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Supreme Court Holds FHFA's Structure Is Unconstitutional but Declines to Unwind the Net-Worth Sweep

On June 23, 2021, the Supreme Court held in *Collins* v. *Yellen* that the structure of the Federal Housing Finance Agency violated the constitutional separation of powers but declined to invalidate the agency's so-called net-worth sweep on that ground. The decision expands upon last term's decision in *Seila Law* v. *Consumer Financial Protection Bureau* and makes it unlikely that the net-worth sweep will be unwound.

Background

In 2008, Congress passed the Housing and Economic Recovery Act after Fannie Mae and Freddie Mac suffered significant losses due to the collapse of the housing market. Through the Recovery Act, Congress created the Federal Housing Finance Agency (FHFA) to regulate Fannie and Freddie. FHFA is structured as an independent agency headed by a single director removable only for cause. The Recovery Act also granted the Treasury Department authority to purchase stock in Fannie and Freddie.

Pursuant to its statutory authority, FHFA appointed itself conservator of both Fannie and Freddie and entered into agreements to sell preferred stock in the enterprises to the Treasury Department. Over the next several years, the fixed dividends associated with that preferred stock grew until they far surpassed Fannie's and Freddie's profits. In 2012, the Secretary of the Treasury and the Acting Director of FHFA entered into an agreement to alter the dividend structure. In a portion of the agreement known as the "net-worth sweep," Treasury's fixed dividend was replaced with a dividend equal to the amount that the enterprises' net worth exceeded a specified capital threshold. The agreement thus ensured that Fannie and Freddie could pay their dividends to Treasury, but the enterprises could no longer accrue capital.

A group of Fannie and Freddie shareholders challenged the agreement in federal court, alleging that FHFA and Treasury had violated the Recovery Act by agreeing to the net-worth sweep and that FHFA was unconstitutionally structured because its single director was removable only for cause. The district court ruled for the government on each of the claims. On appeal, the Fifth Circuit affirmed in part and reversed in part. The full Fifth Circuit subsequently agreed to rehear the case en banc; it reversed the dismissal of the statutory claim; held that FHFA's structure violated the separation of powers; and concluded that the appropriate remedy for the constitutional violation was to sever the removal restriction from the rest of the Recovery Act, but not to invalidate FHFA and Treasury's agreement entirely. The Supreme Court granted review.

The Supreme Court's Decision

In a partially divided decision written by Justice Alito, the Supreme Court held that the for-cause removal restriction protecting FHFA's director violated the separation of powers but that the violation did not necessarily require the net-worth sweep to be unwound.

The Court was unanimous on several threshold issues. All nine Justices agreed that the Recovery Act's anti-injunction provision required the dismissal of the shareholders' statutory claim; that the shareholders had Article III standing to raise their separation-of-powers claim; that the claim was not moot even though FHFA and Treasury had eliminated the net-worth sweep in a subsequent agreement; and that the Recovery Act did not foreclose review of that claim.

Turning to the merits of the constitutional claim, the Court held in another unanimous portion of the decision that FHFA's decision to adopt the net-worth sweep in the first instance was not subject to constitutional challenge. The Court reached that conclusion because, at the time of adoption, FHFA was led by an *acting* director, and the Court concluded that the Recovery Act's for-cause removal restriction applied only to a full-tenure, Senate-confirmed director. Still, that did not dispense with the shareholders' constitutional challenge entirely, the Court explained, because the net-worth sweep had later been implemented by a full-tenure director to whom the removal restriction applied. The Court thus proceeded to address the question whether the removal restriction was constitutional.

In a 7-2 portion of the decision, the Court held that the removal restriction violated the constitutional separation of powers. In so doing, the Court largely relied on its decision from last term in *Seila Law* v. *Consumer Financial Protection Bureau* (2020). There, the Court held that the CFPB was unconstitutionally structured because, like FHFA, it was headed by a single director protected from removal by the President except for cause. In *Collins*, the Court acknowledged that FHFA differed from the CFPB in certain ways, including that FHFA regulates only government-sponsored enterprises and not purely private parties. But the Court reasoned that "the nature and breadth of an agency's authority is not dispositive in determining whether Congress may limit the President's power to remove its head." The Court proceeded to reject the arguments that FHFA does not exercise executive authority when acting as Fannie's and Freddie's conservator; that individual-liberty concerns are less applicable to the regulation of Fannie and Freddie; and that the removal restriction is sufficiently modest so as not to violate the Constitution.

The Court finally addressed the appropriate remedy. The shareholders argued that the constitutional violation rendered FHFA's actions implementing the net-worth sweep void, requiring those actions to be unwound. In an 8-1 portion of the decision, the Court disagreed. The Court held that, because the director of FHFA had been properly appointed, he had the authority to implement the net-worth sweep, meaning that his actions were not void. Nevertheless, the Court explained that the shareholders could still obtain retrospective relief if they could show that the removal restriction inflicted some "harm"—for example, if the President had expressed disapproval of the net-worth sweep and stated that, absent the removal restriction, he would have terminated the director. Because the parties had not briefed the question of harm to the shareholders, the Court remanded the case for the Fifth Circuit to consider that issue.

Justice Thomas wrote a concurring opinion. While he joined the majority opinion in full, he questioned the premise—assumed by both parties—that a particular government act is necessarily unlawful due to the presence of an impermissible removal restriction. In his view, the presence of such a removal provision might not taint the challenged agency action.

Justice Gorsuch concurred in part. He agreed that the removal restriction was unconstitutional, but he disagreed with the Court's remedial holding. In Justice Gorsuch's view, the presence of the unconstitutional removal provision prevented FHFA's director from properly exercising executive power, rendering the director's implementation of the net-worth sweep void.

Justice Kagan also concurred in part. In her view, the decision in *Seila Law* mandated the outcome on the constitutional question, and she felt bound to follow it as a matter of stare decisis. (Justice Kagan wrote the principal dissent in *Seila Law*.) She disagreed, however, with some aspects of the majority opinion, in particular the Court's statement that the degree of executive power exercised by an officer is not relevant to the validity of a removal restriction. In *Seila Law*, she noted, the Court had said the removal restriction at issue was impermissible because the CFPB exercised "significant executive power." In a separate portion of her opinion joined by Justices Breyer and Sotomayor, Justice Kagan approved of the Court's remedial holding.

Justice Sotomayor, joined by Justice Breyer, concurred in part and dissented in part. In her view, *Seila Law* did not govern the constitutional question because FHFA lacked significant executive power and exercised authority only over other governmental actors. Justices Sotomayor and Breyer would have upheld the removal provision against constitutional challenge.

Implications

The decision in *Collins* is a natural extension of the Supreme Court's prior decision in *Seila Law*. Both agencies were created in recent years and had the novel structure of a single agency head protected from removal by the President except for cause. To be sure, FHFA does not regulate private parties in the same way the CFPB does. But as the Court explained in *Collins*, FHFA still exercises executive authority in the sense that it interprets and implements the law.

What is notable about *Collins* is its seeming extension of *Seila Law* to all executive agencies. As Justice Kagan noted in her separate opinion in *Collins*, the Court in *Seila Law* emphasized that the CFPB exercised "significant executive power," in part because it enforced federal statutes against private parties. In *Collins*, however, the Court flatly stated that the degree of executive power exercised by an agency is not dispositive; whether the agency's authority is sweeping or circumscribed, the President must have the authority to remove a single director who leads an agency.

Ultimately, however, FHFA's net-worth sweep does not appear to be in significant danger. The Court's remedial holding requires the shareholders to prove that the removal restriction inflicted "harm" on them. Even if the removal restriction did influence the decision of FHFA's director to implement the net-worth sweep, it would seem difficult for the shareholders to obtain the evidence necessary to prove that fact.

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Susanna M. Buergel
+1-212-373-3553
sbuergel@paulweiss.com

Brad S. Karp
+1-212-373-3316
bkarp@paulweiss.com

Daniel J. Kramer
+1-212-373-3020
dkramer@paulweiss.com

Jane B. O'Brien
+1-202-223-7327
jobrien@paulweiss.com

Jessica E. Phillips
+1-202-223-7338
jphillips@paulweiss.com

Elizabeth M. Sacksteder
+1-212-373-3505
esacksteder@paulweiss.com

Kannon K. Shanmugam
+1-202-223-7325
kshanmugam@paulweiss.com

Liza M. Velazquez
+1-212-373-3096
lvelazquez@paulweiss.com

Associate William T. Marks contributed to this client memorandum.