MEMORANDUM

To: Meeting with representative of Federated Investors, Inc. relating to rule amendments proposed in Securities Exchange Act Release No. 55431 (File No. S7-08-07), titled "Amendments to Financial Responsibility Rules for Broker-Dealers"

From: Office of the Chairman

Date: October 6, 2008

Subject: Meeting with representative of Federated

On October 3, 2008, James Eastman and David Dimitrious, Counsels to the Chairman, spoke with Stuart Kaswell of Bryan Cave who represents Federated Investors, Inc. Mr. Kaswell discussed issues raised by Federated in past submissions it has made with the Commission that are contained in this rulemaking file. Subsequent to the conference call, Mr. Kaswell provided Messrs Eastman and Dimitrious with a letter discussing the conservatorship of Fannie Mae and Freddie Mac, a copy of which is attached to this memorandum. Mr. Eastman and Mr. Kaswell have discussed related issues by phone on several occasions.

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September 17, 2008

Eugene F. Maloney
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Dear Mr. Maloney:

On July 31, 2008, we wrote to you explaining how the recently enacted Housing and Economic Recovery Act of 2008 could affect the risk characteristics of short-term debt obligations issued by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (together, "GSEs"). This letter updates that prior analysis to take into account the recent decision by the Federal Housing Finance Agency to place these two institutions in conservatorship and the concomitant decision by the Department of the Treasury to provide financial support to these companies (referred to herein as the "Assistance Package"). For the reasons indicated below, we believe that the Treasury is legally committed to provide up to $100 billion of equity financial backing to each GSE to ensure that their debt holders are protected, and that this backing may be provided at least through December 31, 2009 and, according to the Treasury Department, even thereafter.

<u>The Conservatorships</u>

Upon enactment of the Housing and Economic Recovery Act on July 30, 2008, the functions of the Office of Federal Housing Enterprise Oversight ("OFHEO") and the Federal Housing Finance Board were transferred to a new agency, the Federal Housing Finance Agency ("FHFA"). Pursuant to this statute, James Lockhart, the Director of OFHEO on the date of enactment, has the responsibility to carry out the functions of the head of FHFA, pending appointment and confirmation of a FHFA's first Director.[1]

On September 7, 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorship. These conservatorships are not subject to any time limitation and will end when FHFA

[1] The Constitutionality of Mr. Lockhart's assuming the powers and authority of the Director of FHFA, without going through the appointment and confirmation process, is beyond the scope of this letter.

determines they are no longer necessary. In an explanatory statement, Mr. Lockhart did not point to any one single critical event that prompted this action, but noted that these companies were facing a number of challenges, including current market conditions and an inability to fund themselves according to normal practices and prices. He stated that conservatorship was necessary to restore the balance between safety and soundness and the companies' critical mission of providing stability and liquidity to the housing market.[2] The boards of both Fannie Mae and Freddie Mac consented to the appointment of a conservator for their respective institutions.[3]

Purpose of the Conservatorships

As the Conservator for the GSEs, the FHFA assumes all of the legal authority of the shareholders, directors and officers of these companies. Mr. Lockhart stated that the goal of the conservatorships is to "help restore confidence in Fannie Mae and Freddie Mac, enhance their capacity to fulfill their mission, and mitigate the systemic risk that has contributed directly to the instability in the current markets."[4] He noted that a lack of market confidence in these companies had resulted in a continuing widening of the spread between Treasury and GSE securities, which means that the drop in interest rates generally has not been fully reflected in mortgage rates. Lockhart reiterated that the objective of the conservatorships is to return the entities to normal business operations.[5]

A "Fact Sheet" distributed by the FHFA on September 7, 2008 reiterates the purpose of the conservatorships to help restore confidence in each of the companies. Significantly, this document states: "There is no reason for concern regarding the ongoing operations of the Company. The Company's operation will not be impaired and business will continue without interruption."[6] However, dividends on both common and preferred shares were suspended by the Conservator.

The FHFA Fact Sheet specifically states the Conservator's intention to repay the GSEs' obligations:[7]

> [T]he Company's obligations will be paid in the normal course of business during the Conservatorship. The Treasury Department, through a secured lending credit facility and a Senior Preferred Stock Purchase Agreement, has significantly enhanced the ability of the Company to meet its obligations. The Conservator does not anticipate that there will be any disruption in the Company's pattern of payments or ongoing business operations.

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[2] Federal Housing Finance Agency, Statement of FHFA Director James B. Lockhart (September 7, 2008) (Hereinafter "Lockhart Statement").
[3] The FHFA announced that Herbert Allison (former Vice Chairman of Merrill Lynch and Chairman of TIAA-CREF) would be taking over CEO responsibilities at Fannie Mae and David Moffett (former Vice Chairman and CFO of US Bancorp) would be assuming these duties at Freddie Mac.
[4] Lockhart Statement at page 6.
[5] Id.
[6] Federal Housing Finance Agency, "Fact Sheet," (September 7, 2008) (Hereinafter "Fact Sheet").
[7] Fact Sheet page 3.

Treasury Financial Backing

The Housing and Economic Recovery Act authorized the Treasury to purchase the obligations and securities issued by Fannie Mae and Freddie Mac. There is no limit on the amount of such purchases, other than the limit imposed by the National Debt Ceiling which the Act increased to $10.6 trillion.[8] The Treasury's authority to purchase obligations and securities under this special provision terminates on December 31, 2009, unless further extended by Congress.

On September 7, 2008, the Treasury Department announced that, pursuant to this authority, it entered into agreements with Fannie Mae and Freddie Mac to provide both capital and liquidity support to these companies. In consideration for these commitments, the Treasury received one million shares of "Variable Liquidation Preference Senior Preferred Stock" of each company, with an initial liquidation preference of $1,000 per share, for a total value of $1 billion per company. The Treasury also received warrants for the purchase of common stock of each GSE representing 79.9% of the common stock of each GSE on a fully-diluted basis at a nominal price. In return, the Treasury is contractually committed to provide up to $100 billion of additional equity funding to each company, upon the call of either company, if certain financial triggering events occur. As these funds are provided, the aggregate liquidation preference of the outstanding shares of the senior preferred stock will automatically increase by the amount of each GSE's draw. The senior preferred stock will be superior to all other issues of preferred and common stock in the event of a liquidation of either GSE.

As part of the justification for Governmental assistance to these entities, the Treasury Department stated that due to "ambiguities" in the statutes establishing Fannie Mae and Freddie Mac, a perception had been created of Government backing, and that there was therefore a governmental responsibility to protect debt holders:[9]

> To address our *responsibility to support GSE debt and mortgage-backed securities holders*, Treasury entered into a Senior Preferred Stock Purchase Agreement with each GSE which ensures that each enterprise maintains a positive net worth. This measure adds to market stability by *providing security to GSE debt holders* – senior and subordinated – and adds to mortgage affordability by providing additional confidence to investors in GSE mortgage-backed securities. [Emphasis added]

In addition to the equity support, the Treasury plan established a credit facility to provide backstop liquidity to these entities. This Treasury credit facility will make advances to either GSE as needed through December 31, 2009. Fannie Mae and Freddie Mac guaranteed

[8] The current national debt is $9.7 trillion.
[9] Fact Sheet.

mortgage-backed securities will be eligible collateral. Loans will have a maturity of between one week and one month, and may be rolled over.[10]

In construing the agreements and the rights of the various parties, the courts will consider these statements and other information about the current market conditions. The contracts will not be construed in a vacuum, and the realities of the need to assure debt holders will be factors guiding a court's interpretation of the words used in the agreement. As the Supreme Court recently stated in a case involving an agreement between a Federal agency and a savings association to allow the association to use a preferential accounting method:[11] "Words and other conduct are interpreted in light of all the circumstances, and if the principal purpose of the parties is ascertainable it is given great weight."

Details of the Senior Preferred Stock Purchase Agreements

The Treasury Department entered into separate, identical Senior Preferred Stock Purchase Agreements with the FHFA, as Conservator, for Fannie Mae and Freddie Mac (the "Agreements").[12] Each Agreement specifies that the Treasury will provide funds to the GSE to the extent that the liabilities of the GSE exceed its assets as determined under GAAP.[13] If a GSE is placed into receivership or becomes subject to any other liquidation process or proceeding, the draw on the Treasury is equal to the amount that total allowed claims (other than those equal to or subordinate to the senior preferred shares) exceeds total assets. These commitments are subject to a $100 billion limit for each GSE, are of "indefinite duration", and will terminate with respect to either GSE at the earlier of:

(i) liquidation of the GSE's assets and the payment of the Treasury's obligations to make up capital deficiency;

(ii) the payment in full of all of the GSE's obligations (or defeasance of such obligations) and provision for unmatured liabilities; or

(iii) the purchase of $100 billion of senior preferred securities.[14]

In other words, the Treasury is obligated, up to $100 billion for each GSE, to ensure that the GSE's assets exceed its liabilities. If a GSE is nevertheless placed into a receivership, the Treasury is obligated, again up to $100 billion for each company, to ensure that the amount of the GSE's assets equals the amount of allowed claims (other than claims equal to or subordinate to the senior preferred shares). There is *no discretion* under the Agreements for the Treasury to refuse to provide such equity funding if the conditions in the Agreements are satisfied (e.g. a

[10] Additional support for the GSEs will be provided by the purchase of GSE issued mortgage-backed securities by the Treasury in the open market. These purchases are scheduled to begin this month, and the amount of the purchases will depend upon conditions.
[11] U.S. v. Winstar, 518 U.S. 839 (1996).
[12] Senior Preferred Stock Purchase Agreement (September 7, 2008).
[13] Id. at par. 1 (Definition of "Deficiency Amount") and par. 2.
[14] Id. at par. 2.3.

determination consistent with GAAP that liabilities exceed assets; the receipt of a written notice from the Director).

Timing

Each Agreement states that the Treasury commits to provide "immediately available funds." However, the procedures for the Director to request a draw state that the request must be made within 15 business days after the end of a fiscal quarter. Following receipt of the request, the Treasury has up to 60 days to provide the funds. If the Director determines that he or she will be required, by law, to place a GSE into conservatorship, the Treasury is required to provide the funds in a shorter time period as may be necessary to avoid a mandatory receivership if "reasonably practicable taking into consideration [Treasury's] access to funds."[15]

Rights of Third-Party Debt Holders

The Agreements provide rights to GSE debt holders to enforce the terms of the Agreements against either the Treasury or FHFA if there is a default on a debt obligation or payment on a guarantee. If a default occurs, the debt holder must first provide notice to the GSE requesting that the entity exercise its rights under the agreement to obtain equity funding from the Treasury.[16] If the GSE fails to make a demand for funds within 30 days of the demand notice, or if the Treasury fails to make the required equity injection and the GSE does not diligently pursue legal remedies, the debt holder is given the right to "seek judicial relief requiring [the GSE] to draw on the commitment or [the Treasury] to fund the commitment, as applicable."[17] Debt holders have "no other rights" under the Agreements and the commitment is not otherwise enforceable by any creditor or other person other than the signatories. No creditor or other person is intended to be a third-party beneficiary.

Each Agreement also states that the parties may agree to waive or amend the terms of the Agreement, but "no such waiver or amendment shall decrease the aggregate commitment or add conditions to funding the amounts required to be funded by [the Treasury] if such waiver or amendment would, in the reasonable opinion of the [GSE], adversely affect in any material aspect the holders of debt securities ... or the beneficiaries of Mortgage Guarantee Obligations."[18]

Finally, each Agreement also states that it is not intended to and shall not be deemed to constitute a guarantee by the Treasury for the payment or performance of any liability of a GSE.[19]

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[15] Id. at par. 2.2
[16] Id. at par. 6.1.
[17] Id.
[18] Id. at par. 6.3.
[19] Id. at par. 6.6.

Discussion and Analysis

The terms of the Assistance Package and statements by the Secretary of the Treasury clearly indicate that the Treasury is committed to providing financial support, up to a maximum of $100 billion for each entity, to ensure the repayment of current and future debt issued by Fannie Mae and Freddie Mac. The FHFA stated that the purpose of the conservatorship was to help restore confidence in these companies and to return these entities to normal business operations, and the Treasury has acknowledged that there is a governmental responsibility to protect GSE debt holders and to honor GSE guarantees.

The terms of the Assistance Package will clearly protect GSE debt holders and all other creditors, other than those who are subordinate to the senior preferred shareholders, up to the limits contained in the commitments. There is no preferred or other equity shareholder that has a senior position to the senior preferred shares held by the Treasury Department. While the contract states that it is not intended to constitute a guarantee of any GSE liability, as an economic matter it will provide a $100 billion source of funds for the payment of debt holders of each company. While that may not be an absolute guaranty, these sums appear to be sufficient to cover the expected losses in the current portfolios of the GSEs,[20] and therefore should provide considerable assurance that GSE debts will be repaid.[21]

While the intent of the plan is clear and undisputed, the terms of the Agreements are detailed and complex. Several legal issues need to be addressed to determine the extent to which the Treasury's commitments under the Agreements are binding upon the United States Government now and in the future. These issues are:

(i) Did Treasury enter into a binding contract that commits the U.S. Government?

(ii) Can the Agreements be amended by the parties to the detriment of debt holders?

(iii) Can the Agreements be amended or overridden by Congress?

(iv) Can the Agreements be enforced after December 31, 2009?

(v) What is the impact of the Anti-Deficiency's Act prohibition on making commitments that are not authorized by appropriations? and

(vi) Can the Treasury continue to provide equity funds to the GSEs after December 31, 2009?

[20] According to the Congressional Budget Office, the both GSEs had a negative net worth of $7 billion on a fair value basis as of March, 2008. The CBO estimated in July, 2008, that the likely cost to the Government of providing equity capital to the GSEs was $25 billion. The $200 billion commitment exceeds this estimate by a factor of 8.

[21] According to Treasury's Question and Answer document, the $100 billion amount was chosen to "give confidence to the markets."

1. Did Treasury Enter Into a Binding Contract that Commits the U.S. Government?

The U.S. Government is bound by contractual arrangements if the parties entering into the contract are authorized to bind the Government. The Treasury clearly is authorized to bind the Government. The general rule is that the authority of an Executive branch department or agency to use contracts to carry out authorized programs is generally assumed in the absence of express statutory prohibitions or limitations.[22] In this case, the Secretary's authority to enter into contracts to purchase GSE securities, acting as an agent of the U.S. Government, and to subject these purchases to rights and conditions, is clearly set out in the Housing and Economy Recovery Act.[23]

The authority of the FHFA, as conservator of Fannie Mae and Freddie Mac, to enter into binding agreements is also clear. The Housing and Economic Recovery Act[24] states that the Conservator shall have all of the rights of the regulated entity and of its shareholders, officers and directors with respect to that entity. This authority would include the right to enter into binding contracts.

The Agreements themselves contain all of the prerequisites for a binding contract, including mutual promises and commitments. In addition to these mutual promises, further consideration was given in the form of the transfer of one million senior preferred shares by each GSE to the Treasury. Finally, in a "Question and Answer" document issued on September 11, 2008, the Treasury Department states that the agreement "is a binding legal obligation between two parties."[25]

In light of the authority of the Secretary and the Conservator to enter into a contractual relationship, the terms used in the Agreements, the satisfaction of the pre-requisites for contract formation, and the clear intent of the parties to enter into a legally binding agreement,[26] we conclude that the September 7, 2008 Agreements are binding legal contracts between the Treasury, as the agent of the U.S. Government, and each GSE.

2. Can the Agreements Be Amended by the Parties to the Detriment of Debt Holders?

In each Agreement, the right to amend the provisions of the contract, or to waive performance, is explicitly limited in paragraph 6.3. This paragraph states that no amendment or waiver may "decrease the aggregate commitment or add conditions to funding the amounts required to be funded by the Purchaser [Treasury Department] if such waiver or amendment would, in the reasonable opinion of the Seller [the GSE], adversely affect in any material respect

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[22] U.S. v. Winstar Corporation, 518 U.S. 839 at note 36 (1996).
[23] Sections 1117-1118.
[24] Section 1145.
[25] U.S. Department of the Treasury, "Frequently Asked Questions: Treasury Senior Preferred Stock Purchase Agreement" (September 11, 2008) (Hereinafter "September 11 Q&A").
[26] The courts will look at the surrounding circumstances and the "realities of the transaction" in determining if the parties intended to enter into a binding contract. U.S. v. Winstar, 518 U.S. 839, 863 (1996).

the holders of debt securities of the Seller and/or beneficiaries of Mortgage Guarantee Obligations..."[27]

Further, the Conservator has a fiduciary duty to protect the interests of the entity under conservatorship. It would be difficult to reconcile this fiduciary responsibility with any change in the agreement that would adversely affect debt holders, or reduce the availability of funding to these companies. Thus, it would be very difficult for the Conservator to agree to any amendment that would reduce the level of Treasury support to these companies.

Finally, if the signatories nevertheless attempted to modify the Treasury's commitment, the holders of GSE debt could pursue legal action to prevent such changes from going into effect. Although each Agreement states that there are no third-party beneficiaries, each also provides in paragraph 6.1 that GSE debt holders have the right to enforce the provisions of the contract requiring the Treasury to provide equity funding to the GSEs. This right would be hollow if the signatories to the Agreements could modify Treasury's commitment so as to materially alter the protection of debt holders. One legal argument debt holders could make against such a modification is that a reduction in the amount of the Treasury's commitment would result in the impairment of their rights under the contract, and thus would constitute a "taking" without compensation.[28]

3. Can the Agreements be Amended or Overridden by Congress?

The general rule is that a future Congress is not bound by the actions of a previous Congress or Administration, although even this rule has exceptions. However, if a valid contract is entered into between the U.S. Government and another party, Congressional action that results in a breach of that agreement can result in damages being awarded to the aggrieved party.

In the case of U.S. v. Winstar,[29] the Supreme Court considered contracts entered into by the Federal Home Loan Bank Board with certain savings and loan associations to permit these companies to include "supervisory goodwill" as an asset notwithstanding GAAP principles to the contrary. In 1989, Congress passed a comprehensive law relating to the regulation of savings associations that included a provision that required supervisory goodwill to be written off, effectively nullifying these contracts. The Supreme Court held that the contracts did not limit the Government's authority to change regulatory policies, but to the extent such changes resulted in a breach of an agreement between the Government and the savings and loans, the Government was required to pay damages for the breach. Interestingly, as part of its decision, the Court noted that permitting the Government to renege on its promises would have significant adverse consequences in the credit markets:[30]

[27] Senior Preferred Stock Purchase Agreement (September 7, 2008), at par. 6.3.
[28] See e.g., Winstar v. U.S. 518 U.S. 839 (1996); Cherokee Nation v. Leavitt, Sec. of HHS, 543 U.S. 631 (2005); Robbins v. U.S., 438 F.3d 1074 (10th Cir. 2006).
[29] 518 U.S. 839 (1996).
[30] Id. at 884-85.

> [P]unctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors...
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> * * *
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> If we allowed the government to break its contractual promises without having to pay compensation, such a policy would come at a high cost in terms of increased default premiums in future government contracts and increased disenchantment with the government generally.

More recent cases have likewise held that the Government is responsible for its breach of a valid contract. In Mobile Oil Exploration and Producing Southeast, Inc. v. U.S,[31] the Supreme Court held that Congressional enactment of new environmental laws effectively repudiated existing contracts with an oil company to explore for and drill for oil off the coast and ordered the Government to pay restitution to the oil companies. In Franconia Associates v. U.S.,[32] the Supreme Court held that a Congressional enactment that prevented developers of low-income housing from prepaying their Government loans constituted a repudiation of their loan agreements that permitted such prepayments. And in Cherokee Nation v. Leavitt, Secretary of Health and Human Services,[33] the Supreme Court rejected the position that the Government is bound to pay under its contractual obligations only if Congress appropriates sufficient funds.[34]

These cases clearly establish that if the Congress enacts legislation that results in the breach of a binding contract with the Government, the parties harmed through such legislation will be able to seek monetary redress for their damages.[35]

The Agreements also specifically grant rights to debt holders to enforce the Treasury's funding commitment through the courts. Debt holders who rely on the Treasury funding commitment, either by holding on to GSE obligations in reliance on the Treasury funding commitment, or who purchase such obligations after September 7 in reliance on the Agreements, would have standing to bring to bring suit against the GSEs or if necessary, the Treasury. The relief that could be provided in such a judicial proceeding against the Government depends upon the legal theory used by the plaintiffs.

[31] 530 U.S. 604 (2000).
[32] 536 U.S. 129 (2002).
[33] 543 U.S. 631 (2005).
[34] See also Wetsel-Oviatt Lumber Company v. U.S., 38 Fed. Cl. 563 (1997) (The insufficiency of appropriations does not affect the rights of citizens honestly contracting with the Government There is a standing appropriation to pay court judgments so courts, in rendering judgment, are not required to investigate whether program funds are available.).
[35] This rule does not apply if the contract allocated the risk of future Governmental action to the party harmed by such action. For example, a contract can specifically provide that it will become void if future legislation prevents either party from performing.

A lawsuit against the Federal Government based on a breach of contract is filed in the Federal Court of Claims, which has (with limited exceptions) exclusive jurisdiction over such suits. Although the Agreement specifies that the District Court for the District of Columbia shall has exclusive jurisdiction over all disputes,[36] the parties to a contract cannot confer jurisdiction on a court, and therefore this contractual provision is ineffective where the suit is based on breach of contract.

It is often stated that the Court of Claims has no authority to require specific performance, and that its jurisdiction is limited to awarding monetary damages. However, the case law indicates that the Court of Claims has the authority to grant relief that is not in the form of "damages," so long as the relief is monetary. For example, in Suess v. U.S.,[37] the court explained:

> Defendant repeats the ancient but inaccurate shibboleth that this court has not 'equity jurisdiction' . . . The correct premise is, not that we are without equity jurisdiction, but that we cannot grant *non-monetary* equitable relief such as an injunction, a declaratory judgment, or specific performance. *Where the relief is monetary, we can call upon such equitable concepts as rescission and reformation to help us reach the right result.*

This formulation of the court's jurisdiction has been accepted by the U.S. Court of Appeals for the Federal Circuit.[38]

Thus, if the debt holders brought suit against the Treasury Department in the Court of Claims, the relief sought would be for the Treasury to fulfill its commitment under the Agreements to provide funds to the GSEs. Even if this is considered to be a request for specific performance, an equitable remedy, the remedy would be purely monetary, and the Court of Claims would have jurisdiction to make the award.

Alternatively, the debt holders could bring suit in the District Court, arguing that they have a property interest created by the Treasury's commitment to provide funds to the GSE's, and the failure of the Treasury to fulfill its commitment is a "taking" raising a constitutional issue subject to district court jurisdiction. As the D.C. Court of Appeals has stated:[39] "litigants may bring statutory and constitutional claims in federal district court even when the claims depend on the existence and terms of a contract with the government... and even where the relief sought is specific performance." The Court of Appeals for the Tenth Circuit reached a similar result holding that the district court has jurisdiction over a claim of breach of a contract by the Government if the breach results in the deprivation of a property interest[40] and relief may include an injunction against violating the agreement. Other courts have held that such injunctions against the

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[36] Par. 6.4.
[37] 33 Fed. Cl. 89 (1995).
[38] First Hartford Corporation Pension Plan & Trust v. U.S., 194 F.3d 1279 (Fed. Cir. 1999).
[39] Transohio Savings Bank v. Director, OTS, 967 F.2d 598, 610 (D.C. Cir. 1992).
[40] Robbins v. Norton, Sec. of the Interior, 438 F.3d 1074 (10th Cir. 2006).

Government are not permitted even in these circumstances.[41] However, since litigation under this theory would be brought in the District Court for the District of Columbia (as specified in the Agreements), the holdings of the D.C. Circuit Court of Appeals would be binding.

Thus, to the extent that the Treasury's funding commitment, and the provisions of the Agreements providing for enforcement by the debt holders, create a constitutionally recognized property interest, the district court would have jurisdiction under current precedent to require the Treasury to perform under the contract by funding the commitment.

In short, the debt holders would have two potential avenues to require the Treasury to downstream funds to the GSEs. The debt holders could bring suit in the Court of Claims on a breach of contract theory, and the plaintiffs could argue that the court has the authority to order the Treasury to comply with the Agreements since compliance would only require the payment of money. Alternatively, the debt holders could sue in the District Court for the District of Columbia on the theory that there was a constitutional taking through Treasury's failure to honor its commitment, and the court would have the authority to order the Treasury to honor its promise to fund.

4. What is the Impact of the Anti-Deficiency Act?

The Anti-Deficiency Act[42] provides that an officer or employee of the United States may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation or other fund for that purpose. In the Housing and Economic Recovery Act, Congress appropriated "such funds as may be necessary" for the Secretary to purchase assets or securities from the GSEs.[43] Thus, on its face, the agreement complies with the Anti-Deficiency Act.

On the other hand, it might be argued that the Agreements contain an indefinite commitment for Government funding of the GSEs, and thus the obligation is not supported by appropriations for future years. However, this argument ignores the fact that the statutory language does not impose any time limit on the appropriations.[44] In addition, the case law is clear that the Anti-Deficiency Act does not shield the Government from liability where the Government has lawfully entered into a contract with another party.[45]

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[41] See, e.g. Tuscon Airport Authority v. General Dynamics Corp. 136 F.3d 641 (9th Cir. 1998).
[42] 31 U.S.C. § 1341.
[43] Sections 1117(a)(3) and (b)(3).
[44] On December 31, 2009, the authority of the Secretary of the Treasury to purchase obligations and securities from the GSEs terminates. However, this "sunset" does not apply to the provision granting the appropriations for such purchases.
[45] See, e.g. Union Pacific Railroad v. U.S., 52 Fed. Cl. 730 (2002); Wetsel-Oviatt Lumber Co. v. U.S., 38 Fed. Cl. 563 (1977).

5. Can the Treasury Purchase Senior Preferred Equity After December 31, 2009?

The Housing and Economic Recovery Act authorized the Secretary of the Treasury to *purchase* obligations and securities issued by the GSEs, on such terms and conditions as the Secretary may determine.[46] This authority expires on December 31, 2009.

The Act also granted additional authority to the Secretary, *without any termination date,* to exercise any rights received in connection with the purchase of securities. Further, as noted previously, the appropriation of funds to purchase obligations and to exercise any rights in connection with such purchases is also explicitly excluded from the December 31, 2009 sunset.

In this case, the Treasury did not agree to make future purchases of senior preferred securities. Rather, the initial purchase of 1 million shares from each company is all that is contemplated by the Agreement. The liquidation value of the shares will increase as the Treasury provides funds to the GSEs in the future, including funding after December 31, 2009.

This funding method appears to meet the letter of the statute, and the Treasury Department has confirmed that it has the ability to provide funds after 2009. As stated in the Treasury's Question and Answer issuance:

> The holders of senior debt, subordinated debt, and mortgage-backed securities issued or guaranteed by these GSEs are protected by the agreement without regard to when those securities were issued or guaranteed. Debt and mortgage-backed securities issued or guaranteed both before and after December 31, 2009 are protected by the agreement.[47]

In addition, the exercise of warrants for common stock that were received by the Treasury as part of the funding agreements does not appear to be time limited. The warrants convey rights to the Treasury, and the statute specifically excludes from the time restriction "the exercise of rights" granted in connection with the purchase of securities.

Further, even if one questions the ability to provide funds after 2009, the Agreements between the Treasury and the GSEs are not time limited. Therefore, the Treasury's contractual obligation does not expire on December 31, 2009, and the right of debt holders to enforce the Agreements is not time limited.

[46] Section 1117(a)(1) and (b)(1).
[47] U.S. Department of the Treasury, "Frequently Asked Questions: Treasury Senior Preferred Stock Purchase Agreement," (September 11, 2008).

Conclusion

The Housing and Economic Recovery Act authorized the Secretary of the Treasury to purchase obligations and securities issued by Fannie Mae or Freddie Mac without limit as to amount. The Secretary may make these purchases conditioned upon such terms and requirements as he or she sees fit.

On September 7, 2008, pursuant to the receivership and conservatorship provisions in the Act , Fannie Mae and Freddie Mac were placed into conservatorship, with the Federal Housing Finance Agency acting as the Conservator for both companies. On the same day, the Secretary of the Treasury, acting on behalf of the U.S. Government, entered into legally binding contracts with the Conservator acting on behalf of the GSEs. The stated purpose of these Agreements is to protect debt holders through a commitment by the Treasury to invest up to $100 billion in each company. The September 7 Agreements specifically grant the right of these debt holders to enforce this commitment if necessary. The Agreements also provide that they may not be amended if the effect of the amendment is to adversely affect, in any material respect, the holders of Fannie Mae or Freddie Mac debt.

Under existing case law, the Agreements impose binding obligations upon the United States. This case law establishes that if the signatories or Congress modify the terms of the Agreements to the detriment of GSE debt holders, the debt holders would have a cause of action in the D.C. Circuit for specific performance in the form of a monetary payment.[48]

The statute terminates the Treasury's authority to purchase GSE obligations on December 31, 2009. However, the termination date does not apply to the exercise of rights following that date. The Treasury acquired senior preferred shares of these GSE companies on September 7, 2008 and is not planning to make further purchases. The value of these shares will increase as funds are provided to the companies. This method of funding appears to meet the letter of the statute. In any case, Treasury's agreements with the GSEs are not subject to the December 31, 2009 time limit and the right of debt holders to seek specific performance is not affected by the passing of that date.

The conclusion that GSE debt holders are protected by the Agreements is supported by recent actions by the credit rating agencies. For example, on September 8, 2008, the day after the Agreements were signed, Standard and Poor's and Fitch affirmed the AAA rating of Fannie Mae and Freddie Mac senior unsecured debt.

For the reasons explained above, we conclude that under the current case law, the September 7, 2008 Agreements should provide legally enforceable U.S. Government backing for Fannie Mae and Freddie Mac short-term debt holders.

[48] Of course, in order to have standing, the GSE debt holders must be able to establish that they relied upon the Agreement when they determined to retain existing debt or decided to purchase new obligations.

This conclusion is based on the assumption that the Agreements and all of the terms of the Agreements will not be determined to be illegal or unenforceable.[49] We are not aware of any issues that would lead a court to declare any of these documents illegal or unenforceable by the parties thereto.

Please let me know if you have any further questions or if we can be of assistance to you in any other manner.

Sincerely,

Raymond Natter

Raymond Natter

[49] Paragraph 6.12 of the Agreements provides that the Treasury may deem the Agreements null and void if any provision of the Agreement, the Senior Preferred Stock or the Warrant is deemed illegal or unenforceable.