 branches of government." *Id.* Other examples of agency decisions that fall into this unreviewable
22 category are cataloged by the Ninth Circuit in *Newman v. Apfel*, 223 F.3d 937, 943 (9th Cir.
23 2000); plaintiffs note that none involve agency rule making.

24 In this case, nothing could be more squarely within a court's ability than to determine
25 whether FHFA's July 6, 2010 Statement shutting down PACE – a substantive rule – is within the
26 legitimate authority of FHFA, consistent with the "public interest" (*see* 12 U.S.C. §
27 4513(a)(1)(B)(v)), and supported by evidence and a reasoned analysis. The *Newman* Court's
28 reasoning is apt. "The fact that an agency has broad discretion in choosing whether to act does
not establish that the agency may justify its choice on specious grounds. To concede otherwise

1 would be to disregard entirely the value of political accountability, which itself is the very
2 premise of administrative discretion in all its forms.” *Newman*, 223 F.3d at 943.

3 **3. Plaintiffs adequately have alleged that FHFA’s July 6, 2010 Statement is a**
4 **substantive rule subject to the APA’s requirement for notice and comment**

5 Section 4526(b) expressly provides that “[a]ny regulations issued by the Director under this
6 section [setting forth the Agency’s general authority to issue regulations necessary to carry out
7 FHFA’s duties] shall be issued after notice and opportunity for public comment pursuant to the
8 provisions of section 553 of Title 5” – the APA’s requirement for rule making notice and
9 comment. Section 553, in turn, has two important requirements. First, the section applies only to
10 rules, not orders resulting from adjudication. *Yesler Terrace Cmty. Council v. Cisneros*, 37 F.3d
11 442, 448 (9th Cir. 1994). Second, the section applies only to substantive rules (also called
12 legislative rules), not to “interpretative rules, general statements of policy, or rules of agency
13 organization, procedure, or practice.” 5 U.S.C. § 553(b); see *Lincoln v. Vigil*, 508 U.S. 182, 195
14 (1993). FHFA challenges both requirements but, as set forth below, its arguments are not
15 supported by the facts alleged.

16 **a. Plaintiffs’ allegations, taken as true, establish that the Statement is a**
17 **rule, not an order**

18 For the first time in its second brief, FHFA argues that its July 6, 2010 Statement is an order
19 and therefore not subject to the APA’s notice and comment requirements. (Motion 2 at pp. 20-
20 21.) Pursuant to 5 U.S.C. § 551(4), a rule is “the whole or a part of an agency statement of
21 general or particular applicability and future effect designed to implement, interpret, or prescribe
22 law or policy or describing the organization, procedure, or practice requirements of an agency.”
23 Two main features distinguish rulemaking from adjudication: breadth and prospective
24 application. *Yesler Terrace Community Council v. Cisneros*, 37 F.3d 442, 448 (9th Cir. 1994).
25 “[A]djudications resolve disputes among specific individuals in specific cases, whereas
26 rulemaking affects the rights of broad classes of unspecified individuals.” *Id.* And, “because
27 adjudications involve concrete disputes, they have an immediate effect on specific individuals
28 (those involved in the dispute)” whereas rulemaking “is prospective, and has a definitive effect on

1 individuals only after the rule subsequently is applied.” *Id.* (holding that a determination by the
2 Housing and Urban Development that state court eviction procedures met the agency’s due
3 process requirements constituted a rule).

4 The breadth and prospective nature of FHFA’s Statement indicate that it is a rule. FHFA’s
5 Statement asserts that PACE “programs present significant safety and soundness concerns that
6 must be addressed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks” (Cal. FAC,
7 Ex. C. (Statement at p. 1)), and then directs Fannie Mae and Freddie Mac to change their
8 practices and undertake a specified set of so-called “prudential actions” in order to “protect their
9 safe and sound operations.” (*Id.* (Statement at p. 2).) Each category of action is designed to
10 severely limit PACE programs across the nation and in California and to affect lending practices
11 in the entire residential mortgage market; as discussed, Fannie Mae and Freddie Mac together
12 own or guarantee approximately one-half of all residential home mortgages in the United States
13 and control the secondary market for such mortgages. The Statement is broad and prospective in
14 its application, and thus is a rule. *See, e.g., San Diego Air Sports Center, Inc. v. FAA*, 887 F.2d
15 966, 970 (9th Cir. 1989) (holding that letter sent to sports parachuting center stating “that *all*
16 parachuting by any party will be prohibited” in the San Diego Traffic Area was a rule (emphasis
17 in original)).

18 **b. Plaintiff’s allegations, taken as true, establish that the Statement is a**
19 **substantive, not interpretive, rule**

20 FHFA argues that its rule falls within the exception to the APA’s notice and comment
21 requirements because it is an interpretive rule, not a substantive rule. (Motion 1 at pp. 42-44.)
22 The label an agency puts on its actions is not conclusive, and a court need not accept an agency’s
23 characterization at face value. *San Diego Air Sports Center*, 897 F.2d at 970; *Hemp Indus. Ass’n*
24 *v. Drug Enforcement Admin.*, 333 F.3d 1082, 1087 (9th Cir. 2003). There is no “bright-line
25 distinction” between interpretive and substantive rules. *Flagstaff Medical Ctr., Inc. v. Sullivan*,
26 962 F.2d 879, 886 (9th Cir. 1992). Whether a rule is interpretive or substantive must be
27 determined by its attributes. In this Circuit, courts construe narrowly the APA’s interpretive rule
28

1 exception. *Reno-Sparks Indian Colony v. U.S. E.P.A.*, 336 F.3d 899, 909 (9th Cir. 2003). As set
2 forth below, the relevant attributes of the Statement establish that it is a substantive rule.

3
4 **i. The Statement constitutes general law making and not merely
discretionary “fine tuning”**

5 “Interpretative rules are issued by an agency to advise the public of the agency’s
6 construction of the statutes and rules which it administers.” *L.A. Closeout, Inc. v. Dept. of*
7 *Homeland Sec.*, 513 F.3d 940, 942 (9th Cir. 2008) (internal quotations, citation omitted). Such
8 rules merely clarify or explain existing law or regulations, setting out what the agency thinks a
9 statute or regulation means. *Reno-Sparks*, 336 F.3d at 909. Interpretive rules, “generally clarify
10 the application of a law in a specific situation”; accordingly, “they are used more for discretionary
11 fine-tuning than for general law making.” *Flagstaff*, 962 F.2d at 886. By contrast, legislative or
12 substantive rules, which require notice and comment, create rights, impose obligations, or effect a
13 change in existing law. *L.A. Closeout, Inc.*, 513 F.3d at 942. They “are of general, rather than
14 situational, application.” *Flagstaff*, 962 F.2d at 886.

15 In the July 6, 2010 Statement, FHFA states that after “over a year of working with federal
16 and state government agencies,” it directs Fannie Mae, Freddie Mac, and the Federal Home Loan
17 Banks to take specific anti-PACE actions. (See Section II.A, above.) FHFA’s Statement
18 directing all three regulated entities to take actions to limit and shut down operating and
19 prospective PACE programs across the nation (regardless of the specifics of the state PACE law
20 or local program requirements), does not simply interpret existing law and clarify its application
21 in a specific situation; rather it changes existing law, broadly creating new rights, and imposing
22 new obligations and duties on the entities.

23 In that respect, FHFA’s Statement is similar to a notice of proposed “guidance” issued by
24 FHFA in August 2010 concerning transfer fee covenants attached to real property. FHFA in the
25 proposed guidance instructs Fannie Mae and Freddie Mac not to purchase or invest in any
26 mortgages encumbered by private transfer fee covenants or securities backed by such mortgages
27 because they “appear adverse to liquidity, affordability and stability in the housing finance market
28 and to financially safe and sound investments.” 75 Fed. Reg. 49932 (Aug. 16, 2010). In that

1 instance, however, FHFA complied with the requirements of the APA, sending out a notice of
2 proposed guidance and requesting comments from the public. *Id.*

3
4 **ii. The Statement was issued pursuant to statutory direction**

5 Substantive rules generally are issued pursuant to statutory direction. *W.C. v. Bowen*, 807
6 F.2d 1502, 1505 (9th Cir. 1987). As discussed above, FHFA cited no specific statutory sections
7 in its Statement. It did, however, state that it was directing Fannie Mae, Freddie Mac, and the
8 Federal Home Loan Banks to take specified “prudential actions[.]” (Cal. FAC, Ex. C (Statement
9 at p. 2).) Under the Safety and Soundness Act, one of FHFA’s principle duties is to “oversee the
10 prudential operations of each regulated entity[.]” 12 U.S.C. § 4513(a)(1)(A). FHFA must ensure
11 that “each regulated entity operates in a safe and sound manner,” and fosters “liquid, efficient,
12 competitive, and resilient national housing finance markets.” 12 U.S.C. § 4513(a)(1)(B)(i),(ii).
13 As noted, where FHFA proposed a directive to the regulated entities instructing them not to
14 purchase certain mortgages, the Agency cited these provisions (12 U.S.C. section 4513(a)(1)(B))
15 as the basis for its regulatory authority, and it complied with the APA’s notice and comment
16 provisions. 75 Fed. Reg. 49932. In this case, FHFA’s action was taken under color of the same
17 statutory provisions.

18 **iii. The Statement reflects a change from previous policy**

19 A rule is considered substantive where it represents a change from previous policy.
20 *Southern California Aerial Advertisers’ Ass’n v. F.A.A.*, 881 F.2d 672, 677 (9th Cir. 1989). In the
21 *Southern California* case, for example, the Court held that a letter from the Federal Aviation
22 Administration (“FAA”) to an aerial advertising group stating that the shoreline near Los Angeles
23 Airport was closed to fixed-wing aircraft was a change from previous FAA policy of allowing
24 access on a first-come-first-served basis subject to air traffic controller authorization, and
25 therefore constituted a substantive rule. *Id.*; see also *W.C. v. Bowen*, 807 F.2d at 1505 (holding
26 program governing Secretary of Health and Human Services review of awards of Social Security
27 benefits by administrative law judges was a substantive rule because it changed existing policy
28

1 by making some class of claimants more likely to have their claims reviewed than others); *Linoz*
 2 *v. Heckler*, 800 F.2d 871, 877 (9th Cir. 1986) (holding that provision in agency’s manual that
 3 created exception to rule that ambulance service to the “nearest institution with appropriate
 4 facilities” was covered by Medicare was substantive rule). In this case, similarly, FHFA’s
 5 Statement changed the existing legal and policy landscape, under which all tax assessments were
 6 treated similarly, and created a discriminatory exception for PACE assessments. The Enterprises
 7 and thus the entire mortgage lending market now must treat this one single type of assessment
 8 differently, to the serious detriment of PACE programs.

9
 10 **iv. The Statement directs the regulated entities to take certain actions
 and creates a basis for enforcement**

11 Further, a rule is substantive where it has the force of law and provides a new basis for
 12 enforcement action against third parties. *Hemp Indus.*, 333 F.3d at 1087-1088; *see also Rivera v.*
 13 *Patino*, 524 F. Supp. 136, 148 (N.D. Cal. 1981) (holding that agency’s statement explaining how
 14 states should apply new pension offset rule was substantive rule, since agency’s “own
 15 characterization of its statement as a ‘directive’ quite candidly and accurately suggests that states
 16 will face the drastic consequence of decertification if they fail to comply with its terms”). Here,
 17 as discussed, FHFA’s Statement is directive in nature, ordering the regulated entities to take
 18 specific so-called “prudential actions” against PACE. Further, under FHFA’s authorizing statute,
 19 FHFA may take enforcement action for failure to comply with such direction (which fully
 20 explains Fannie Mae’s and Freddie Mac’s prompt and decisive action against PACE on August
 21 31, 2010). *See* 12 U.S.C. § 4631(a)(1). Because the Statement creates a new basis for
 22 enforcement against the regulated entities, it is a substantive rule.

23
 24 **v. After the Statement, the regulated entities retained little or no
 discretion to accommodate California PACE programs**

25 Finally, the less discretion that is reserved to the recipient of the agency’s statement or
 26 directive, the higher the likelihood that the agency’s action constitutes a substantive rule.
 27 *Barahona-Gomez v. Reno*, 167 F.3d 1228, 1232, 1235 (9th Cir. 1999) (noting that even though
 28 directives – which ordered immigration judges to “reserve decision” in any case in which the

1 judge intended to grant suspension of deportation – were “purportedly temporary and internal”
2 they “did not leave any real discretion” to the judges). In this case, FHFA in its Statement was
3 clear that the regulated entities were not simply to investigate whether PACE might pose a risk in
4 specific programs instituted under specific state laws, or if specific requirements are not observed,
5 and to determine what actions, if any might be necessary to address such risk. Instead, FHFA
6 found that in all instances, PACE programs “present significant safety and soundness concerns”
7 and “disrupt a fragile housing market” and directed the regulated entities to take the anti-PACE
8 actions described in Section II.A, above. (Cal. FAC, Ex. C (Statement at p. 1).) The Statement
9 reserved no discretion to the regulated entities to do anything less than aggressively obstruct and
10 derail PACE.

11 On balance, and considering all relevant attributes of the July 6, 2010 Statement as pleaded
12 by plaintiffs and as analyzed above, the Statement is a substantive rule.

13 **B. Plaintiffs have alleged sufficient facts to state a claim under NEPA**

14 FHFA asserts two grounds for dismissal of plaintiff’s NEPA claims. As a threshold matter,
15 FHFA argues that it has no discretion to consider the environmental impacts of its actions and
16 thus is exempt from NEPA. Alternatively, the Agency argues that even if NEPA could apply to
17 it, its July 6 Statement is not a “major federal action” because any effect to the environment
18 cannot be traced to the Statement, and because the Statement does not “alter the status quo.”
19 (Motion 1 at pp. 45-50.) Neither of these arguments is valid.

20 **1. NEPA is broadly interpreted to serve its public information and action-forcing**
21 **purposes**

22 The purposes of NEPA are twofold: to require an agency to “carefully consider, detailed
23 information concerning significant environmental impacts,” while “giv[ing] the public the
24 assurance that the agency ‘has indeed considered environmental concerns in its decisionmaking
25 process.’” *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 349 (1989) (citations
26 omitted). Consistent with the statute’s purposes, the Ninth Circuit has instructed the courts to
27 “give NEPA the broadest possible interpretation.” *Westlands Water Dist. v. Natural Res. Def.*
28 *Council*, 43 F.3d 457, 460 (9th Cir. 1994).

1 NEPA requires the production of an Environmental Impact Statement (EIS) for “major
2 federal actions significantly affecting the quality of the human environment.” *Ctr. for Biological*
3 *Diversity v. Kempthorne*, 588 F.3d 701, 711 (9th Cir. 2009); 42 U.S.C. § 4332(C). An agency
4 may choose to prepare an environmental assessment, a concise public document that provides
5 sufficient evidence and analysis for determining whether to prepare an EIS or a finding of no
6 significant impact (FONSI). *Ctr. for Biological Diversity*, 588 F.2d at 711; 40 C.F.R. §
7 1508.9(a). If the agency determines that an EIS is not required, it must supply a convincing
8 statement of reasons why the project’s impacts are insignificant. *Id.* This process is necessary to
9 show that the agency took the requisite “hard look” at the consequences of its action.” *Id.*

10 **2. There is no irreconcilable conflict between the Safety and Soundness Act and**
11 **NEPA; thus FHFA is not exempt from NEPA**

12 FHFA contends that its general duties under the Safety and Soundness Act preclude it from
13 considering the possibility of environmental effects when taking regulatory action. (Motion 1 at
14 pp. 48-50.) FHFA cites no express statutory prohibition, but appears merely to appeal to the
15 importance of its mission.

16 NEPA makes consideration of environmental impacts an obligation for all federal agencies.
17 *Robertson v. Methow Valley*, 490 U.S. at 348. NEPA requires agencies to comply with its
18 mandate “to the fullest extent possible.” An agency may avoid NEPA only where there is an
19 “irreconcilable and fundamental conflict” between NEPA’s requirements and the requirements of
20 another statute. *Flint Ridge Dev. Co v. Scenic Rivers Ass’n of Okla.*, 426 U.S. 776, 787-88
21 (1976); *see also Jones v. Gordon*, 792 F.2d 821, 826 (9th Cir. 1986); 40 C.F.R. § 1500.6.
22 Applying these standards, courts have repeatedly rejected agency appeals for special exemptions
23 from NEPA. *Compare, e.g., San Luis Obispo Mothers for Peace v. Nuclear Regulatory Comm’n*,
24 449 F.3d 1016, 1035 (9th Cir. 2006) (Navy, just like any federal agency, must comply with
25 NEPA to “the fullest extent possible” which includes weighing environmental costs of a project,
26 even though it has serious security implications); *Friends of the Earth, Inc. v. Mosbacher*, 488 F.
27 Supp. 2d 889, 908 (N.D. Cal. 2007) (rejecting argument of Overseas Private Investment
28 Corporation that it is not subject to NEPA) *with Flint Ridge*, 426 U.S. at 791 (finding

1 irreconcilable conflict because relevant statute deemed record properly filed by a real estate
2 developer to become effective 30 days after filing, and it was impossible to for agency to comply
3 with NEPA in short time frame).

4 In this case, FHFA has identified no irreconcilable and fundamental conflict with NEPA.
5 While the Safety and Soundness Act charges FHFA to ensure the safety and soundness of Fannie
6 Mae and Freddie Mac, the Act does not require only one outcome;¹⁹ it does not prohibit adoption
7 of mitigation measures to address environmental impacts; and it does not impose a short and
8 mandatory deadline for action that precludes a “hard look” at impacts and alternatives.²⁰ On the
9 last point, the face of FHFA’s Statement indicates that the Agency took more than a year to act.

10 Contrary to FHFA’s arguments, ensuring the safe and sound operation of Fannie Mae and
11 Freddie Mac is not the Agency’s exclusive duty. The Director is also required to ensure that:
12 “the operations and activities of each regulated entity foster liquid, efficient, competitive, and
13 resilient national housing financing markets....” [12 U.S.C. § 4513(a)(1)(B)(ii)] and that their
14 activities “are consistent with the public interest.” 12 U.S.C. § 4513(a)(1)(B)(v). For the latter
15 provision to have any meaning, it must authorize (or even require) that FHFA consider factors
16 beyond the financial considerations that are identified in the statute. The Director of FHFA is
17 also required “to ensure that the purposes of this Act, the authorizing statutes, and any other
18 applicable law are carried out.” 12 U.S.C. 4511(b)(2). Such laws include NEPA and state laws
19 (such as AB 811) that could be undermined or thwarted by FHFA regulations.²¹

20
21 ¹⁹ See *Grindstone Butte Project v. Kleppe*, 638 F.2d 100, 102-03 (9th Cir. 1981) (where
22 statute required Secretary of Interior to grant irrigation right-of-way when two conditions were
23 met, and Secretary had ability to condition the grant upon compliance with reasonable regulations
24 and terms designed to protect the public interest, the Secretary was not precluded from
25 considering environmental values and was not exempt from NEPA).

26 ²⁰ See *Jones v. Gordon*, 792 F.2d at 826 (even where agency must act within specified
27 time after publishing notice of application, no irreconcilable conflict because agency can wait to
28 publish notice until after it complies with NEPA).

²¹ The out-of-circuit case of *Grand Council of the Crees v. FERC*, 198 F.3d 950 (D.C. Cir.
2000), involving FERC rate setting, is distinguishable on this ground, as there was no discussion
by the court about any requirement for FERC to consider the “public interest” or other laws. The
Crees case is not an “irreconcilable conflict” case in any event. In the *Crees* case, the D.C. Court
of Appeals held that plaintiffs lacked prudential standing under the laws governing FERC rate
setting. In this case, as discussed above (see Section III.A.1, above), plaintiffs are in the “zone of
interests” of the Safety and Soundness Act and NEPA.

1 FHFA attempts to avoid this result by arguing that compliance with NEPA would be a
2 “useless act.” (Motion 1 at p. 48 (*Dept. of Public Transp. v. Public Citizen*, 541 U.S. 752
3 (2004).) *Public Citizen* is not on point. In that case, the agency, the Federal Motor Carrier Safety
4 Administration (FMSCA), had “only limited discretion regarding motor vehicle carrier
5 registration”; it was required to grant registration to all motor carriers that comply with the
6 applicable safety, fitness, and financial-responsibility requirements. *Id.* at 758. FMSCA prepared
7 an EA analyzing its new safety rules for Mexican motor carriers and determined that they would
8 not have a significant impact. *Id.* at 761-62. The agency’s failure to prepare an EIS was then
9 challenged. The Court agreed that the entry of the Mexican trucks into the United States was not
10 an effect of the agency’s regulations since it had no ability to prevent the border crossing of
11 Mexican trucks and, therefore, the agency’s decision not to further evaluate this impact in an EIS
12 was reasonable. *Id.* at 768. The Court made clear, however, that the FMSCA was required to and
13 did evaluate the environmental impacts of its own regulation, which included an increase in air
14 emissions from truck idling during required roadside inspections. *Id.* at 761-62, 769-70.

15 In this case, FHFA has substantial supervisory and regulatory control over the entities
16 regulated by it – as evidenced by the July 6, 2010 Statement. Unlike the FMSCA, however, the
17 Agency conducted absolutely no analysis at all to assess the environmental impacts of its
18 Statement effecting a “pause” in PACE. Having ignored NEPA, FHFA has not had occasion to
19 consider alternatives that could address FHFA’s safety and soundness concerns (to the extent that
20 they are borne out by substantial evidence) while still respecting state law designed to conserve
21 energy and reduce greenhouse gas emissions. Remedying such institutional inertia is exactly the
22 “action-forcing” purpose that NEPA was designed to serve. *See Methow Valley*, 490 U.S. at 348.

23
24 **3. FHFA’s July 6, 2010 Statement is a major federal action that could significantly
affect the environment and therefore is subject to NEPA**

25 FHFA argues that there is no federal action because its “financial” actions cannot impact
26 the environment (Motion 1 at pp. 45-46); the mortgage market functions independently from
27 FHFA’s directives (Motion 1 at p. 46); and its actions do not alter the “status quo” (Motion 1 at
28 pp. 47-48).

1 FHFA's arguments that NEPA is not triggered fail for a number of reasons. First, they are
2 grounded in assertions of fact that are contrary to plaintiffs' allegations, which, for purposes of
3 this Motion, must be taken as true. Second, as a matter of law, the Agency's arguments are
4 irrelevant, because they do not appear in an EA, FONSI, or any other document contemporaneous
5 with the Statement. As a substitute for NEPA compliance, "courts may not accept ... counsel's
6 *post hoc* rationalizations for agency action." *Oregon Natural Desert Ass'n v. Bureau of Land*
7 *Mgmt.*, ___ F.3d ___, 2010 WL 3398386, *26 (9th Cir. Aug. 31, 2010) (quoting *State Farm*, 463
8 U.S. at 50).

9 Third, FHFA implies that only direct environmental impacts can be "fairly traceable" to an
10 agency's action, and thus only direct impacts are relevant under NEPA. FHFA is wrong. NEPA
11 requires agencies to consider the indirect effects of their actions. *Idaho Sporting Congress, Inc. v.*
12 *Rittenhouse*, 305 F.3d 957, 963 (9th Cir. 2002). NEPA's implementing regulations define
13 "indirect effects" as those "which are caused by the action and are later in time or farther removed
14 in distance, but are still reasonably foreseeable." 40 C.F.R. § 1508.8(b). Where the agency does
15 not directly undertake the action that harms the environment, NEPA still applies where the
16 agency "can influence or does possess actual power to control non-federal activity." *Mosbacher*,
17 488 F. Supp. 2d at 918. Adoption of agency rules, regulations or policies constitutes "major
18 federal action" under NEPA. *See* 40 C.F.R. § 1508.18(a) ("[m]ajor Federal action" includes "new
19 or revised agency rules, regulations, plans, policies, or procedures") and 40 C.F.R. §
20 1508.18(b)(1); *accord Humane Soc'y of the U.S. v. Johanns*, 520 F. Supp. 2d 8, 19-22 (D.D.C.
21 2007) (adoption of regulation changes the status quo and is major federal action).

22 In this case, the facts as alleged by plaintiffs are that FHFA took regulatory action to impair
23 and shut down California PACE programs by controlling and influencing the mortgage
24 marketplace; PACE programs, as the California legislature expressly found, are essential to the
25 state's conservation and greenhouse gas reduction objectives; and FHFA's action is in fact
26 impairing and preventing the operations of these programs. The resulting environmental impacts
27 are fairly traceable to FHFA's action.
28

1 FHFA's remaining contentions – that FHFA's actions do not change the "status quo" and
2 that the mortgage market functions independently of FHFA regulations issued to the regulated
3 entities – must fail because they are at odds with the facts pleaded. As discussed, on this motion
4 to dismiss, the Court assumes that the facts alleged by plaintiffs in their complaints are true.

5 The "status quo" alleged by plaintiffs is that prior to FHFA's challenged action, PACE
6 financing was available to property owners in California, and, further, there was the possibility of
7 FHFA clarifying that the Enterprises' May 5, 2010 lender letters did not apply to California.
8 FHFA's July 6 Statement changed the status quo by restricting or eliminating the ability of
9 property owners to participate in PACE in the same way that they had previously (*e.g.*, without
10 requiring full payment of the amount financed at time of sale). FHFA's Statement also adversely
11 impacted the ability of local jurisdictions to operate PACE programs and continues to prevent
12 federal funding for PACE. Before FHFA issued its July 6, 2010 Statement, there remained the
13 possibility that FHFA could clarify that Fannie Mae's and Freddie Mac's lender letters,
14 addressing energy efficiency loans with first lien priority, did not apply to California PACE
15 programs using assessments that run with the land. That possibility ended when FHFA issued its
16 Statement. In addition, as FHFA establishes in its Request for Judicial Notice, FHFA's Statement
17 led to Fannie Mae and Freddie Mac issuing new lender letters that state unequivocally that Fannie
18 Mae and Freddie Mac, going forward, will not purchase mortgages with PACE priority liens.
19 (Border Decl. Exs. 20, 21.)

20 FHFA's contention that the market may still accept PACE, disregarding FHFA's actions
21 and stern pronouncements of risk, is inconsistent with the facts alleged by plaintiff and
22 acknowledged by defendants. Plaintiffs allege that "Fannie Mae and Freddie Mac together own
23 or guarantee about half of all residential home mortgages in the United States." (Cal. FAC ¶ 3;
24 *see* Motion 1 at p. 5.) "As of June 2008, the Enterprises' combined debt and obligations totaled
25 \$6.6 trillion – exceeding the national debt by \$1.3 trillion." (Motion 1 at p. 5.) "Because Fannie
26 Mae and Freddie Mac control the mortgage resale market, lenders will not issue mortgages that
27 do not meet Fannie Mae's and Freddie Mac's requirements." (Cal. FAC ¶ 3.) Plaintiffs allege
28 that various banks have already refused to refinance or provide a mortgage on properties that are

1 subject to a PACE lien unless the lien is paid off in full (defeating the very purpose of PACE that
2 the obligation runs with the land). (Cal. FAC ¶ 35.) These allegations are sufficient at the
3 pleading stage.

4 To be clear, plaintiffs are not arguing that every action taken by FHFA has the potential to
5 affect indirectly the mortgage market, which in turn could affect the environment. Rather,
6 plaintiffs' contention is simply this: where FHFA takes action expressly intended to "pause" state
7 law-based programs that are expressly designed to address one of the most important
8 environmental problems currently facing the California and the nation – climate change and
9 greenhouse gas pollution – that action is a "major federal action" under NEPA.

10 **C. Placer County adequately has pleaded that FHFA has violated the Constitution**

11 **1. Placer County has stated a claim that FHFA's actions violate the Tenth**
12 **Amendment**

13 FHFA's cursory Tenth Amendment argument (Motion 2 at pp. 7-9) lays out general
14 principles without showing how those general principles apply to the allegations of Placer
15 County's complaint. Whether or not FHFA's arguments may ultimately prevail, they should not
16 prevail as framed in this Rule 12(b)(6) motion, nor should the Agency be permitted to augment
17 the deficits in its reply brief.

18 First, FHFA broadly assert without benefit of authority that "Placer cannot plausibly allege
19 that FHFA has interfered with any state or local tax assessment, or lien power." (Motion 2 at p.
20 7). While it may be true that Placer County can still formulate the parameters of its mPOWER
21 program, as the County has alleged, the program has been otherwise torpedoed by the FHFA rule
22 in question. FHFA disclaims acting directly against the assessment power. Whether the
23 Agency's interference is direct or indirect is irrelevant; FHFA's actions have interfered with the
24 "state [and] local tax assessment, or lien power" used to establish mPOWER by rendering that
25 power meaningless in the context of the mPOWER program. FHFA does not explain how
26 significantly impacting the mPOWER program in this fashion is somehow not "interfering" with
27 "the state or local tax assessment or lien power" used to create it. In any event, without benefit of
28

1 authority for FHFA’s first proposition, the allegations of Placer County’s complaint to the
2 contrary must be accepted as true.

3 Second, FHFA asserts that Placer’s Tenth Amendment Claim is vitiated by the fact that
4 FHFA’s actions “embody a proper exercise of federal Commerce Clause power.” (Motion 2 at p.
5 8). Placer County agrees that regulation of the banks is generally a valid exercise of
6 congressional authority under the Commerce Clause. However, the state PACE law and its local
7 implementation does not attempt to regulate banks. FHFA’s interference with state and local tax
8 and assessment mechanisms is not directed by congressional action, but by the actions of an
9 administrative agency in issuing the challenged Statement. Each of the cases cited by defendant
10 addresses a challenge to congressional legislation. *See, e.g. Arizona v. Atchison, T. & S. F. R.*
11 *Co.*, 656 F.2d 398, 401 (9th Cir. 1981) (“In the alternative, Arizona asserts that section 306 is
12 unconstitutional because it was beyond the power of Congress, acting pursuant to its Commerce
13 Clause power, to enact, and that it violates the Tenth Amendment.”) Placer County is not
14 complaining that a particular statute enacted by Congress has violated the Tenth Amendment, but
15 that the act of an administrative agency ostensibly in furtherance of its statutory authority has
16 improperly interfered with state and local sovereignty. FHFA’s arguments simply fail to address
17 the issue presented by Placer County’s Tenth Amendment claim for relief.

18 Third, FHFA asserts that Placer County’s complaint does not allege a Tenth Amendment
19 complaint arising from a federal program that ““commandee[rs] the legislative processes of the
20 States by directly compelling them to enact and enforce a federal regulatory program.”” (Motion
21 2 at p. 9 (quoting *New York v. U.S.*, 505 U.S. 144, 162 (1992))). Placer County did not plead this
22 theory of the Tenth Amendment, so FHFA’s third argument is both correct and irrelevant.
23 FHFA’s motion to dismiss Placer County’s Tenth Amendment claim therefore should be denied.

24 **2. Placer County has stated a claim that FHFA’s actions violate the Spending** 25 **Clause**

26 Placer County alleges that FHFA’s Statement had the effect of placing post-acceptance
27 conditions on Placer County’s receipt of funds, awarded to the County by DOE pursuant to the
28 American Recovery and Reinvestment Act of 2009, in violation of the Spending Clause. (Placer

1 Co. Compl. ¶ 18, 33-34, 52-58.) The legal basis of Placer County’s Spending Clause claim is
 2 articulated in *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1 (1981). In *Pennhurst*, the
 3 Court noted that while “Congress may fix the terms on which it shall disburse federal money to
 4 the States[,]” the limitations imposed are “much in the nature of a contract”; states thus cannot be
 5 held to conditions unless they are “unambiguously” stated. *Id.* at 17.

6 In this case, Placer County alleges that the federal government, in awarding the County
 7 federal funds for PACE, and in issuing PACE guidelines which the County followed, expressly
 8 sanctioned PACE; only then did the federal government – in the form of FHFA’s Statement –
 9 impose anti-PACE conditions, in effect, killing the same program that the federal government
 10 previously sanctioned. The County has thus adequately pleaded a Spending Clause violation.

11 In response, FHFA presents various summary, fact-based contentions that contradict Placer
 12 County’s complaint, *e.g.*, that its Statement does not impose any “obligation” on the County;²²
 13 that the County can still operate its PACE program;²³ and that FHFA placed no post-award
 14 conditions on the federal funds. (Motion 2 at pp. 9-11.) As discussed, the Court must accept the
 15 facts pleaded by the County as true and, accordingly, FHFA’s factual assertions provide no basis
 16 for dismissal.

17 **D. California’s, Sonoma County’s, and Placer County’s state law claims against**
 18 **Fannie Mae and Freddie Mac are not subject to dismissal**

19 California, Sonoma County, and Placer County have alleged state law claims against Fannie
 20 Mae and Freddie Mac grounded in California’s Unfair Business Practices Act (Cal. Business and
 21 Prof. Code §§ 17200, *et seq.* (California and Sonoma County)); and state tort law (interference

22 ²² The only case cited by FHFA, *Winkelman ex rel. Winkelman v. Parma City Sch. Dist.*,
 23 550 U.S. 516 (2007) is not in any way helpful to FHFA. In *Winkelman*, the Court expressly
 24 reaffirms the proposition that when Congress attaches conditions to a State’s acceptance of
 25 federal funds, they must be set out unambiguously. *Id.* at 534. The Court held that a
 “determination that [a federal statute] grants to parents independent, enforceable rights does not
 impose any substantive condition or obligation on States they would not otherwise be required by
 law to observe.” *Id.*

26 ²³ The FHFA’s insistence that it has done nothing that singles out Placer County and other
 27 entities that attempt to assert assessments as first priority liens because its action applies to
 28 everyone equally is reminiscent of Anatole France’s observation about “equality” under the law:
 “the law in its majestic equality prohibits the rich, as well as the poor, from sleeping under
 bridges”

1 with prospective economic relations (Sonoma and Placer Counties) and interference with
 2 contractual relations (Placer County)). As discussed below, plaintiffs have adequately pleaded
 3 these claims, and neither the face of the pleadings nor any fact that can be judicially noticed
 4 establishes at this early stage of the litigation that these claims are preempted.

5
 6 **1. California has pleaded sufficient facts to state a claim that Fannie Mae and
 Freddie Mac violated the Unfair Competition Law**

7 California’s Unfair Competition Law prohibits any “unlawful, unfair or fraudulent business
 8 act or practice and unfair, deceptive, untrue or misleading advertising.” Cal. Bus. & Prof. Code §
 9 17200. Violation of federal, state or local law may serve as the basis for a section 17200 claim.
 10 *Saunders v. Superior Court*, 27 Cal. App. 4th 832, 838-39 (1994). Because the Unfair
 11 Competition Law is written in the disjunctive, a business practice may be “unfair or fraudulent”
 12 in violation of section 17200 even if the practice does not violate any law. *Olszewski v. Scripps*
 13 *Health*, 30 Cal. 4th 798, 827 (2003). A practice is unfair if it “‘offends an established public
 14 policy’ or is ‘immoral, unethical, oppressive, unscrupulous or substantially injurious to
 15 consumers.’” *McDonald v. Coldwell Banker*, 543 F.3d 498, 506 (9th Cir. 2008) (quoting *People*
 16 *v. Casa Blanca Convalescent Homes, Inc.*, 159 Cal. App. 3d 509, 530 (1984), *abrogated on other*
 17 *grounds in Cel-Tech Communications, Inc. v. Los Angeles Cellular Tel. Co.*, 20 Cal. 4th 163,
 18 186-87 & n. 12 (1999)). This determination requires the court to weigh the utility of the
 19 defendant’s conduct against the gravity of the harm to the alleged victim. *Smith v. State Farm*
 20 *Mut. Auto. Ins. Co.*, 93 Cal. App. 4th 700, 718 (2001).²⁴ The term “fraud” is similarly broad. It is
 21 not “predicated upon proof of the common law tort of deceit or deception but simply means
 22 whether the public is likely to be deceived.” *Countrywide Financial Corp. v. Bundy*, 187 Cal.
 23 App. 4th 234, 257 (2010).

24 In this case, California’s Unfair Competition Law claim focuses on Fannie Mae’s and
 25 Freddie Mac’s about-face in their treatment of PACE assessments. The Enterprises first

26
 27 ²⁴ Fannie Mae and Freddie Mac suggest that the balancing test is “pre-*Cel-Tech*” (Motion
 28 at p. 33) but, in fact, as the cases cited indicate, the test continues to be cited and applied after the
 1999 *Cel-Tech* case.

1 acknowledged that PACE financing must be treated like all other taxes and assessments that may
2 take priority over a mortgage, and then, unexpectedly and with no change in circumstances,
3 announced that PACE involved “loans” that violate Fannie Mae’s and Freddie Mac’s Uniform
4 Security Instruments. (Cal. FAC, Exs. A, B.) Fannie Mae’s and Freddie Mac’s characterization
5 misrepresents California PACE law, which finances improvements through assessments;
6 discriminates against California PACE assessments, treating them differently from all other tax
7 assessments; and has had substantial negative effects on PACE to the environmental and
8 economic detriment of California and its residents. These allegations are sufficient at the
9 pleading stage: even if the alleged conduct is not unlawful,²⁵ it is certainly fraudulent or unfair.

10 In their Motion, defendants first argue that California has failed to allege a violation of any
11 underlying law. As discussed, this is not a required element of an Unfair Competition Law claim.

12 Defendants next argue that there can be no violation of the Unfair Competition Law where
13 the “governing authority” has expressly approved the conduct at issue. In support, defendants
14 cite *Webb v. Smart Document Solutions, LLC*, 499 F.3d 1078 (9th Cir. 2007). In that case, the
15 plaintiffs alleged that a medical records processor had violated the Unfair Competition Law by
16 charging a patient’s attorney for medical records at a higher rate than the regulations would have
17 allowed if the individual had requested the records. *Webb*, 499 F.3d at 1080. The Court held
18 there was no unfair competition because, in writing the regulations, the agency had considered
19 and expressly rejected a definition of “individual” that would include that person’s attorney. *Id.*
20 at 1085-87. At the time of the defendant’s alleged unfair practice, the agency already had by
21 regulation “explicitly ruled out Plaintiffs’ proposed interpretation.” *Id.*

22 Here, in contrast, Fannie Mae’s and Freddie Mac’s misrepresentations occurred before
23 FHFA issued its July 6, 2010 Statement. Moreover, FHFA’s “approval” occurred after the fact,
24 and not through regularly issued regulations, but through a hastily issued directive that plaintiffs
25 allege violated the APA. There is no law suggesting that a federal agency can act *post hoc* and in
26 contravention of the APA to insulate private corporations from liability for actions that, at the

27 ²⁵ Plaintiffs intend fully to explore in discovery whether Fannie Mae’s and Freddie Mac’s
28 about-face violates their authorizing statutes or FHFA regulations.

1 time they were taken, were unlawful, unfair, or fraudulent as defined in the Unfair Competition
2 Law.²⁶

3 Finally, defendants argue that the benefits of Fannie Mae's and Freddie Mac's conduct in
4 "guarding against unsafe and unsound lending practices far outweigh the speculative harm to
5 Californians" (Motion 1 at p. 33.) Not surprisingly, plaintiffs disagree. "Whether particular
6 conduct is 'unfair,' 'unlawful' or 'fraudulent' within the meaning of Business and Professions
7 Code section 17200 is generally a question of fact which depends on the circumstances of each
8 case." *Countrywide*, 187 Cal. App. 4th at 257. Defendants will be free to pursue these arguments
9 at the summary judgment stage, or at trial, based on the evidence, at which time the Court can
10 resolve the parties' factual disputes. Defendants' arguments in this Motion, however, do not
11 provide a basis for dismissal.

12 **2. Sonoma and Placer Counties have pleaded sufficient facts to support their tort**
13 **claims**

14 Placer and Sonoma Counties each claim that Fannie Mae and Freddie Mac intentionally and
15 negligently interfered with each County's prospective economic advantage. Sonoma County's
16 claim is grounded in the expectation of future contracts with its residents who would have
17 participated in PACE to the benefit of the County (Fourth Cause of Action). Placer County's
18 claims are grounded in similar claims concerning future PACE participants, and in the economic
19 relationship between the County of Placer and the Placer County Public Financing Authority, and
20 between Placer County and third-party investor bond purchasers to the benefit of the County
21 (Fourth and Fifth Causes of Action). Placer County also claims intentional interference with
22 existing contractual relations (Sixth Cause of Action).

23 Fannie Mae and Freddie Mac allege that the Counties have failed to properly plead their
24 interference with prospective economic advantage claims by (1) not alleging existing economic

25 ²⁶ In ruling on defendants' Motion, there is no occasion to determine whether plaintiffs
26 will be entitled to a remedy that addresses Fannie Mae's and Freddie Mac's actions only up until
27 July 6, 2010, the date that FHFA issued its statement. On a motion to dismiss, the question is
28 whether the plaintiffs has pleaded facts that would entitle it to some remedy; the nature and extent
of that remedy is left for later stages of the litigation. *See Holt Civic Club v. City of Tuscaloosa*,
439 U.S. 60, 64 (1978).

1 relationships (Sonoma County only, Motion 1 at pp. 34-35)); and (2) not alleging an
2 independently wrongful act by Fannie Mae and Freddie Mac (both Counties, Motion 1 at p. 36
3 and Motion 2 at pp. 12-14). Defendants also contend that Placer County’s claim for interference
4 with existing contracts does not include all required elements (Motion 2 at pp. 15-16).
5 Defendants are wrong on all counts.

6 **a. The Counties adequately have pleaded interference with prospective**
7 **economic advantage**

8 The elements of the tort of intentional interference with prospective economic advantage
9 are: (1) an economic relationship between the plaintiff and some third party, with the probability
10 of future economic benefit to the plaintiff; (2) defendant’s knowledge of the relationship; (3)
11 intentional acts on the part of the defendant designed to disrupt the relationship; (4) actual
12 disruption of the relationship; and (5) economic harm to the plaintiff proximately caused by the
13 acts of the defendant. *Korea Supply Co. v. Lockheed Martin Corp.*, 29 Cal. 4th 1134, 1153
14 (2003). As to the third element, the “plaintiff must plead that the defendant engaged in an act that
15 is wrongful apart from the interference itself.” *Id.* at 1154. While a defendant’s actions must be
16 intentional, specific intent to disrupt is not a required element of the tort of interference with
17 prospective economic advantage. *Id.* at 1155. “[T]o satisfy the intent requirement for this tort, it
18 is sufficient to plead that the defendant knew that the interference was certain or substantially
19 certain to occur as a result of its action.” *Id.* at 1153. A claim for negligent interference with
20 prospective economic advantage is similar, except that it is based on the defendant’s negligence.
21 *See Venhaus v. Shultz*, 155 Cal. App. 4th 1072, 1078 (2007) (holding that claim requires that
22 “defendant knew of the existence of the relationship and was aware or should have been aware
23 that if it did not act with due care its actions would interfere with this relationship and cause
24 plaintiff to lose in whole or in part the probable future economic benefit or advantage of the
25 relationship”).

26 Fannie Mae and Freddie Mac allege that Sonoma County has not alleged an existing
27 economic relationship, citing to a few of the more general paragraphs in the County’s lengthy
28 complaint. A fair reading of the whole complaint, however, demonstrates that this element is

1 more than adequately pled. Sonoma County has an existing taxing and assessing relationship
2 with *all* of its property owning residents. Before defendants' action, many Sonoma County
3 property owners were entering into the PACE program. Sonoma County alleged that since its
4 Energy Independence Program first opened, it has financed over \$34.5 million in approved
5 assessment contracts supporting over 1,000 energy-efficiency projects, using its traditional
6 powers of assessment. (Sonoma Compl. ¶ 28). It is reasonable to infer that the County's PACE
7 program would continue to draw participants from among the County's homeowners. In addition,
8 Sonoma County alleges that there were 21 identified property owners in the process of executing
9 assessment contracts with the County who withdrew their applications because of defendants'
10 actions. (Sonoma Compl. ¶ 46.) This is sufficiently specific to meet the first element of the
11 cause of action. *See Lowell v. Mother's Cake & Cookie Co.*, 79 Cal. App. 3d 13, 19 (1978)
12 (allegation that plaintiff intended to sell the company, and had received several offers from
13 potential purchasers, which offers were withdrawn because of defendant's conduct, demonstrated
14 interference with prospective advantageous business relationship).²⁷

15 Fannie Mae and Freddie Mac also imply, without any specific argument, that Sonoma
16 County has failed to plead probable future economic advantage from the contractual relations
17 with which they have interfered. (Motion 1 at p 35.) In fact, Sonoma has alleged that its PACE
18 program is an essential component of the County's greenhouse gas reduction goals, and a
19 component of the County's plan to meet its statutory obligations such as those under the
20 California Environmental Quality Act (Cal. Public Resources Code sections 21000, *et seq.*), and
21 the Global Warming Solutions Act of 2006 (Cal. Health & Safety Code sections 38500, *et seq.*).
22 (Sonoma Compl. ¶ 27.) By interfering with County's prospective contractual relationships,
23 defendants are also "severely hampering County's efforts to ... reduce their energy and water use,
24 help drive the County's economy, and create significant numbers of skilled, stable and well-

25 _____
26 ²⁷ Sonoma County also alleges when PACE projects are completed, they are funded
27 through bonds issued each month by the Sonoma County Public Finance Authority, which bonds
28 are purchased by the County Treasury. (Sonoma Compl., ¶ 35). To the extent defendants' actions
have decreased participation in the County's PACE program, this economic relationship would
also be affected. Placer County makes similar allegations. (Placer Compl. ¶¶ 29, 66, 67, 71, 72.)

1 paying jobs.” (Sonoma Compl. ¶ 47). Defendants are “interfering with the County’s taxing
2 authority,” and “severely hampering the county’s ability to tax its residents for a legitimate public
3 purpose.” (Sonoma Compl. ¶ 49). Taking the Counties’ allegations as true, there cannot be a
4 serious argument that Fannie Mae’s and Freddie Mac’s actions have not impacted the Counties’
5 reasonable probability of future economic benefit from contractual assessments lawfully
6 established under state law.

7 Fannie Mae and Freddie Mac next argue that both Counties have failed to state sufficient
8 facts to establish that actions taken by defendants were independently wrongful. (Motion at pp.
9 35; Motion 2 at pp. 12-14.) Again, defendants are mistaken. Taking the facts as alleged as true,
10 defendants’ actions are independently wrongful under a variety of theories, any one of which is
11 sufficient to support the tort claim. For example, discussed in Section III.D.1, defendants’
12 behavior constitutes a violation of California’s Unfair Competition Law. Accordingly, their
13 conduct is, as required, “wrongful by some legal measure, rather than merely a product of an
14 improper, but lawful, purpose or motive.” *Korea Supply*, 29 Cal. 4th at 1159 n.11.²⁸ Moreover,
15 “[i]ntentionally interfering with an existing contract is a wrong in and of itself[.]” *Id.* at 1158
16 (citation omitted). Sonoma County alleges that Fannie Mae and Freddie Mac are interfering with
17 existing contracts (mortgages) of current PACE participants, and that this behavior is chilling and
18 dissuading other residents from participating in the PACE program. (Sonoma Compl. ¶ 46.)

19 Both Counties, in addition, have alleged that Fannie Mae and Freddie Mac made
20 statements, purported to be factual, that “mischaracterize” the nature of a PACE assessment, and
21 that this mischaracterization has adversely affected the marketability of PACE participants’
22 properties. (Sonoma Compl. ¶¶ 42, 46; Placer Compl. ¶¶ 39, 41.) Such misrepresentations
23 constitute wrongful conduct. Defendants’ alleged actions may also constitute slander of title or
24 disparagement, an independent tort. *See Seeley v. Seymour*, 190 Cal. App. 3d 844, 857-858

25
26 ²⁸ Placer County acknowledges that if the only wrongful conduct supporting its claims for
27 interference with prospective economic advantage were the common law tort of unfair
28 competition (*see* Placer Co. Compl. ¶¶ 67, 70), the claim would be subject to dismissal. This is
not, however, the only basis for these claims and, accordingly, defendants’ argument at Motion 2
p. 14 is irrelevant.

1 (1987).²⁹ While Fannie Mae and Freddie Mac apparently dispute the facts underlying their
 2 wrongful acts (*see* Motion 2 at p. 14), such disputes are not appropriately resolved on a motion to
 3 dismiss. Accordingly, defendants' motion to dismiss the Counties' intentional interference with
 4 prospective economic advantage claims should be denied.

5 **b. Placer County adequately has pleaded interference with contractual**
 6 **relations**

7 Placer County pleads, in addition, a claim for interference with contractual relations. The
 8 required elements of a claim for intentional interference with contractual relations are: (1) a valid
 9 contract between the plaintiff and a third party; (2) defendant's knowledge of the contract; (3)
 10 defendant's intentional acts designed to disrupt the contractual relationship; (4) actual breach or
 11 disruption of the contractual relationship, including performance made more expensive or
 12 burdensome; and (5) resulting damage. *Quelimane Co. v. Stewart Title Guaranty Co.*, 19 Cal. 4th
 13 26, 55 (1998). Placer County alleges that there were three relevant types of contracts with which
 14 Fannie Mae and Freddie Mac interfered: a Bond Purchase Agreement between the County and the
 15 Placer County Public Financing Authority, and the Placer County Treasurer-Tax Collector; a
 16 Limited Obligation Loan Agreement between these same parties; and Assessment Contracts
 17 entered into between the County and identified owners of real property in the County. (Placer
 18 Compl. ¶ 76.)

19 Defendants first assert that the first two types of contracts are not between third parties,
 20 citing Placer County's complaint at ¶ 29. (Motion 2 at p. 15.) Placer County in Paragraph 29
 21 states that the Placer County Public Financing Authority is a joint authority created under
 22 California Government Code sections 6500, *et seq.* by the County of Placer and the Placer County
 23 Redevelopment Agency. This paragraph does not establish that the Placer County Public
 24 Financing Authority is incapable of contracting with the County. Without more, the Court must

25 _____
 26 ²⁹ Defendants suggest that if the underlying wrongful act is "slander of title," the title at
 27 issue must held by the County, and the County must have standing to bring a "slander of title"
 28 claim. Defendants cite no authority for these additional requirements. As the California Supreme
 Court held in *Korea Supply*, all that is required is that the conduct be wrongful by "some legal
 measure" – not that it be independently actionable by the plaintiffs. *See* 29 Cal. 4th at 1159 n.11.

1 take the County's pleadings as true – that they are in fact separate entities with the power to
2 create enforceable contracts.

3 Fannie Mae and Freddie Mac next contend that as to the third type of contract – contracts
4 between the County and owners of real property – “no harm could have resulted from any alleged
5 acts by the Enterprises” because they waived certain conditions in the mortgages of homeowners
6 already participating in PACE. (Motion 2 at p. 15.) Defendants miss the point. The County
7 alleges that defendants' actions required it to cancel the entire residential portion of its PACE
8 program. Defendants may dispute the causation, but cannot do so in this Motion to Dismiss.

9 Defendants contend that Placer County's complaint “fails to plead any facts to support its
10 bald assertions that the Enterprises intended to disrupt” these contracts. (Motion 2 at p. 16.) As
11 the very case cited by defendants notes, “[i]ntent to interfere with the contract does not need to be
12 the primary purpose of the defendant's acts; rather, intent may be shown if the defendant ‘knows
13 that the interference is certain or substantially certain to occur as a result of his action.’” *Dollar
14 Tree Stores Inc. v. Oyama Partners, LLC*, No. C 10-00325 SI, 2010 WL 1688583, *2 (N. D. Cal.
15 Apr. 26, 2010) (quoting *Quelimane Co. v. Stewart Title Guaranty Co.*, 19 Cal. 4th at 56). Placer
16 County's allegations, construed in the light most favorable to the County, establish that
17 defendants acted with such knowledge.

18 Finally, defendants assert that there can be no interference cause of action because their
19 actions constituted “valid business decisions,” citing the *Dollar Tree* case. (Motion 2 at p. 16.)
20 In *Dollar Tree*, the plaintiff alleged that defendant Comerica intentionally interfered with a lease
21 contract between the plaintiff and a third party; the financing was to pay for certain
22 redevelopment required under the lease. *Id.* at *3. “However, the complaint also alleges that
23 Comerica ceased its funding ‘because the prospective anchor tenant of the redeveloped shopping
24 center ... filed bankruptcy and thereafter chose to liquidate.’” *Id.* at *4. Because the face of the
25 complaint showed that “Comerica was acting with a legitimate business purpose” the Court held
26 that “as pled the facts do not plausibly indicate that by ceasing funding Comerica intended to
27 interfere with plaintiff's right to receive a replacement store under its contract.” *Id.* In this case,
28 in contrast, Placer County's complaint does not suggest that Fannie Mae or Freddie Mac's May 5,

1 2010 lender letters serve any type of legitimate purpose when applied to Placer County's PACE
 2 program. Accordingly, defendants' motion to dismiss Placer County's intentional interference
 3 with contractual relations claim must be denied.

4 **3. California's and the Counties' state law claims are not preempted**

5 Federal law may preempt state law in one of three ways: (1) through express preemption,
 6 in which Congress defines explicitly the extent to which its laws preempt state law; (2) through
 7 field preemption, in which federal law is so pervasive as to leave no room for the states to
 8 supplement it; or (3) through conflict preemption, in which state law "actually conflicts" with
 9 federal law. *English v. Gen. Elec. Co.*, 496 U.S. 72, 78-79 (1990). Fannie Mae and Freddie Mac
 10 argue for preemption of the first and third types: that the Safety and Soundness Act expressly
 11 preempts state law, and that state Unfair Competition Law claims conflict with the federal
 12 delegation of authority to FHFA. (Motion 1 at pp. 27-31.)

13 Courts are guided by two "cornerstones" of preemption jurisprudence: "First, the purpose
 14 of Congress is the ultimate touchstone in every pre-emption case. Second [i]n all pre-emption
 15 cases, . . . we start with the assumption that the historic police powers of the States were not to be
 16 superseded by the Federal Act unless that was the clear and manifest purpose of Congress."
 17 *Wyeth v. Levin*, __, U.S. __, 129 S.Ct. 1187, 1194-95 (2009) (citations omitted, alterations in
 18 original). An agency's legal opinion as to whether its own regulations preempt state law is not
 19 entitled to deference; it is up to the courts to find preemption. *See Smiley v. Citibank (South*
 20 *Dakota), N.A.*, 517 U.S. 735, 744 (1996); *Colo. Pub. Util. Comm'n v. Harmon*, 951 F.2d 1571,
 21 1579 (10th Cir. 1991).

22 As set forth below, neither of the Enterprises' preemption theories is supported.

23 **a. Nothing in the Safety and Soundness Act expressly preempts state law** 24 **claims against Fannie Mae and Freddie Mac**

25 To support their claim for express preemption, Fannie Mae and Freddie Mac again cite 12
 26 U.S.C. § 4617, the provision addressing FHFA appointment as conservator or receiver, this time
 27 invoking section 4617(a)(7). Section 4617(a)(7) provides: "When acting as conservator or
 28

1 receiver, the Agency shall not be subject to the direction or supervision of any other agency of the
2 United States or any State in the exercise of the rights, powers, and privileges of the Agency.”

3 As a threshold matter, the plaintiffs’ state law claims are against the Enterprises. Section
4 4617(a)(7) prohibits state supervision of *FHFA* when it is acting as conservator. Thus, by its
5 plain language, nothing in section 4617(a)(7) would preclude claims against the Enterprises.
6 Consistent with this limitation, the Safety and Soundness Act contains a savings clause which
7 explicitly preserves state law claims brought against regulated entities: “[t]his chapter [Chapter
8 46] shall not create any private right of action on behalf of any person against a regulated entity,
9 or any director or executive officer of a regulated entity, *or impair any existing private right of*
10 *action under other applicable law.*” 12 U.S.C. § 4638 (emphasis added). The only plausible
11 reading of these two provisions is that the appointment of FHFA as a conservator does not bar
12 claims against Fannie Mae and Freddie Mac that exist independent of that appointment.

13 Further, even as to FHFA itself, section 4617(a) does not preempt state common law
14 claims. Congress knows how to draft provisions that clearly and expressly preempt state law.
15 *See, e.g., Retirement Fund Trust of Plumbing v. Franchise Tax Board*, 909 F.2d 1266, 1282 and
16 n. 66 (9th Cir. 1990); *Chamber of Commerce of the U.S. v. Edmundson*, 594 F.3d 742, 770 (10th
17 Cir. 2010); 29 U.S.C. § 1144(a) (specified provisions in subchapters of Employee Retirement
18 Income Security Act “shall supersede any and all State laws”); 21 U.S.C. § 360k(a) (provisions in
19 Federal Food, Drug, and Cosmetic Act, prohibiting any state requirement for regulated drugs or
20 devices “which is different from, or in addition to, any requirement applicable under this
21 chapter”). In contrast to such provisions, section 4617(a) does not reference laws, regulations, or
22 requirements imposed by states. Rather, it refers to the “direction or supervision of any other
23 agency of the United States or any State.” 12 U.S.C. § 4617(a)(7). Those terms – direction and
24 supervision – are distinct from law enforcement and refer to state supervisory power such as
25 additional licensing requirements, record keeping requirements, and any type of administrative
26 oversight. *See Cuomo v. Clearing House Ass’n*, ___ U.S. ___, 129 S.Ct. 2710, 2717 (2009)
27 (holding that federal banking law provision that limits state law administrative oversight
28 (“visitorial powers”) over national banks does not preempt law enforcement actions, because

1 “‘general supervision and control’ and ‘oversight’ are worlds apart from law enforcement”). This
2 distinction has been recognized in the context of interpreting a similar provision under the
3 Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. section
4 1821(c)(2)(C).³⁰ In rejecting express preemption of state law by that provision, the courts have
5 recognized that limitation on state power to supervise and control the receiver is not a “plain
6 statement’s of Congress’s intent to preempt” state laws, *Resolution Trust Corp. v. State of*
7 *California*, 851 F. Supp. 1453, 1458 (C.D. Cal. 1994), and does not expressly preempt state laws
8 that control unclaimed property, state law claims to foreclose on mortgage interests held by a
9 federal receiver (*Birdville Indep. School Dist. v. Hurst Assoc.*, 806 F. Supp. 122, 126, 128 (N.D.
10 Tex. 1992), and state laws that define contract rights. *Waterview Mgmt. Co. v. FDIC*, 105 F.3d
11 696, 700 (D.C. Cir. 1997).³¹ In each instance, the courts recognized that the state laws at issue do
12 not subject the agency to the direction or supervision of the state, and section 1821(j) does not
13 indicate a congressional intent to preempt the state laws at issue. *See, e.g., id.* at 700.

14 The same analysis applies here. The state unfair competition and tort claims against Fannie
15 Mae and Freddie Mac do not attempt to exercise administrative oversight or control over FHFA.
16 They are not laws that supervise, control, or regulate FHFA and are not expressly preempted by
17 12 U.S.C. section 4617(c)(2)(C). Under any reasonable analysis, section 4617(a)(7) was not
18 intended by Congress to be an express preemption provision that preempts state law claims
19 against the regulated entities.

20
21
22
23
24 ³⁰ Title 12 U.S.C. section 1821(c)(2)(C) is identical to 12 U.S.C. section 4617(a)(7) and
25 provides that “When acting as conservator or receiver... the [agency] shall not be subject to the
26 direction or supervision of any . . . State in the exercise of the [agency’s] rights, powers and
27 privileges.”

28 ³¹ The language relied on by defendants in *Waterview Mgm’t Co. v. FDIC*, 105 F.3d at
700, which states that section 1821(c)(2)(C) is an express preemption provision, is irrelevant here.
The issue is that section 1821(c)(2)(C), and similarly section 4617(a)(7) expressly preempt
“direction or supervision” of an agency by a state. They do not preempt the law enforcement and
tort claims at issue here.

1
2 **b. Plaintiffs' state law claims do not conflict with the Safety and Soundness Act**

3 Under the doctrine of conflict preemption, federal law also preempts state law: (1) where it
4 is impossible for a private party to comply with both state and federal requirements or (2) where
5 state law stands as an “obstacle to the accomplishment and execution of the full purposes and
6 objectives of Congress.” *English*, 496 U.S. at 79 (citation omitted). Because courts must
7 construe federal statutes “in light of the presumption against the pre-emption of state police
8 power regulations,” *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 518 (1992), the Supreme
9 Court has accordingly held that in cases of implied conflict preemption, the party asserting
10 preemption has the burden of showing that state law and federal law cannot “constitutionally
11 coexist.” *Hillsborough County, Fla. v. Automated Medical Laboratories, Inc.*, 471 U.S. 707, 716
12 (1985); *see also Barrientos v. 1801-1825 Morton LLC*, 583 F.3d 1197, 1209 (9th Cir. 2009).
13 Further, It is generally recognized that the proper approach to conflict preemption is to reconcile
14 the operation of both statutory schemes with one another rather than holding one completely
15 ousted. *Silver v. New York Stock Exchange*, 373 U.S. 341, 357 (1963).

16 **i. Fannie Mae and Freddie Mac cannot avoid the presumption against
17 conflict preemption by misconstruing the purpose of the underlying
18 state laws**

19 In their attempt to avoid the presumption against preemption – which they must do to
20 prevail – defendants argue that the presumption does not apply because the “State regulates in an
21 area where there has been a history of significant federal presence,” *i.e.*, banking. (Motion 1 at p.
22 28 (citations omitted).) Defendants misconstrue plaintiffs’ unfair competition and tort claims.
23 The state laws at issue here are not laws that are designed to regulate banks and banking. *See,*
24 *e.g., Bank of America v. City and County of San Francisco*, 309 F.3d 551, 556, 557-58 (9th Cir.
25 2002) (preemption of municipal ordinances regulating bank ATM fees). The state laws at issue
26 here are consumer protection laws of general applicability, enacted consistent with the state’s
27 police powers to protect its citizens. Thus, the presumption against preemption continues to
28 apply because “contract and consumer protection laws have traditionally been in state law

1 enforcement hands.” *Chae v. SLM Corporation*, 593 F.3d 936, 944 (9th Cir. 2010) (applying
2 presumption against preemption of state consumer remedy laws by federal student loan laws).

3
4 **ii. Fannie Mae and Freddie Mac have failed to demonstrate a direct
5 conflict between federal and state unfair competition and tort law
6 claims that makes dual compliance impossible**

7 In order to establish that an “actual conflict” with federal law exists, the party asserting
8 preemption must “show a physical impossibility of complying with both” state and federal
9 requirements. *English*, 496 U.S. at 79. Here, on a motion to dismiss, the defendants have not
10 made such a showing. It is clearly not physically impossible for the Enterprises to take steps
11 consistent with federal law, while simultaneously complying with the state unfair competition and
12 tort laws. Nothing in the Safety and Soundness Act prohibits the Enterprises from acknowledging
13 that PACE programs function through tax assessments, and treating them like all other routine tax
14 assessments, consistent with the loan documents – indeed, they did so prior to May 5, 2010.
15 Accordingly, Fannie Mae’s and Freddie Mac’s claim of implied conflict preemption based on
16 impossibility must fail.

17 **iii. Fannie Mae and Freddie Mac have failed to demonstrate that state
18 unfair competition and tort claims pose an obstacle to the goals and
19 purposes of the Safety and Soundness Act**

20 Obstacle preemption exists where state law stands as an “obstacle to the accomplishment
21 and execution of the full purposes and objectives of Congress.” *English*, 496 U.S. at p. 79
22 (citation omitted). Defendants argue in a conclusory fashion that the state law requirements
23 prohibiting entities from engaging in unfair competition interfere with Congress’s intent that
24 FHFA be the supervisory financial regulator and conservator of the Enterprises, and undermine
25 the Enterprises’ ability to operate under uniform standards. (Motion 1 at pp. 29-30.)

26 As noted above, in order to overcome the presumption against preemption, the party
27 asserting preemption has the burden of showing that state law and federal law cannot
28 harmoniously coexist. *Hillsborough County*, 471 U.S. at 716; *Barrientos*, 583 F.3d at p. 1197.
There are several reasons why an obstacle-preemption determination would be premature in the

1 present case: First, plaintiffs seek a declaration against Fannie Mae and Freddie Mac that PACE
2 programs are operated by assessments, not loans, and that such assessments are valid; liens that
3 result from PACE assessments, like those resulting from other assessments, have priority over
4 mortgages; and participating in the PACE program is compatible with and not in violation of
5 Fannie Mae and Freddie Mac's standardized mortgage documents.

6 The defendants fail to establish why such a ruling would pose an obstacle to the purpose
7 and goals of the Safety and Soundness Act and would frustrate federal law. At this stage of the
8 litigation, defendants have not established that the PACE mortgages pose any risk to the assets of
9 the Enterprises, or undermine their "safety and soundness." In fact, plaintiffs believe strongly
10 that defendants cannot make such a showing. Defendants' bare statement that they are concerned
11 about these issues does not establish conflict.

12 FHFA further argues that state-imposed obligations undermine the Enterprises' ability to
13 operate under consistent and uniform standards. Again, this is merely a conclusory statement that
14 is subject to dispute. Nothing in the state law claims requires FHFA or the Enterprises to
15 establish a different set of standards for each state. Rather, it may be possible for the defendants
16 (particularly FHFA) to create a single set of standards that apply to all PACE programs.³² In
17 fact, FHFA's claims are tantamount to a claim that FHFA has preempted the entire field of
18 consumer protection and tort law as it applies to the Enterprises, a claim that is contrary to the
19 express savings clause contained in section 4638 which preserves claims against the Enterprises,
20 and must be rejected. *See Courtney v. Halleran*, 485 F.3d 942, 951 (7th Cir. 2007) (reasoning
21 that because federal banking laws do not preempt non-conflicting state banking laws, "there is
22 even less reason to think that federal banking laws preempt state laws of general applicability.")

23 Applying the presumption against preemption of state laws, and the legal requirement that
24 all allegations of material fact in the complaint are taken as true and construed in the light most
25 favorable to the plaintiff, *Cousins*, 568 F.3d at p. 1067, the Court should find that Fannie Mae and

26 ³² Plaintiffs note that Fannie Mae and Freddie Mac have devised Uniform Security
27 Instruments that are specific to individual states (*see*
28 <http://www.freddie.com/uniform/unifsecurity.html>); the need for uniformity thus likely is overstated.

1 Freddie Mac have failed to meet their burden of demonstrating on a motion to dismiss, that state
2 consumer protection and tort laws against the Enterprises are preempted.

3 **c. It would be premature to reach preemption – an affirmative defense**
4 **based on disputed facts and grounded in a constitutional doctrine – at**
5 **the pleading stage**

6 Even if Fannie Mae and Freddie Mac could make out a plausible argument for preemption,
7 it would be premature to reach this affirmative defense at the pleading stage. Ordinarily,
8 affirmative defenses may not be raised in motion to dismiss for failure to state a claim. *Scott v.*
9 *Kuhlmann*, 746 F.2d 1377, 1378 (9th Cir. 1984) (citing C. Wright & A. Miller, Federal Practice
10 and Procedure, § 1277, at 328-30). An exception applies where the affirmative defense appears
11 clearly on the face of the pleading, *McCalden v. California Library Ass’n*, 955 F.2d 1214, 1219
12 (9th Cir. 1990) or raises no disputed factual issues, *Scott*, 746 F.2d at 1378. Where, as in this
13 case, preemption is not so established, a motion to dismiss must be denied. *See Morris v. Bank of*
14 *America*, __ F. Supp. 2d __, 2010 WL 761318, *6, n.4 (N.D. Cal., Mar. 3, 2010) (declining to
15 consider argument in motion to dismiss that Unfair Competition Law claim is preempted
16 “[b]ecause this argument rests upon facts not alleged in the pleadings”).

17 Moreover, in general, courts seek to avoid reaching constitutional issues where the case can
18 be decided on other grounds. Accordingly, it would be prudent to turn to preemption only after
19 California’s unfair competition claim, and the Counties’ tort claims, have been fully developed
20 after discovery, and the Court has occasion to determine whether the evidence supports violations
21 of these state laws. If it does not, there is no occasion to reach the constitutional issue of
22 preemption. *See Jimenez v. BP Oil, Inc.*, 853 F.2d 268, 270 (4th Cir. 1988) (holding that before
23 deciding preemption claim under the Supremacy Clause, court must decide whether state law
24 applied to facts at issue). Defendants’ motion to dismiss based on preemption should be denied.

25 **E. Plaintiffs’ allegations establish that they are entitled to a declaration of the**
26 **parties’ rights and duties relating to PACE**

27 All plaintiffs have requested that this Court declare the legal rights and duties of the parties
28 with respect to how PACE assessments are treated under California law. Plaintiffs contend that
PACE assessments must be treated in the same manner as all other assessments pursuant to the

1 clear language of state law, as Fannie Mae and Freddie Mac had done before their May 5, 2010
2 lender letters and before FHFA's July 6, 2010 Statement. Plaintiffs' request for a declaration on
3 this topic is reasonable given that the parties are in disagreement on this important and
4 fundamental issue.

5 Defendants contend that the claim is a mere exercise in "semantics" (Motion 1 at p. 37),
6 and note that others, including California, have at times used the term "loan" to characterize
7 PACE's financing mechanism. (Motion 1 at p. 37-38.) This is beside the point. The legal issue
8 is that when defendants began using the term "loan," it was to distinguish PACE assessments
9 from all other assessments and justify their discrimination. It is this practice, and not mere word
10 choice, about which plaintiffs seek clarification. Since defendants have failed to establish that,
11 under this claim, "no relief can be granted under any set of facts that could be proved consistent
12 with the allegations" (*Whitmire v. Arizona*, 298 F.3d 1134, 1136 (9th Cir. 2002)), their motion to
13 dismiss plaintiffs' declaratory relief claim must be denied.

14 CONCLUSION

15 For the foregoing reasons, FHFA's strained reading of the Safety and Soundness Act, the
16 Agency's *post hoc* justifications for its actions in order to evade review, and all defendants'
17 appeals to facts that are not before the Court or are disputed by plaintiffs' allegations must be
18 rejected. Accordingly, plaintiffs respectfully request that the Court deny defendants' Motion to
19 Dismiss. A proposed order is submitted contemporaneously with the filing of this memorandum.

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Dated: November 12, 2010

Respectfully Submitted,

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CERTIFICATE OF SERVICE

Case Name: People of the State of California v. Federal Housing Finance Agency, et al.	Nos. 10-cv-03084-CW 10-cv-03270 CW 10-cv-03317 CW 10-cv-04482 CW
– and related cases –	

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar at which member’s direction this service is made. I am 18 years of age or older and not a party to this matter; my business address is: 1515 Clay Street, 20th Floor, P. O. Box 70550, Oakland, California 94612-0550.

I hereby certify that on November 12, 2010, the following documents were electronically filed with the Clerk of the Court at the United States District Court for the Northern District of California by using the Court’s CM/ECF system:

**PLAINTIFFS’ JOINT MEMORANDUM OF POINTS AND AUTHORITIES IN
OPPOSITION TO DEFENDANTS’ MOTION TO DISMISS**

Participants in the case who are registered CM/ECF users will be served by the CM/ECF system. In addition, the following will be served by U.S. Mail:

Stephen E. Hart
Federal Housing Finance Agency
1700 G Street NW
Washington, DC 20552

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on November 12, 2010, at Oakland, California.

Janill L. Richards
Declarant

/s/
Signature