

# *The Delaware Bay Company* LLC

*"You can fool all of the people some of the time, and some of the people all of the time, but you cannot fool all of the people all of the time." – A. Lincoln*

HINDESight™ November 26, 2019

## Why did it take so long?

### **FINALLY, A JUDGE WHO GETS IT.**

Since its seizure of **Fannie Mae** and **Freddie Mac** on September 6, 2008, our government has been able to fool most of the judges most of the time. But so far, at least, not so with **Margaret M. Sweeney**, chief judge of the U.S. Court of Claims.

Last Tuesday, Her Honor heard oral arguments on the government's motion to dismiss several shareholder lawsuits challenging the **Treasury Department's** 2012 decision to alter the terms of its so-called 'bailouts'. You may recall that the 2008 terms called for the government to be paid a 10 percent dividend on its 'investment' in the companies. But four years later – just days after **Obama Administration** officials were informed that Fannie and Freddie were about to start booking record profits – the 10 percent dividend was replaced with something called the "Net Worth Sweep" ("NWS"). The NWS required that going forward, Fannie and Freddie were to fork over *100 percent* of their net worths (minus a minor reserve) *in perpetuity*. As a result, Uncle Sam has so far been paid nearly \$115 billion more than he was entitled to under the original agreement.<sup>1</sup> Nonetheless, no matter how much Fannie and Freddie pay, not a penny counts towards principal reduction, for under the terms of the NWS, the two companies will be in hock to Uncle Sam for the rest of their corporate lives. (For more detail, see links on page 3.)

The hearing began promptly at 9 a.m. and went on until after 7 that evening. As expected, the **Department of Justice** ("DOJ") was represented by an armada of attorneys who trotted out their 'golden oldies' – the same ones which have served them so well in numerous other courtrooms throughout the country over

the past decade. In a nutshell, their basic arguments are that Fannie and Freddie were insolvent when they were taken over and thus the government had no choice but to "rescue" them – and, regardless, the courts are prohibited by law from interfering. Judge Sweeney, however, didn't seem to be buying it.

By my count, about two dozen lawsuits challenging the NWS have been filed by angry shareholders. Between the various District Courts and their respective Courts of Appeal, I estimate that over 20 judges throughout the nation have addressed these cases over the past decade. Until very recently, however, virtually every one of those judges sided with the government. Indeed, only two agreed with the shareholders.<sup>2</sup> (They were in the minority on separate three-judge appellate panels.)

As might be expected, the DOJ attorneys forcefully argued that Judge Sweeney should come down on the same side as the rest of her peers: namely, throw out the shareholder lawsuits pending in her court. All those other judges couldn't have gotten it wrong, right?

Judge Sweeney was having none of it. She was especially critical of a provision of the NWS which prohibits Fannie and Freddie from ever repaying their debt, suggesting that the Treasury Department saw in the GSEs a "*funding stream . . .*" and used them "*. . . like a piggy bank*". When an attorney for the government responded the NWS was justified because "*we threw a lifeline to the companies*", an attorney for the shareholders retorted:

*"(In) what sort of bailout does the government say, 'oh,*

<sup>1</sup> As of June 30, 2019, the companies have repaid \$306.2 vs. \$191.5 billion advanced by the government.

<sup>2</sup> **Janice Rogers Brown** of the District of Columbia Circuit and **Don R. Willett** of the 5<sup>th</sup> Circuit.

*we're going to give you this money, but you can never pay it back, we don't want it back. Just keep paying us the 10 percent (in perpetuity), okay?' That's a 'tell'. Your Honor, that this was not a 'lifeline', it was a concrete life preserver."*

Likening the government's "siphoning of every dollar of (their) profit" to a "mob" loan, Judge Sweeney called the arrangement an "aberration".

*"One would not expect in the United States of America that the Government would step in with an infusion of capital and . . . the company would never be able to repay that which it borrowed, get back on its feet, and resume normal operations and pay dividends again . . . that doesn't seem cricket."*

Aside from the NWS, Judge Sweeney also questioned the imposition of the conservatorships themselves, suggesting the companies' boards of directors had been coerced into going along with the seizures:

*"At the critical time period, you have the directors . . . being told you either play ball with Treasury or you're out. And that is a Hobson's choice . . . they're concerned that their organization is going to be raided . . . financially . . . and it seems to me that's what happened."*<sup>3</sup>

### A shareholder win.

In September, a negative ruling from a 5<sup>th</sup> District judge, which had subsequently been upheld by yet another three-judge appellate panel, was reheard *en banc* by all 16 of that district's appeals court judges. By a 9-7 vote, the rulings by the three-judge panel and the district judge were overturned. The full Court of Appeals ruled in the shareholders' favor.

How to explain that unlike Judges Sweeney, Brown and Willett (and, most recently, the majority of the 5<sup>th</sup> Circuit *en banc* panel), so many well-educated and highly respected jurists have been unwilling to confront the government's blatant misbehavior? Instead of original thinking, many simply piggy-backed off a 2014 decision which the government won in the District

of Columbia Circuit. Without addressing the merits, they let the government off on bogus and tortured technicalities, ("may" vs. "shall") and linguistic gymnastics (the 'conserve' in 'conservator' doesn't mean what you think it does). Is cut-and-paste/monkey-see, monkey-do really the way the courts are supposed to operate? Do many of the judges simply not understand complex financial issues? Is there perhaps a bit of laziness involved here ("it's above my pay grade so I'll let the judges who make the big bucks sort it out.")?

Unfortunately, this problem of the federal courts seeming to lean in on the government's behalf is not new. During the so-called "supervisory goodwill" lawsuits of the 1990s, the government argued that healthy banks (such as Philadelphia's **Meritor Savings Bank**) which, at the government's urging, had taken over failing savings and loan associations, had never entered into valid contracts. Really? All those armies of investment bankers, lawyers, accountants and consultants who put the deals together got it wrong? None knew how to put together a basic contract? Yet in those 120-plus cases, judge after judge sided with the government. But then, as now, it was the chief judge of the Court of Claims who was the outlier. In *Winstar Corp. v. United States*, **Loren A. Smith** ruled that the government was in the wrong. Even so, he was reversed by his own Court of Appeals before his verdict was finally upheld by the highest court in the land, 7-2. It established a precedent which stands to this day.

To me, the failure of so many esteemed jurists to exhibit some of what the Lion in the *Wizard of Oz* described as "c-c-c-courage" is very disturbing. They seem to have chosen willful blindness over doing the right thing.

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<sup>3</sup> In his memoirs, **Henry Paulson**, then Secretary of the Treasury, confirmed as much, referring to it as an "ambush". "Do they know it's coming, Hank?" President Bush asked me. 'Mr. President,' I said, 'we're going to move quickly

and take them by surprise. The first sound they'll hear is their heads hitting the floor."

Additional resources:

HINDESight™ Oct. 23, 2019: [In Defense of the Hedge Funds \(Part 2\)](#)  
HINDESight™ Sept. 19, 2019: [Best Deal Since the Louisiana Purchase](#)  
HINDESight™ Feb. 19, 2019: [In Defense of the Hedge Funds \(Part 1\)](#)  
HINDESight™ Nov. 26, 2018: [Release the Hostages](#)  
HINDESight™ Sept. 4, 2018: [Ten Years After Henry Paulson's Colossal Blunder](#)  
HINDESight™ Sept. 6, 2017: ["The Case of the Concrete Life Preserver"](#)  
HINDESight™ Aug. 25, 2017: [Fanniegate: The Cover-up Unravels](#)  
HINDESight™ Sept. 6, 2016: [The Myth of Private Gains and Public Losses](#)  
J. Timothy Howard Feb. 26, 2016: [The Takeover and the Terms](#)

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