

1 STEPHEN E. HART – stephen.hart@fhfa.gov
2 FEDERAL HOUSING FINANCE AGENCY
3 1700 G Street, NW
4 Washington, D.C. 20552
(202) 414-3800
Fax: (202) 414-6504

5 HOWARD N. CAYNE – howard.cayne@aporter.com
6 ASIM VARMA – asim.varma@aporter.com
7 SCOTT M. BORDER – scott.border@aporter.com
8 ARNOLD & PORTER LLP
9 555 Twelfth Street, NW
Washington, D.C. 20004
(202) 942-5000
Fax: (202) 942-5999

10 *Attorneys for Defendants*
11 FEDERAL HOUSING FINANCE AGENCY and EDWARD DeMARCO

12 **UNITED STATES DISTRICT COURT**
13 **NORTHERN DISTRICT OF CALIFORNIA**
14 **OAKLAND DIVISION**

14) Case No. 4:10-CV-03270-CW
15 County of Sonoma,)
16)
17 Plaintiff,)
18)
19 v.) DEFENDANTS’ BRIEF ON THE
20) BALANCE OF HARDSHIPS THAT
21 FEDERAL HOUSING FINANCE AGENCY;) WOULD RESULT FROM THE
22 EDWARD DeMARCO, in his capacity as) PRELIMINARY INJUNCTION PROPOSED
23 Acting Director of FEDERAL HOUSING) IN THE COURT’S DECEMBER 20, 2010
24 FINANCE AGENCY; FEDERAL HOME) ORDER
25 LOAN MORTGAGE CORPORATION;)
26 FEDERAL NATIONAL MORTGAGE)
27 ASSOCIATION,)
28 Defendants.)
_____)

DEFENDANTS' BRIEF ON THE BALANCE OF HARDSHIPS

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2 In an Order entered December 20, 2010, the Court stated that it “is inclined to deny”
3 plaintiff Sonoma County’s sole existing request for preliminary injunctive relief. Order (Dec. 20,
4 2010) (Dkt. No. 90) at 4. The Court explained that “Sonoma is not likely to succeed on the merits
5 to obtain the broad relief it requests” and noted that “the balance of hardships” does not “tip sharply
6 in [Sonoma’s] favor” given the broad mandatory injunction Sonoma sought. *Id.*

7 The Court then stated its view that “Plaintiffs’ likelihood of success on their Administrative
8 Procedure Act claims for notice and comment is greater than on their other claims,” and offered *sua*
9 *sponte* to “entertain a narrower request for relief” tailored to that claim, “such as an order that,
10 although not being required in the interim to withdraw their challenged announcements, Defendants
11 proceed to initiate the notice and comment process while this lawsuit is pending.” *Id.* The Court
12 acknowledged that “this form of preliminary relief was not requested in Sonoma County’s motion,”
13 but nevertheless asked “Defendants to address it,” specifically directing Defendants to “address the
14 balance of hardships that would be incurred by a preliminary injunction requiring [FHFA] to begin
15 the notice and comment process, without being required to withdraw their announcements.” *Id.* at
16 5. The Court further directed that “Defendants may not reiterate their arguments about the merits of
17 Plaintiffs’ case.” *Id.*

18 Pursuant to the Court’s Order, and without waiver of any argument as to any issue relating
19 to jurisdiction or the appropriateness of the proposed preliminary relief other than the balance of
20 hardships, Defendants FHFA and Edward DeMarco respectfully submit this brief on the balance of
21 hardships.

22 The preliminary injunctive relief the Court proposes would impose upon Defendant FHFA
23 the significant hardship of compelled formal rulemaking on a matter as to which the routine and
24 responsive approach of supervisory guidance — an essential tool employed by all financial
25 regulators and sanctioned in statute — would be more effective and more efficient. Moreover,
26 compelling formal rulemaking in this instance would embolden future plaintiffs, including regulated
27 entities, to assert that any form of directive or guidance other than formal regulation is improper
28 under the APA, forcing FHFA and other financial regulators to tailor their safety-and-soundness

1 supervision to litigation considerations, a burdensome result that Congress plainly intended to
 2 avoid. At the same time, the proposed preliminary relief would appear not to address the hardships
 3 alleged by Plaintiff Sonoma or lead directly to any tangible benefit to Sonoma. Therefore, FHFA
 4 urges the Court to refrain from granting such injunctive relief, as the present record contains no
 5 showing that the relief proposed would alleviate any purportedly irreparable harm Sonoma has
 6 alleged.

ARGUMENT

8 “A preliminary injunction is an extraordinary remedy never awarded as of right.” *Winter v.*
 9 *Natural Res. Defense Council, Inc.*, 555 U.S. 7, 129 S. Ct. 365, 376 (2008). A “plaintiff seeking a
 10 preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to
 11 suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his
 12 favor, and that an injunction is in the public interest.” *Id.* at 374. A party seeking an injunction
 13 must show all four elements, and the court must assess the three non-merits factors — including the
 14 balance of hardships — in light of the specific injunction sought. *Sierra Forest Legacy v. Rey*, 577
 15 F.3d 1015, 1019 (9th Cir. 2009). A court balancing the hardships in the context of a request for a
 16 preliminary injunction “will look to the possible harm that could befall the various parties.” *Maxim*
 17 *Integrated Products, Inc. v. Quintana*, 654 F. Supp. 2d 1024, 1036 (N.D. Cal. 2009) (citation
 18 omitted).

19 It is Sonoma’s burden to show that the purported harm it would suffer in the absence of the
 20 proposed preliminary injunction outweighs the hardship the proposed relief would inflict upon
 21 FHFA. But because Sonoma has not yet offered its views on the proposed preliminary relief,
 22 Defendants are left in the unusual position of arguing the insufficiency of a showing that has yet to
 23 be attempted. Nevertheless, as discussed *infra*, the balance of hardship plainly tips against granting
 24 the proposed preliminary relief.

I. THE PROPOSED PRELIMINARY RELIEF WOULD IMPOSE SIGNIFICANT HARDSHIP ON FHFA

25 Requiring formal notice-and-comment rulemaking here would impose a substantial hardship
 26 on FHFA by impairing FHFA’s ability to address safety and soundness concerns in a timely and
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1 effective manner. All federal financial institution regulators address their supervisory concerns
2 principally through informal supervisory guidance. As the D.C. Circuit noted in a 1992 decision:

3 [S]afety and soundness supervision is an iterative process of comment by the
4 regulators and response by the [regulated entity]. The success of the
5 supervision therefore depends vitally upon the quality of communication
6 between the regulated . . . firm and the . . . regulatory agency. This
7 relationship is both extensive and informal. It is extensive in that [the
8 regulators] concern themselves with all manner of a [regulated entity]'s
9 affairs. . . . [It] is informal in the sense that it calls for adjustment, not
10 adjudication. . . . It is the very rare dispute . . . that culminates in any formal
11 action, such as a cease and desist order.

12 *In re Subpoena Served upon the Comptroller of the Currency*, 967 F.2d 630, 633-34 (D.C. Cir.
13 1992) (citations omitted) (analyzing applicability of bank examination privilege). *See also Lee v.*
14 *FDIC*, 923 F.Supp. 451, 458 (S.D.N.Y. 1996) (quoting *id.*). Accordingly, formal notice-and-
15 comment rulemaking is not required where a federal financial institution regulator addresses a
16 safety and soundness concern arising out of the operations of a regulated entity, especially where
17 the regulator acts to protect the regulatee. As the leading Administrative Law treatise explains,
18 “The critical process in the federal control of banking is the supervising power, not adjudication or
19 rule making. The supervising power is not and probably cannot be surrounded by procedural
20 safeguards in formal hearings, and it is largely immune from the check of judicial review. Freedom
21 from arbitrary or unfair administrative action must depend upon factors other than formal
22 procedures or judicial review.” 1 Davis, *Admin. Law Treatise* (1958), Vol. 1, sec. 4.04, p. 251.¹

23 Indeed, in its 1991 *Gaubert* decision, the Supreme Court reiterated the importance of
24 informality to the supervisory process, confirming its earlier observation that “recommendations by
25 the agencies concerning banking practices tend to be followed by bankers without the necessity of
26 formal compliance proceedings.” *United States v. Gaubert*, 499 U.S. 315, 333 (1991) (quoting
27 *United States v. Phila. Nat’l Bank*, 374 U.S. 321, 330 (1963)). The Supreme Court also noted that
28 “[w]hen a governmental agency holds such great powers over its offspring, even to the point of

¹ *See also In re Franklin Nat’l Bank Securities Litig.*, 478 F. Supp. 210, 218 (E.D.N.Y. 1979) (financial agencies’ “extensive [enforcement] powers are further magnified by the *informality and flexibility that characterizes much of the agencies’ regulatory activity.*”) (emphasis added).

1 appointing a conservator or receiver to replace the management . . . , it is difficult to hold that an
2 informal request, even demand, to clean house would amount to an abuse of the statutory powers
3 and discretion of the agency.” *Id.* at 333 (quoting *Miami Beach Fed. S. & L. Ass’n v. Callender*,
4 256 F.2d 410, 414-15 (5th Cir. 1958)). Agencies like FHFA routinely communicate information
5 and guidance to regulated entities informally and transparently, as FHFA did here — a practice
6 courts have characterized as “excellent” and “vital.” As one district court summarized:

7 This technique of apprising persons informally as to their rights and
8 liabilities has been termed an ‘excellent practice in administrative
9 procedure.’ Administrative opinions should, to the greatest extent possible,
10 be available to the public as a matter of routine; it would be unfortunate if
the prospect of judicial review were to make an agency reluctant to give
them.

11 *American Land Title Ass’n v. Clarke*, 743 F. Supp. 491, 494 (W.D. Tex. 1989) (quoting *Nat’l*
12 *Automatic Laundry and Cleaning Council v. Shultz*, 443 F.2d 689 (D.C. Cir. 1971)). And as the
13 Fourth Circuit recently confirmed, permitting APA review of such informal guidance intended to
14 facilitate compliance with existing statutory requirements “‘would quickly muzzle any informal
15 communications between agencies and their regulated communities — communications that are
16 vital to the smooth operation of both government and business.’” *Golden and Zimmerman, LLC v.*
17 *Domenech*, 599 F.3d 426, 432 (4th Cir. 2010) (quoting *Indep. Equipment Dealers Ass’n v. EPA*,
18 372 F.3d 420, 428 (D.C. Cir. 2004)).

19 As discussed in greater detail *infra*, requiring FHFA to depart from its essential, routine, and
20 efficient method of addressing safety and soundness concerns through supervisory guidance would
21 impair FHFA’s capability to function as a financial regulator, imposing a substantial hardship on
22 the agency. Further, Congress contemplated that agencies have the ability to act promptly and
23 decisively to protect the financial system in unpredictable and fluid circumstances; otherwise,
24 parties could seek notice and comment rulemaking and defeat the purpose of prudent financial
25 oversight. To that end, FHFA’s organic statute, the Housing and Economic Reform Act of 2008,
26 empowers the Director of FHFA to “issue any regulations or guidelines or orders as necessary to
27 carry out the duties of the Director,” including, but not limited to ensuring that the Enterprises are
28 operating safely. 12 U.S.C. §§ 4526(a), 4511(b)(2), 4513(a). But only regulations (i.e., not

1 guidelines, orders, or other informal guidance) are subject to the APA’s notice and comment
2 provisions. *See id.* § 4526. Mandating one form of guidance over the others, especially where, as
3 here, each could be appropriate, would unnecessarily constrain the agency—imperiling the safety
4 and soundness of the Enterprises’ operations— and, thereby, placing taxpayers and the financial
5 system at greater risk.

6 **A. Financial Regulators Routinely Provide Informal Supervisory Guidance on**
7 **Matters of Safety and Soundness**

8 The Fifth Circuit’s 1980 *LaMarque* decision rejected a challenge to the authority of federal
9 financial regulatory agencies to address safety and soundness concerns by providing informal
10 guidance and directives to their regulated entities. *See First Nat’l Bank of LaMarque v. Smith*, 610
11 F.2d 1258 (5th Cir. 1980). Specifically, the Circuit upheld the authority of the Office of the
12 Comptroller of the Currency to issue supervisory guidance in the form of informal “letter
13 directives.” *Id.* at 1263-65. The letter directives at issue in *LaMarque* notified the recipient banks
14 that certain practices related to credit life insurance policies were unacceptable. “The thrust of the
15 Comptroller’s letter was clear: “self-dealing” relating to credit life must stop!” *Id.* at 1261
16 (quoting 436 F. Supp 824, 829 (S.D. Tex. 1977) (underlying district court decision)). Indeed, the
17 letters incorporated mandatory language, such as a directive that “all credit life insurance income
18 . . . must ultimately be credited on the bank’s books for the benefit of all shareholders,” and “we
19 [*i.e.*, OCC] will not permit a national bank to distribute this income to its officers as a substitute for
20 salary” *LaMarque*, 610 F.2d at 1260 (quoting letters).

21 The Fifth Circuit emphatically rejected a challenge to the OCC’s authority to issue such
22 guidance, concluding that “the Comptroller’s informal directives to appellant banks were a proper
23 exercise of his authority.” *Id.* at 1265. The court noted that “[t]he phrase “unsafe or unsound
24 banking practice” is widely used in the regulatory statutes and in case law, and one of the purposes
25 of the banking acts is clearly to commit the progressive definition and eradication of such practices
26 to the expertise of the appropriate regulatory agencies,” and specifically held that “[t]he letter
27 directives sent to the appellant banks constitute a lawful exercise of the Comptroller’s authority to
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1 prevent national banks from engaging in unsafe and unsound banking practices” *Id.* at 1263-
2 65 (quoting *Groos Nat’l Bank v. Comptroller of the Currency*, 573 F.2d 889, 897 (5th Cir. 1978)).

3 Here, FHFA has acted in substantially the same manner — based on safety and soundness
4 concerns, FHFA provided supervisory guidance and directives to specific regulated entities. As in
5 *LaMarque*, the guidance was tailored to the specific activities of the particular regulated entities; as
6 the directives FHFA issued to the Enterprises differ from those FHFA issued to the Federal Home
7 Loan Banks. Just as the OCC has ample authority to apply guidance and issue directives to address
8 safety and soundness concerns in the national-bank context (as *LaMarque* confirms), FHFA has
9 ample authority to apply guidance and issue directives to address its safety and soundness concerns
10 relating to the Enterprises’ investment in PACE-encumbered mortgages. Yet PACE program
11 advocates are already characterizing the proposed preliminary relief as a renewed opportunity to
12 insert themselves into FHFA’s safety and soundness determinations. *See PACE Litigation Alert*,
13 PACENow, (Dec. 22, 2010), <http://pacenow.org/blog/2010/12/pace-litigation-alert/>. By second-
14 guessing FHFA’s judgment and requiring FHFA to proceed through formal notice-and-comment
15 rulemaking, the proposed preliminary relief would remove an essential, effective, and efficient tool
16 from FHFA’s supervisory kit, thereby impairing FHFA’s ability to supervise and direct the
17 Enterprises effectively and inflicting substantial hardship on the agency and altering congressional
18 intent and regulatory practice well beyond the confines of this action.

19 **B. Informal Supervisory Guidance Is More Efficient and More Effective Than**
20 **Formal Rulemaking**

21 As the Supreme Court noted in *Gaubert*, “There is no doubt that . . . [financial institutions]
22 regulators use[] the power of persuasion to accomplish their goals. . . . [N]either the pervasiveness
23 of the regulators’ presence . . . nor the forcefulness of their recommendations is sufficient to alter
24 the supervisory nature of the regulators’ actions.” *Gaubert*, 499 U.S. at 333-34. Where, as here, a
25 financial regulatory agency confronts circumstances that raise supervisory concerns relating to
26 particular regulated entities, providing situation-specific guidance informally, including through
27 informal adjudication, is often more flexible and efficient than promulgating generally applicable
28 rules through the APA notice-and-comment process. Allowing an agency to address developing

1 supervisory concerns with informal, case-by-case guidance rather than through across-the-board
2 rulemaking permits the agency to react more quickly and to tailor its guidance more precisely to
3 new information and changing circumstances. See *Hindes v. Federal Deposit Ins. Corp.*, 137 F.3d
4 148, 162-63 (3d Cir. 1998) (FDIC’s issuance of “Notification which stated that . . . [bank] was
5 undercapitalized . . . [and that] procedures would be initiated to cancel [bank’s] deposit insurance if
6 [bank] did not come into immediate compliance” was merely a “preliminary step in FDIC
7 procedure” and therefore not subject to APA challenge). By contrast, requiring rulemaking would
8 undermine the regulatory structure Congress established, would in many instances cause delays that
9 would deprive regulated entities of needed guidance, and would in FHFA’s case pose grave risk to
10 the American economy given the vital importance of the Enterprises to housing finance.

11 With regard to financial regulator prerogatives to use persuasion and guidance to accomplish
12 entity-specific safety and soundness goals outside the formal rulemaking process, this case is
13 similar to *American Council of Life Insurance v. Ludwig*, 1 F. Supp. 2d 24 (D.D.C. 1998), *vacated*
14 *as moot* 194 F.3d 173 (D.C. Cir. 1999). There, in what the court termed an “informal adjudication,”
15 the Comptroller of the Currency approved a state-chartered bank’s conversion to a national bank
16 charter in a way that allowed the bank to retain certain insurance subsidiaries the bank would
17 otherwise have had to divest. *Id.* at 26, 31. The court noted that the OCC not only “considered the
18 role the subsidiaries played in [the bank’s] operations” but also “considered whether retention of the
19 [subsidiaries] would present any safety and soundness problems, and concluded that [they] would
20 not.” *Id.* at 30-31.

21 As is the case here, the plaintiff in *American Council*, an insurance trade association, was
22 not an entity supervised by the defendant agency, but nevertheless challenged the agency’s
23 supervisory action as procedurally improper under the APA. Specifically, the plaintiff in *American*
24 *Council* argued that the Comptroller’s decision amounted to a change in policy and that the
25 Comptroller was therefore required to issue a new rule through notice-and-comment process before
26 it could approve the bank’s request to retain the subsidiaries. *Id.* at 31. The court rejected that
27 argument, holding that “an agency is not prohibited from advancing new principles through
28 adjudication and the choice between proceeding by adjudication or rulemaking lies in the first

1 instance within the discretion of the administrative agency.” *Id.* (internal quotation marks and
2 citation omitted). The court concluded that “[i]nsofar as adjudication does not require notice in the
3 Federal Register and an opportunity for public comment as rulemaking does pursuant to [the APA],
4 the OCC is in compliance with the APA in issuing this informal adjudication, and Plaintiff’s
5 procedural claim must be dismissed.” *Id.*

6 Here, likewise, FHFA recognized that changing circumstances created new concerns — *i.e.*,
7 that the increased adoption of PACE programs presented significant safety and soundness concerns
8 — and undertook an informal adjudicative process through which specific guidance was tailored to
9 particular regulated entities. As noted above, FHFA’s July 6, 2010 Statement provides certain
10 guidance to the Enterprises, and different but equally particularized guidance to the Home Loan
11 Banks, related to addressing the developing risks posed by PACE programs. FHFA’s ability to
12 react in a timely and effective fashion to further developments in PACE programs (or to other,
13 presently unknown, developments that pose risks to the Enterprises’ portfolios) depends upon
14 FHFA’s ability to provide timely and specific guidance like that provided in the July 6, 2010
15 Statement. The proposed preliminary relief would limit FHFA’s ability to do so, thereby hampering
16 FHFA’s ability to act effectively on issues raising safety-and-soundness concerns and imposing a
17 substantial hardship on the agency in independently fulfilling its mandated conservatorship and
18 supervisory responsibilities.

19 Especially where, as here, requests for injunctions against an agency should be “rare
20 exceptions” rather than “a matter of course,” the hardship that would befall the agency were it
21 suddenly made “subject to similar suits for preliminary injunctions” concerning the routine exercise
22 of its statutory powers must be the focus of due consideration. *See McBride v. West*, 940 F. Supp.
23 893, 896 (E.D.N.C. 1996) (risk of subjecting armed forces to requests for preliminary injunctions
24 concerning disciplinary matters outweighed potential harm to plaintiff absent preliminary
25 injunction). Congress has expressly limited the availability of injunctive relief and other judicial
26 involvement in FHFA’s supervision of the Enterprises. *See* 12 U.S.C §§ 4617(f), 4623(d), 4635(b)
27 (jurisdiction-withdrawal provisions applicable to FHFA). Under the circumstances, imposing upon
28 FHFA, which operates as conservator and regulator, a mandatory injunction directing the agency to

1 implement notice-and-comment rulemaking in response to a specific safety-and-soundness concern,
2 which the agency identified and duly acted upon in the course of exercising its congressionally-
3 mandated responsibilities, would invite other parties to attempt to involve the courts in the
4 formulation of FHFA’s response to future supervisory and conservatorship concerns, a result
5 Congress plainly sought to avoid.

6 **II. SONOMA CANNOT ESTABLISH ANY COGNIZABLE COUNTERVAILING**
7 **HARDSHIP**

8 Given the severity of the hardship the proposed preliminary relief would impose on FHFA,
9 Sonoma must demonstrate that serious hardship would befall it in the absence of compelled notice-
10 and-comment rulemaking in order to warrant the proposed preliminary relief. It cannot.

11 If the purely procedural relief proposed would alleviate any purportedly irreparable harm
12 Sonoma perceives, Sonoma would have requested such relief in its Motion for a Preliminary
13 Injunction. But as the Court observes in its Order, Sonoma has never sought notice-and-comment
14 rulemaking or any other procedural remedy as preliminary relief. *See* Order (Dec. 20, 2010) (Dkt.
15 No. 90) at 3-4, 5. Indeed, in briefing its request for a preliminary injunction, Sonoma argued that
16 irreparable harm would result from the *substance* of FHFA’s Statement, not the *procedure* by which
17 FHFA issued the Statement. Son. Mot. for Prelim. Inj. (Oct. 14, 2010) (Dkt. No. 33) at 21-23.
18 Thus, on the present record there is no showing of any harm the now proposed preliminary relief
19 would prevent. Moreover, Sonoma *cannot* make the requisite showing that whatever harm Sonoma
20 purportedly would avoid through the proposed preliminary relief *outweighs* the harm that the
21 proposed preliminary relief would cause to FHFA. An order requiring FHFA to initiate a formal
22 rulemaking process would not of itself change any of the decisions the Enterprises have made (or
23 actions the Enterprises have taken) concerning PACE while in conservatorship. Additionally,
24 because any substantive benefit to Sonoma is contingent upon the *outcome* of the rulemaking
25 process rather than the proposed *procedure* of notice and comment, any potential benefit or harm to
26 Sonoma is purely speculative, indirect, and insufficient to warrant the proposed preliminary relief.
27 “Speculative injury does not constitute irreparable injury sufficient to warrant granting a
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1 preliminary injunction.” *Caribbean Marine Services Co., Inc. v. Baldrige*, 844 F.2d 668, 674 (9th
2 Cir. 1988) (citing *Goldie’s Bookstore, Inc. v. Superior Court*, 739 F.2d 466, 472 (9th Cir. 1984)).²

3 At bottom, the hardship the proposed preliminary relief would inflict on FHFA is so
4 substantial that it clearly outweighs whatever speculative, contingent, and indirect benefit Sonoma
5 might realize from the relief under consideration.

6 **CONCLUSION**

7 Preliminary relief, especially in the form of a mandatory injunction, is an extraordinary
8 remedy. Here, FHFA respectfully submits that the balance of hardships that would result from the
9 preliminary relief the Court has proposed tips sharply against granting such relief, in large part
10 because the proposed preliminary relief would materially impair FHFA’s ability to function
11 effectively as a safety-and-soundness regulator. Accordingly, FHFA respectfully requests that the
12 Court grant no preliminary relief to Sonoma in this action.

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² No jurisdiction exists to issue an injunction that would restrain or affect the exercise of the statutory powers and functions of the Conservator, *see* 12 U.S.C. § 4617(f), including the powers and functions the Conservator exercised in connection with the issuance of the Enterprise August 31, 2010 Lender Letters.

