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Bove Briefing

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Sweeney Decision Unsealed
Powerful Background Commentary

Two Surprises

- It was expected that the Supreme Court would indicate, last Friday, whether it was willing to review the Collins Case heard earlier by the 5th Circuit Court in New Orleans. It said nothing..
- It was also expected that the decision on the Fairholme Case heard by Chief Judge Margaret Sweeney would be unsealed on Monday, the 16th of December. The decision was unsealed Friday afternoon instead.

It is now my understanding that the Supreme Court may make its decision known on the Collins case by January 10th or January 13th. It is still unknown whether it will review this case or not. However, if it chooses to review the case, a decision would be forth coming by June 2020.

The unsealed decision in the Fairholme case was exactly as we published a week ago:

- The direct claim was denied. This claim was believed to have been for about $1 billion.
- The derivative claim was allowed to proceed. It is believed to be for $125 billion.
- The Court also argued that the plaintiffs had standing to bring this claim.
- By no later than January 10th 2020, the participants in this case are instructed to file a joint status report and possibly a schedule for future proceedings.

Collins Case Speculation

The vast majority of the people I have spoken with believe that the Supreme Court will decide to hear this case. Further, they believe that the government wants to lose this dispute.

The theory is that the government is not free to act to end the conservatorship if the biggest beneficiaries are perceived to be hedge funds. Thus, neither the Treasury nor the Federal Housing Finance Agency (FHFA) wants to take actions which would lead to their being accused of toadying to billionaires.

Conversely, if the Supreme Court states that the Net Worth Sweep is illegal, then Treasury and the FHFA will be free to impose the solutions they consider best without any political backlash. All of this is theoretical, however, and we must wait until early January to learn if the Supreme Court is even willing to hear the case.

The Fairholme Decision Bombshells

One of the plaintiff's counsels was kind enough to send me the Decision made by Chief Judge Margaret Sweeney in the Fairholme case. The wording of this decision is compelling and almost more positive than the decision to go forward with the derivative lawsuit itself.

The decision starts with a "Background" section. In this section, Judge Sweeney explains the issues involved in the action she is deciding upon. Let me state up front that this woman in my judgement is a true American hero. She has the intelligence and courage to make decisions that are unpopular with the government while every one of her brethren were not. In sum, I am very biased and a Sweeney acolyte.

Government Sponsored Enterprise (GSE) Status

The second paragraph of the Background Section of this decision states the following:

> "The Enterprises, up until the financial crisis in the late 2000s, were consistently profitable; Fannie had not reported a full-year loss since 1985, and Freddie had not reported such a loss since becoming privately owned. Id. ¶43. Although the Enterprises recorded losses in 2007 and the first two quarters of 2008, the Enterprises continued to generate sufficient cash to pay their debts and retained sufficient capital to operate. Id. ¶ 44. Otherwise stated, the Enterprises were not in financial distress or otherwise at risk of insolvency. Id. ¶¶ 45, 64."

Followers of the GSE lawsuits in the past 7 years have claimed this from Day 1. It is the basis of the Washington Federal et al lawsuit arguing that there was never any need to set up the GSE conservatorships in the first place. This lawsuit is in the Sweeney Court. This paragraph has to make the people in the Treasury and the FHFA tremble. If they lose the Washington Federal lawsuit the conservatorship is invalid and the government might owe these companies upwards of $200 billion. And, here in paragraph 2, Judge Sweeney is stating the plaintiff's position as fact – simply unbelievable.

Mafia Tactic

Further on Judge Sweeney states:

> "The FHFA and Treasury told each Enterprise's board that the FHFA would seize the Enterprises if the board did not consent to the conservatorship."

This, the Corleone family of "Godfather " fame, would call an "offer you cannot refuse."

The Big Lie

In sub-section 6 of the Background, Judge Sweeney writes the following:

> "In the early stages of the conservatorships, each Enterprise's net worth decreased as it reported losses. The bulk of the losses resulted from the FHFA-C writing down the value of deferred tax assets and designating large loan loss reserves. Id. ¶ 85. Notwithstanding those on-paper losses, the Enterprises' cash receipts consistently exceeded their expenses; they maintained net operating revenue in excess of their net operating expenses from the onset of the conservatorships under the PSPAs and through the first two amendments of the agreements. Id. ¶ 91.
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> By 2012, the Enterprises' financial outlooks were promising. In addition to an improvement in the housing market, the Enterprises began generating consistent profits and anticipated losing less money on their newer mortgages. Id. ¶¶ 92, 94-95. They were positioned to further improve their financial condition by settling lawsuits brought by each Enterprise. Id. ¶109, and revising their valuations of (1) deferred tax assets because of growing profits and (2) loan loss reserves because losses were less than expected, id. ¶¶ 98-99. The FHFA-C and Treasury were aware of those forthcoming changes and the Enterprises improving outlooks. Id. ¶¶ 94 – 104. In August 2012, Treasury noted that the Enterprises would post "[r]ecord earnings," id. ¶ 98 (alteration in the original) (quoting Treasury document), and Treasury received projections reflecting that the Enterprises would have positive comprehensive income between 2012 and 2022, id. ¶ 101. The FHFA-C had similar information; in July 2012, it circulated, within the FHFA, comparable projections and meeting minutes in which Fannie's treasurer was reported as stating that that the next eight years were likely to be "the golden years of [the Enterprises'] earnings." Id. ¶ 103 (quoting the minutes). Otherwise stated, the FHFA-C and Treasury knew, by early August 2012, that the Enterprises were poised to generate profits in excess of their respective dividend obligations to Treasury. Id. ¶ 97."

Sorry for the long quote. However, this one is critical. It demonstrates that this judge, at least, understands that the Treasury and the FHFA lied to the courts, the gullible media, and to Congress. In the Lamberth Court, Treasury Under Secretary Mario Ugoletti told the judge the exact opposite. He knew, as the above quote indicates, that the GSEs were going to make a sizable profit on a sustained basis but he blatantly lied. (This sounds like a joke but supposedly Mr. Ugolettit has been in Ecuador bird watching for years, now.)

The Treasury told Congress that the companies would not be able to make the required quarterly cash dividend payments so the Net Worth Sweep was necessary. The press bought this story as they say "hook, line, and sinker." What is even more outrageous here is that the Enterprises were not under any obligation to make the quarterly dividend payments in cash. They could have used stock instead. Judge Sweeney understands this and noted it in her decision.

When thinking about the trial set for October 2020, in Judge Lamberth's court one needs to keep in mind that:

- This judge was lied to and he knows it;
- It may be the reason that some of his initial findings were over-ruled by the U.S. Appeals Court; and
- Judge Sweeney has laid out the plaintiffs' case in relatively stringent language, which cannot be argued against by the government in this new trial.

Think about the words in this very long paragraph if the Supreme Court decides to take this case. It is very unlikely that this court will reject Chief Judge Sweeney's words.

Congress Be Damned

Note the words, in this my final quote, from Judge Sweeney's decision:

> "During the lead-up to the PSPA Amendments, a Treasury official acknowledged in a December 2010 memorandum to the Treasury Secretary that the government was "commit[ed] to ensur[ing] existing common equity holders will not have access to any positive earnings from the [Enterprises] in the future." Id. ¶ 118 (quoting the memorandum).
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> … When announcing the PSPA amendments, Treasury openly acknowledged that the new terms would "expedite the wind down of Fannie Mae and Freddie Mac." Id. ¶ 134 (quoting a Treasury press release). Treasury further explained that the new deal would ensure that the Enterprises "will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." Id.; accord id. ¶ 114 (explaining that the Treasury noted that, "[b]y taking all of their profits going forward, we are making clear that [the Enterprises] will not ever be allowed to return to be profitable entities"). Indeed, a White House official sent a message to a Treasury official on the day the deal was announced noting that "we've closed off [the] possibility that [the Enterprises] ever [] go (pretend) private again."

These statements and actions are directly contrary to the specific directives in the Housing and Economic Recovery Act of 2008 (HERA) which clearly directed that

- The Enterprises be brought back to health and
- Returned to the private markets.

It is as if Congress did not exist and that the Administration had the right to ignore whatever Congress requires in the laws that they pass. It is also evident that these quotes demonstrate that the Treasury is setting the agenda for the FHFA and the Enterprises. This is also not allowed by HERA.

Think back to the hearings for Supreme Court Justice Neil Gorsuch. One of the more serious points of debate in these hearings was whether Judge Gorsuch was a "strict constructionist" or not. A strict constructionist is a judge who believes that the bureaucracy is obligated to adhere to the laws that Congress passes and it must not deviate. The bureaucracy

in a democracy cannot legislate it must execute what Congress intends because Congress is the arbiter of the "people's" will.

What a farce this belief has been in face of what the Treasury and the FHFA did in totally ignoring the mandate of HERA. If the Supreme Court takes this case, and if it is truly constructionist, the FHFA and the Net Worth Sweep are in all probability "dead meat."

Conclusion

The Sweeney decision in the Fairholme case states the facts in a fashion that make it highly likely that the government is about to lose in multiple lawsuits. So, what is likely to happen?

My belief is that

- The Treasury will negotiate a settlement with the junior preferred shareholders in which the Enterprises simply start paying a dividend.
- The Treasury will be allowed to keep all of the money it has gotten through its chicanery.
- The senior preferred will be retired.
- The junior preferreds will jump a minimum of 100% in price and then they will be called and replaced by a new comprehensive issue.
- The much-reduced Enterprises will then become the equivalent of liquidation trusts as they run off their huge portfolios.
- The value of the common stocks will
    - Benefit from the rise in the preferred; and then
    - Settle back reflecting their expected dividend payments on a
    - Highly diluted base.

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