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THE INDEFINITE CONSERVATORSHIP OF FANNIE MAE AND FREDDIE MAC IS STATE-ACTION

*Brian Taylor Goldman**

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I. INTRODUCTION

People could be forgiven for being preoccupied during November of 2016. As a result, it wouldn't be surprising that many missed an investor report buried in the doldrums of real estate finance: Freddie Mac's November 2016 Investor Update.¹ The report, while purporting to be a rather straightforward, if banal, update on the status of Freddie Mac's business, is in actuality much more exciting. The report states that there is "significant uncertainty" whether Freddie Mac will ever emerge from conservatorship. This comes a mere eight years after the U.S. Treasury Department announced that control of the two mortgage giants—Fannie Mae ("Fannie") and Freddie Mac ("Freddie")—would be under the "temporary" conservatorship of the Federal Housing Finance Agency ("FHFA").² The November 2016 Update also quietly explained that the FHFA still assumed all powers of governance and management and controlled business activity and strategy. Yet, our federal courts have still been slow to recognize the obvious wolf marauding in reports like these. Fannie and Freddie are state-actors.

Fannie and Freddie are truly dominant figures in the national housing market.³ Collectively, the two entities guarantee roughly 60% of mortgages in the United States.⁴

As a result, even in a relatively calm housing market, Fannie and Freddie have to collect a significant amount of mortgage debt. From 2008-2014, of course, the market was not calm. Millions of homeowners had their residences foreclosed upon.⁵ Like most lending agencies, Fannie and Freddie utilize agents, known as *servicers*, to collect debt.⁶

¹ Freddie Mac Update (Nov. 2016),

<http://www.freddiemac.com/investors/pdf/files/investor-presentation.pdf>.

² *Treasury, FHFA Outline Fannie, Freddie Rescue*, THE STREET (Sept. 8, 2008), <https://www.thestreet.com/story/10436159/1/treasury-fhfa-outline-fannie-freddie-rescue.html>.

³ John Ligon & David Muhlhausen, *The Role of GSEs in the Housing Market*, HERITAGE FOUNDATION (Jan. 11, 2013), <https://perma.cc/KF9R-QBU9> (stating that Fannie and Freddie "hold dominant positions in the U.S. housing market.").

⁴ Jason Lange, *Fannie Mae, Freddie Mac to Lose Market Share to Private Capital: CBO*, REUTERS (Dec. 16, 2014, 9:23 PM), <https://perma.cc/QYN6-NH2E>.

⁵ Corelogic, *National Foreclosure Report 1, 2* (Mar. 2014), <https://perma.cc/6QY2-BC2M>.

⁶ *See, e.g., Greater Transparencies and Efficiencies in Guide Bulletin 2015-22*, FREDDIE MAC (Dec. 16, 2015), <https://perma.cc/U7KG-GWC8>.

However, when a mortgagee becomes delinquent on their mortgage, servicers suddenly assume a more impactful role. They are clothed, largely, with the decision of whether or not to proceed with a foreclosure.⁷

It is in this context that the mechanics of a foreclosure proceeding and the applicable governing law becomes crucial. A majority of states statutorily permit non-judicial foreclosures,⁸ which allows for foreclosure sales without interference or approval from a court—in essence, there is no warning to the delinquent mortgagee.⁹ The problem with these non-judicial proceedings is that they have been found to violate Constitutional guarantees of due process for lack of prior notice.¹⁰ The result is that the millions of mortgagees holding loans guaranteed by Fannie or Freddie are at risk of suffering through a foreclosure proceeding that abrogates Constitutional procedural protections.

The *raison d'être* of this problem, though, is not just the non-judicial foreclosure proceedings themselves. The broader issue is the status of Fannie and Freddie. As long as the foreclosures initiated by Fannie and Freddie are not considered *state-action*,¹¹ the actions of the

⁷ Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 WASH. L. REV. 755, 765 (2011) (“Decisions about whether to foreclose or modify must be made. The homeowner must be contacted. If the house is vacant, it must be secured. The timing of the foreclosure must be managed, and ancillary service providers, from title companies to attorneys to real estate brokers for a post-foreclosure sale, must be hired. All those decisions are left largely to [sic] servicers’ discretion.”).

⁸ *Id.*

⁹ See Florence W. Roisman, *Protecting Homeowners from Non-Judicial Foreclosure of Mortgages Held by Fannie Mae and Freddie Mac*, 43 REAL EST. L.J. 125, 127 (2014) [hereinafter Roisman, *Protecting Homeowners*].

¹⁰ *Id.* at 128; see also Grant S. Nelson, *Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law*, 37 PEPP. L. REV. 583, 611 (2010) (setting out a list of state cases that found non-judicial proceedings violated due process requirements such as fair notice).

¹¹ I refrain from using a capital “S” in invoking the term *state-action*. It should be noted that the term *state-action* as used in this article refers to action undertaken by either, or both, the federal government and a state government. The capitalized version of *state* can connote a broader, more transcendental view of government. This article is not directly invoking that aspect of a *State*. See generally Franz Oppenheimer, *DER STAAT* (1908), <https://perma.cc/P4TD-XEGH> (last visited Nov. 7, 2016 3:24 PM).

servicers—and whether or not their foreclosure proceedings violate the Fourteenth Amendment—is not a cognizable claim.¹²

Thus, the threshold question is whether mortgages foreclosed on by servicers of Fannie Mae and Freddie Mac constitutes state-action. This article resolves that question in the affirmative.

Part I gives an overview of the state-action doctrine, particularly three specific tests that courts have used in articulating what constitutes state-action. Part II argues that the courts to have passed on the issue at hand, especially the United States District Court for the District of Columbia in *Herron v. Fannie Mae*,¹³ made a series of errors that materially affected the state-action analysis. Part III sets out how correcting these errors provides a much stronger basis for viewing the conservatorships of both Fannie and Freddie as state-action. The Conclusion describes the consequences that would flow from labeling the conservatorship of Fannie and Freddie state-action.

II. HOW FANNIE AND FREDDIE ESCAPED THE REACH OF THE STATE-ACTION DOCTRINE

This Part argues that the state-action doctrine developed in order to effectuate the Constitutional prerogative to bind government, not individuals. This Part then discusses a few tests, among several others, used by courts to determine whether an ostensibly private activity constitutes state-action. Finally, this Part will describe how Fannie and Freddie, both pre and post conservatorship, have been deemed by courts to not be engaged in state-action.

A. How the State-Action Doctrine Developed to Protect Private Activity

The classical rendition of the state-action doctrine usually begins with Justice Bradley's pronouncement in the *Civil Rights Cases* that "civil rights, such as are guaranteed by the Constitution against State aggression, cannot be impaired by the wrongful acts of individuals, unsupported by State authority"¹⁴

However, the state-action doctrine has deeper roots. The Bill of Rights is framed in terms of negative liberties, "freedom *from*, not

¹² See *Civil Rights Cases*, 109 U.S. 3, 17 (1883); see also discussion *infra* Part II.A.

¹³ 857 F. Supp. 2d 87, 95 (D.D.C. 2012).

¹⁴ *Civil Rights Cases*, 109 U.S. 3, 17 (1883).

freedom to . . . social and political evils, including arbitrary government power.”¹⁵ For example, the First Amendment states that “*Congress shall make no law . . .*”¹⁶ and the Second Amendment concludes with, “the right of the people to keep and bear arms *shall not be infringed.*”¹⁷ The Constitution seeks to constrain the government based on the principal concern that an unrestrained federal government would infringe upon natural liberties held by the ultimate sovereign, the body politic, itself composed of individual citizens.¹⁸ Individual citizens and natural liberties also lie at the heart of Constitutional structural protections—a view embodied by our Tenth Amendment jurisprudence.¹⁹ “State sovereignty is not just an end in itself: ‘Rather, federalism secures to citizens the liberties that derive from the diffusion of sovereign power.’”²⁰ The Bill of Rights and principles of federalism, secured by the structure of our government, require that “[the courts] restrain government action, not that of private persons.”²¹ It is this conception of natural liberties, and the subsequent necessary limits on federal power,²² that motivates the state-action doctrine. “Careful adherence to the state-action requirement preserves an area of individual freedom by limiting the reach of federal law and federal judicial power.”²³

¹⁵ *Obergefell v. Hodges*, 135 S. Ct. 2584, 2635 (2015) (Thomas, J., dissenting).

¹⁶ U.S. CONST. amend. I (emphasis added).

¹⁷ U.S. CONST. amend. II (emphasis added).

¹⁸ See THE FEDERALIST NO. 51 (James Madison) (“It is of great importance in a republic not only to guard the society against the oppression of its rulers, but to guard one part of the society against the injustice of the other part.”). Madison’s argument is that negative liberty fosters a stronger republican democracy. See REPORT ON THE VIRGINIA RESOLUTIONS, JAMES MADISON (1800) <https://perma.cc/8EP7-6YP9> (“The People, not the Government, possess the absolute sovereignty.”).

¹⁹ That is, the Bill of Rights is not the only mechanism by which natural liberties are secured against government interference. The structural design of the government, embodied by federalism and separation of power principles, also fastens these rights.

²⁰ *New York v. United States*, 505 U.S. 144, 181 (1992) (citing *Coleman v. Thompson*, 501 U.S. 722, 759 (1991) (Blackmun, J., dissenting)).

²¹ *Columbia Br. Sys., Inc. v. Democratic Nat’l Comm.*, 412 U.S. 94, 114 (1973).

²² For but one recent example. See *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2592 (2012) (stating that the Necessary and Proper clause cannot uphold an act when the expansion of federal power is not “proper.”).

²³ See *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 936 (1982).

The core question of the state-action doctrine is whether private conduct can be sufficiently attributable to the state.²⁴ In practice, the analysis is a fact-bound inquiry.²⁵ Certain parameters are outlined next.²⁶ How these tests are applied to Fannie and Freddie is discussed thereafter.

Coerciveness. The state can be held responsible for a private decision when it has exercised coercive power (or enough encouragement) that the course of action is effectively the state's action.²⁷ Coercion, however, is not acquiescence. The latter usually does not suffice to transform private action into state-action.²⁸ With respect to regulations, the Court has held that "regulations themselves do not dictate the decision[s]" in particular situations.²⁹

Joint Participation. Joint participation, alternatively labeled *symbiotic relationship*, exists, for example, when a private lessee leases space for a restaurant from a state parking authority in a publicly owned building, and then racially discriminates between customers who can and cannot use the lot.³⁰ In *Burton v. Wilmington Parking Authority*,³¹ the Court held that the state and the restaurant were effectively joint participants in the enterprise.

Joint participation also exists when a private actor receives a benefit from the state (without which it could not act) and in return the state receives a benefit from the private actor.³² *Burton* has arguably been narrowed by the proposition that the alleged state-action must be in an area where the state, absent the private conduct, would otherwise act.³³

²⁴ *Jackson v. Metro. Edison Co.*, 419 U.S. 351 (1974).

²⁵ *Lugar*, 457 U.S. at 936 (1982).

²⁶ These parameters are not clearly defined in the case law, but this article will utilize one helpful grouping articulated by Justice O'Connor. See *Brentwood Acad. v. Tennessee Secondary Sch. Athletic Ass'n*, 531 U.S. 288, 292 (2001) (discussing how state-action can arise when the federal government exercises "coercive power," is in a "joint activity" with the private entity or is otherwise "entwined" with the private entity).

²⁷ *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982).

²⁸ *Flagg Bros., Inc. v. Brooks*, 436 U.S. 149, 164-65 (1978); *Jackson*, 419 U.S. at 357.

²⁹ *Blum*, 457 U.S. at 1010.

³⁰ 365 U.S. 715, 726 (1961).

³¹ *Id.*

³² See *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163, 175 (1972) (describing a symbiotic relationship as one where the private party receives a benefit from the state in return for carrying out a public function).

³³ See *Jackson*, 419 U.S. at 352 (stating that a private action can be state action if it is in an area "traditionally exclusively reserved to the State").

Thus, if the private conduct exists in an area where the state would *not* otherwise act, state-action is not satisfied.³⁴

Entwinement. Courts have also sometimes looked to whether an ostensibly private entity and the state are sufficiently *entwined*. One articulation of the test asks whether the private actor is “entwined with governmental policies” or whether the government is “entwined in [its] management or control.”³⁵

This test has several dimensions. One form of entwinement, quite obviously, occurs when the state creates and controls an agency. For example, in *Pennsylvania v. Board of Directors of City Trusts of Philadelphia*,³⁶ the Court held the privately endowed Girard College to be a state actor, and that enforcement of its discriminatory admissions policy was “attributable to the state because . . . the college's board of directors was a state agency established by state law.”³⁷

The entwinement test becomes muddled when the federal government is entangled with a private enterprise in some respects but not all. In *Evans v. Newton*, “private trustees to whom a city had transferred a park were state-actors barred from enforcing racial segregation, since the park served the public purpose of providing community recreation, and the municipality remained entwined in its management and control.”³⁸

In *Lebron v. National Railroad Passenger Corporation*,³⁹ the Court held that Amtrak was a state-actor for constitutional purposes. Regardless of its congressional designation as private, it was organized under federal law to attain governmental objectives and was directed and controlled by federal appointees.

Lebron has two aspects, both of which will prove important to the analysis herein. First, the Court examined the purpose of Amtrak, concluding that the corporation was formed explicitly in furtherance of the federal government’s goals.⁴⁰ Second, the Court examined the degree to which the federal government controlled Amtrak. In finding that the government retained a heavy degree of control, including the ability to

³⁴ *Blum*, 457 U.S. at 1011.

³⁵ *Evans v. Newton*, 382 U.S. 296, 299, 301 (1966).

³⁶ 353 U.S. 230 (1957).

³⁷ *Brentwood Acad. v. Tennessee Secondary Sch. Athletic Ass'n*, 531 U.S. 288, 296-97 (2001) (citing *Pennsylvania*, 353 U.S. at 231 (1957)).

³⁸ *Brentwood Acad.*, 531 U.S. at 296-97 (citing *Evans*, 382 U.S. at 296).

³⁹ 513 U.S. 374 (1995).

⁴⁰ *Id.* at 397.

appoint a majority of the directors, the Court concluded that Amtrak was under the *permanent* control of the federal government.⁴¹

B. Pre-Conservatorship: Fannie & Freddie Not Engaged in State-Action

Fannie was created in 1968 when Congress partitioned the Federal National Mortgage Association into two entities, Fannie (a private corporation) and Ginnie Mae (a government entity).⁴² Fannie was empowered to purchase, sell, and service mortgages⁴³ and was privately controlled by a board of directors, the majority of whom were elected annually by the shareholders.⁴⁴

Congress created Freddie in 1970, and in 1989, under the Financial Institutions Reform, Recovery, and Enforcement Act (“FIRREA”), Congress privatized Freddie.⁴⁵

The primary activity of Fannie and Freddie is to promote quality, affordable housing by: “(a) purchasing qualifying residential loans from mortgage originators to increase home finance market liquidity, and (b) providing capital support to multifamily housing projects.”⁴⁶ Fannie and Freddie, also called government sponsored entities or “GSEs,” purchase mortgages from originators, creating a secondary market in mortgages (fueled by the creation of mortgage-backed securities).⁴⁷ The secondary market sale of mortgages, by shifting risk, allows capital to be freed for the purpose of originating more mortgages, where the process then repeats itself.⁴⁸ The GSEs were particularly vital cogs in the mortgage marketplace because they were viewed as implicitly supported by the

⁴¹ *Id.*

⁴² *Herron v. Fannie Mae*, 857 F. Supp. 2d 87, 89 (D.D.C. 2012).

⁴³ *See* 12 U.S.C. § 1717(a)(2)(1964).

⁴⁴ *See* 12 U.S.C. § 1718(a)(2006) (establishing common stock with the right to vote for directors and preferred stock on terms and conditions as prescribed by such directors); *see also Herron*, 857 F. Supp. at 89-90.

⁴⁵ Roisman, *Protecting Homeowners*, *supra* note 7, at 130-38.

⁴⁶ Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae & Freddie Mac*, 60 AM. U. L. REV. 1489, 1495 (2011).

⁴⁷ *See* Basics of Fannie Mae Single-Family MBS 1, 1 (Aug. 5, 2013), <https://perma.cc/N4CU-NGHM>; *see also* Freddie Mac, INVESTOPEDIA.COM, <https://perma.cc/2C5S-U2AB>.

⁴⁸ *See* Boyack *supra* note 45, at 1495.

“full faith and credit” of the United States.⁴⁹ As a result, the GSEs could borrow at lower rates and secure strong credit ratings.⁵⁰

The court system viewed both Fannie and Freddie as private actors engaged in private activity. In *Roberts v. Cameron-Brown*,⁵¹ the Fifth Circuit invoked the entwinement test to conclude that the state and Fannie were not so entangled as to trigger state-action. The court compared Fannie to a “privately-owned mortgage banker providing secondary mortgage loans,” and described the structure of Fannie as resembling the capital structure of a privately owned corporation.⁵² The Sixth Circuit reached the same conclusion.⁵³

Freddie was also deemed to not be a state-actor, but the analysis was more sanguine. First, the Ninth Circuit concluded that Freddie in fact satisfied the first prong of the *Lebron* test. That is, “Freddie Mac’s purposes are federal governmental objectives.”⁵⁴ Nevertheless, the court found that Freddie was not a state-actor because it was not “controlled” by the federal government, thus failing the second part of *Lebron*’s conjunctive test:

Freddie Mac’s board of directors consists of 18 persons, of whom 13 are elected annually by the voting common shareholders. Freddie Mac has apparently issued nearly 60 million common shares of stock, and its shares are publicly traded on the New York Stock Exchange. Amtrak, by contrast, had only four private shareholders at the time *Lebron* was decided. Freddie Mac’s five remaining directors are appointed annually by the President, independently of the Senate. Thus, the U.S. government is entitled to appoint less than one-third of Freddie Mac’s directors.⁵⁵

⁴⁹ SELDEN BIGGS & LEILA B. HELMS, *THE PRACTICE OF AMERICAN PUBLIC POLICY-MAKING* 209 (Routledge, 2006).

⁵⁰ Boyack, *supra* note 45, at 1495.

⁵¹ 556 F.2d 356 (5th Cir. 1977).

⁵² *Id.* at 359.

⁵³ See *Northrip v. Fed. Nat’l Mortg. Ass’n*, 527 F.2d 23, 31 (6th Cir. 1975).

⁵⁴ *Am. Bankers Mortg. Corp. v. Fed. Home Loan Mortg. Corp.*, 75 F.3d 1401, 1407 (9th Cir. 1996) (internal quotations omitted).

⁵⁵ *Id.* (citation omitted).

The court continued its comparison of Freddie with Amtrak, pointing out that the federal government unanimously handpicked Amtrak's board, whereas the board of Freddie was, to a degree, influenced by the shareholders of privately owned common stock.⁵⁶

C. Post-Conservatorship: Fannie & Freddie Still Not Engaged in State-Action

In 2008, Fannie and Freddie faced intense liquidity pressure due to the dwindling value of homes and the skyrocketing foreclosure rate.⁵⁷ In response, Congress passed the Housing and Economic Recovery Act,⁵⁸ effective July 30, 2008.⁵⁹ The Federal Housing Finance Authority ("FHFA"), created under HERA, was given "general regulatory authority"⁶⁰ over Fannie and Freddie at the discretion of the Director of the FHFA.⁶¹ This authority included the ability for the Director to appoint the FHFA as conservator or receiver.⁶²

The FHFA placed Fannie and Freddie into conservatorship on September 7, 2008.⁶³ The FHFA is authorized to appoint the board of both entities,⁶⁴ as well as to:

- (i) take over the assets of and operate the regulated entity with all the powers of the shareholders, the directors, and the officers of the regulated entity and conduct all business of the regulated entity; (ii) collect all obligations and money due the regulated entity; (iii) perform all functions of the regulated entity in the name of the regulated entity which are consistent with the appointment as conservator or receiver; (iv)

⁵⁶ *See id.*

⁵⁷ *See Federal Reserve Programs To Strengthen Credit Markets & the Economy: Testimony Before the H. Comm. on Fin. Servs.*, (Feb. 10, 2009) <https://perma.cc/Z5H9-NJLU>, (testimony of Ben S. Bernanke, chairman, Federal Reserve)

⁵⁸ The Housing & Economic Recovery Act of 2008, 12 U.S.C. § 4501 et. seq. (2008) [hereinafter HERA]; *see also supra* note 2 and accompanying discussion.

⁵⁹ Roisman, *Protecting Homeowners*, *supra* note 7, at 130-38.

⁶⁰ *See supra* note 2 and accompanying discussion.

⁶¹ *See supra* note 2 and accompanying discussion.

⁶² 12 U.S.C. § 4617 (2008).

⁶³ Roisman, *Protecting Homeowners*, *supra* note 7, at 135.

⁶⁴ *See* 12 U.S.C. § 4617(d) (2008).

preserve and conserve the assets and property of the regulated entity; and (v) provide by contract for assistance in fulfilling any function, activity, action, or duty of the Agency as conservator or receiver.⁶⁵

The FHFA used many of the powers afforded to it. The FHFA as conservator “reconstituted Fannie Mae’s Board of Directors,”⁶⁶ sold up to \$100 billion of its stock to the treasury, and sold up to \$1.25 trillion of mortgage-backed securities to the Federal Reserve.⁶⁷

This article argues that the conservatorship of Fannie and Freddie renders the activities of these entities state-action. Yet, a few federal courts have wrongly rejected this argument in favor of maintaining the pre-conservatorship (no state-action) status quo.⁶⁸

The most prominent case is *Herron v. Fannie Mae*, where a federal district court closely considered whether post-conservatorship Fannie resembled Amtrak enough for it to be considered a state-actor.⁶⁹ Ultimately, the court concluded no. Specifically, the court stated that Fannie would be a state-actor if the government retained “*permanent authority*” to appoint a majority of the corporation’s directors. To the contrary, the court ruled, the appointment of FHFA as conservator did not establish *permanent* government authority to control Fannie.⁷⁰

The court made three notable moves. First, it separated the concept of conservatorship from control.⁷¹ Second, the court found that although the FHFA was in control of Fannie, it was only on a temporary basis, insofar as “conservatorship is by nature temporary.”⁷² Thus, the requirement of permanency was not met. Finally, the court found that the

⁶⁵ 12 U.S.C. § 4617 (2008).

⁶⁶ *Herron v. Fannie Mae*, 857 F. Supp. 2d 87, 90 (D.D.C. 2012).

⁶⁷ Roisman, *Protecting Homeowners*, *supra* note 7, at 135.

⁶⁸ *See, e.g., Meridian Inv., Inc. v. Fed. Home Loan Mortg. Corp.*, 2016 WL 795454, at *2 (E.D. Va. Mar. 1, 2016) (rejecting argument that Freddie Mac is a state-actor); *Rubin v. Fannie Mae*, 587 F. App’x 273, 275 (6th Cir. 2014) (rejecting argument that Fannie Mae is a state-actor); *Mik v. Federal Home Loan Mortg. Corp.*, 743 F.3d 149, 168 (6th Cir. 2014) (rejecting argument that Freddie Mac is a state-actor); *Syriani v. Freddie Mac Multiclass Certificates*, Series 3365, 2012 WL 6200251, at *4 (C.D. Cal. July 10, 2012) (rejecting argument that Freddie Mac is a stat-actor).

⁶⁹ *Herron*, 857 F. Supp. 2d at 87.

⁷⁰ *Id.* at 95 (internal citation omitted).

⁷¹ *See id.* at 96.

⁷² *Id.*

agreements between Fannie and the FHFA either expressly or implicitly maintained Fannie's status as an entity distinct from the government. Underlying the court's analysis was the idea that a conservator or receiver *steps into the shoes* of the private entity—it assumes the private status of the entity.⁷³

The Sixth Circuit reached the same conclusion, albeit with significantly less discussion of the issue.⁷⁴ In failing to recognize that Fannie Mae was a state-actor, the court relied quite heavily on the idea that “[u]nder HERA Congress empowered the FHFA to become conservator for Fannie Mae for the limited purpose of reorganizing, rehabilitating, or winding up [its] affairs. This, the court found, is an inherently “temporary” purpose.”⁷⁵

One state appellate court in Michigan found that Fannie, in its post-conservatorship form, was a state-actor. The key for the court was its obligation to sift through perfunctory labels in order to determine Fannie's status *in fact*. Though the court wrote that the conservatorship was described as temporary, “the procedures and provisions in place made the conservatorship, in all practicality, permanent.”⁷⁶

In March 2015, the Supreme Court issued an opinion in *Department of Transportation v. Association of American Railroads*,⁷⁷ and included dicta that seemingly changed the framework for understanding *Lebron*. The Court stated that instead of relying on Congressional labels to determine an entity's status, courts should scrutinize the “practical reality” of an entity's status.⁷⁸ This clarification of *Lebron* comports closely with the Michigan Court of Appeals' analysis in *Kelley*—and requires a close look at whether, in their current conservatorship state, Fannie and Freddie are indeed engaged in state-action.

⁷³ See, e.g., *O'Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 86 (1994) (quoting *Coit Indep. Joint Venture v. Fed. Sav. & Loan Ins. Corp.*, 489 U.S. 561, 585 (1989)); *accord* *Am. Nat'l Ins. Co. v. F.D.I.C.*, 642 F.3d 1137, 1144 (D.C. Cir. 2011); *accord* *United States v. Beszborn*, 21 F.3d 62, 68 (5th Cir. 1994).

⁷⁴ See *Mik v. Fed. Home Loan Mortg. Corp.*, 743 F.3d 149, 168 (6th Cir. 2014) (finding that Freddie Mac is not a state actor but relying on pre-conservatorship holdings).

⁷⁵ See *Rubin v. Fannie Mae*, 587 F. App'x 273, 275 (6th Cir. 2014) (quoting 12 U.S.C. § 4617(a)(2)(2008)).

⁷⁶ *Fed. Home Loan Mortg. Corp. v. Kelley*, No. 12000885AV, 2013 WL 3812051, at *5 (Mich. Cir. Ct. Feb. 21, 2013).

⁷⁷ 135 S. Ct. 1225 (2015)

⁷⁸ *Dep't of Transp.*, 135 S. Ct. at 1233.

III. FANNIE AND FREDDIE ARE UNDER INDEFINITE CONSERVATORSHIP

This part argues in Section A that in relation to Fannie and Freddie, courts have been slipshod in distinguishing between receivership and conservatorship. The *Herron* court was particularly guilty of this. Section B argues that the conservatorship is *not* temporary; the reality is quite the opposite—the conservatorships of Fannie and Freddie are indefinite. This dispels the incorrect notion, furthered by the *Herron* decision, that the conservatorships are merely temporary. As a result of being shuttered in indefinite conservatorships under the guise of the FHFA, Fannie and Freddie are engaged in state-action.

A. The First Problem with *Herron*: Conservatorship, Not Receivership

Herron conflated the distinct notions of conservatorship and receivership, without digging deeper to determine which relationship actually existed between the FHFA, Fannie and Freddie. This is vital. Conservatorship and receivership differ in material ways, and the differences amount to separate and unique legal treatment. As detailed below, a company under the *receivership* of the federal government is much less likely to be engaged in state-action, whereas a company under the *conservatorship* of the federal government is more likely to tread in state-action.

This section proceeds by first examining the differences between receivership and conservatorship. This section then argues that Congress specifically recognized the differences between conservatorship and receivership, but the *Herron* court failed to distinguish between the two. This led the court to the incorrect conclusion that Fannie was not engaged in state-action. In fact, Fannie and Freddie are in conservatorship, and as a result are engaged in state-action.

i. Receivership: Designed for an Orderly Liquidation

Receivership is designed to preserve a company's assets, for the benefit of creditors, in the face of bankruptcy.⁷⁹ For example, the FDIC

⁷⁹ See *Receivership Management Program*, FEDERAL DEPOSIT INSURANCE CORP. (May 19, 2015), <https://perma.cc/DLR4-NXJT> (“[FDIC] assumes responsibility for efficiently recovering the maximum amount possible from the disposition of

often acts as a receiver— typically, the FDIC is appointed by a court as a receiver for an insured depository institution.⁸⁰ In such situations, the FDIC is charged with “the disposition of the receivership’s assets and . . . resolv[ing] all obligations, claims, and other legal impediments”⁸¹ In *O’Melveny*, the Court found that receivership places the FDIC “in the shoes” of the insolvent company.⁸²

This legal characterization of receivership comports with the fiduciary duties that receivership carries. A receiver has fiduciary obligations to its stakeholders and the court.⁸³ Fiduciary duties run to the court due to the fact that the court appoints the receiver.

Stakeholders for this purpose constitute defrauded investors, claimants and creditors.⁸⁴ Although fiduciary duties do not typically run to creditors, the Supreme Court of Delaware has recognized that during a period of “actual insolvency,” a corporation owes to creditors the same fiduciary duties that it typically owes to shareholders.⁸⁵

In this vein, the legal understanding of receivership is closely tied to the direction of fiduciary duties. In receivership, the receiver owes fiduciary duties to the creditors, which the corporation would otherwise owe to creditors during a period of insolvency. In this sense, as the Court accurately stated, the receiver “steps into the shoes” of the private entity, and assumes the typical menu of fiduciary obligations.⁸⁶

the receivership’s assets and the pursuit of the receivership’s claims.”)

⁸⁰ *See id.* (“[W]hen an insured depository institution fails, the FDIC is ordinarily appointed receiver.”).

⁸¹ *Id.*

⁸² *O’Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 87 (1994).

⁸³ SEC, INVESTOR BULLETIN: 10 THINGS TO KNOW ABOUT RECEIVERS, (Aug. 27, 2015), <https://perma.cc/ZRL5-3FL8> (“[a] receiver has a fiduciary duty to stakeholders and the court, and typically has the discretion to marshal, manage and liquidate the receivership company’s assets, while accounting for all receipts and payments.”).

⁸⁴ *See id.* (“A receiver’s powers generally include . . . distributing assets to defrauded investors, claimants or creditors through a court-approved plan.”).

⁸⁵ *See* *Quadrant Structured Products Co. v. Vertin*, 102 A.3d 155, 176 (Del. Ch. 2014) (citing *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, at 100 (Del. 2007)) (“The fiduciary duties that creditors gain derivative standing to enforce are not special duties to creditors, but rather the fiduciary duties that directors owe to the corporation to maximize its value for the benefit of all residual claimants.”); *See also* *N. Am. Catholic Educ. Programming Found., Inc.*, 930 A.2d at 103 (stating that during insolvency, “[c]reditors may . . . protect their interest by bringing derivative claims on behalf of the insolvent corporation.”).

⁸⁶ *O’Melveny & Myers*, 512 U.S. at 87.

ii. *Conservatorship: Designed for Returning a Company to Business*

Conservatorship functions in a different manner. Critically, it is not limited to bankruptcy, unlike receivership. Rather, as stated by the FHFA, conservatorship is:

[T]he legal process [for entities that are not eligible for Bankruptcy court reorganization] in which a person or entity is appointed to establish control and oversight of a company to put it in a sound and solvent condition. In a conservatorship, the powers of the Company’s directors, officers, and shareholders are transferred to the designated Conservator.⁸⁷

In this sense, the starting point for conservatorship and receivership differ. Receivership is a court-oriented mechanism to provide for protection of a company’s assets during or prior to liquidation; conservatorship is a broader notion that has at its center a company’s “sound and solvent condition.”⁸⁸ Conservatorship is instituted in order to return a company back to financial health; receivership’s mandate is exactly the opposite—to provide for an orderly and deliberate liquidation.⁸⁹

The endpoint of conservatorship also differs from the endpoint of receivership. In receivership, once the FDIC has completed the disposition of the receivership’s assets and has resolved all obligations, claims, and other legal impediments, the receivership is terminated.⁹⁰

In contrast, conservatorship has no inherent duration.⁹¹ The organic statute or order creating the conservatorship defines its goals, operations, and conditions for existence, “differing from the FDIC

⁸⁷ *Questions & Answers on Conservatorship*, FEDERAL HOUSING FINANCE AGENCY FEDERAL HOUSING FINANCE AGENCY, <https://perma.cc/7GB9-2YVL>.

⁸⁸ See William Isaac & Sen. Bob Kerry, *How the Fannie and Freddie Conservatorship Has Undermined the Resolution Process*, INVESTORS UNITE 1, 3 (2015), <https://perma.cc/7L2G-YZFB>.

⁸⁹ *Id.* at 3-4.

⁹⁰ See *Receivership Management Program*, FEDERAL DEPOSIT INSURANCE CORP. (May 19, 2015), <https://perma.cc/8L8E-VHHB>.

⁹¹ *Frequently Asked Questions*, FED. HOUS. FIN. AGENCY, <https://perma.cc/UMN8-QW4N>.

receivership context, which does not anticipate a return to business.”⁹² Thus, conservatorship is an open-ended relationship, not tethered to strictly financial goals. Receivership more narrowly addresses liquidation protection, and the receivership dissolves when this goal is accomplished.

While a receiver “steps into the shoes” of a company and assumes its fiduciary obligations to the company’s shareholders, a conservator has a more complicated relationship to the underlying company’s fiduciary duties. In the case of Fannie and Freddie, the federal government had effective control of 79.9% of the common stock in both entities.⁹³ This overwhelming stake in both Fannie and Freddie rendered the government essentially⁹⁴ a “dominant shareholder.”⁹⁵ Dominant shareholders are widely recognized to have fiduciary duties running to the *corporation*, unlike to creditors, as is the case for the receiver.⁹⁶

In this sense, the fiduciary obligations of receivers and conservators diverge sharply. Receivers have fiduciary obligations as if they are the corporation themselves.⁹⁷ Conservators owe fiduciary duties to the corporation, which is critically distinct from stepping into the “shoes” of the company itself.⁹⁸ This difference recognizes that Fannie

⁹² *Id.*

⁹³ Steven D. Solomon & David Zaring, *After the Deal: Fannie, Freddie, and the Financial Crisis Aftermath*, 95 B.U. L. REV. 371, 382 (2015).

⁹⁴ While the government has not yet exercised its warrant to purchase 79.9% of the common stock, this option still gives the government effective control over the GSEs, especially with its control of the board of director. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 307 (Del. 2015) (stating that a stockholder is deemed to have effective control if it has control of management and potent voting power).

⁹⁵ Although there is dispute over whether smaller ownership percentages constitute a controlling shareholder, *see In re Zhongpin Inc. Stockholders Litigation*, No. CV 7393-VCN, 2014 WL 6735457, at *7 (Del. Ch. Nov. 26, 2014), 79.9% renders the federal government an in-fact controlling shareholder.

⁹⁶ *See, e.g., Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1115 (Del. 1994) (“[a] controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidary context, bears the burden of proving its entire fairness.”) (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983)).

⁹⁷ *See* 12 U.S.C.A. § 4617 (West 2008).

⁹⁸ The doctrine of conservatorship was left unaddressed in *O'Melveny*. The Court narrowly focused on the FDIC's position as a receiver. *See O'Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 86 (1994) (noting that FDIC as the receiver stepped into the shoes of the failed savings and loan).

and Freddie are engaged in state-action because they are effectively agents of the FHFA. By contrast, receivership does not support an agency argument because there is only one entity; in conservatorship there are two.

iii. HERA's Deliberate Wording

The distinction between receivership and conservatorship was recognized when Congress passed HERA, which granted the FHFA the requisite statutory authority to manage the affairs of Fannie and Freddie.⁹⁹

12 U.S.C. § 4617, which governs the FHFA's authority over Fannie and Freddie, explicitly provides that, "the Director [of the FHFA] may appoint the Agency as conservator *or* receiver for a regulated entity."¹⁰⁰ The statute also provides for a situation where receivership, *not* conservatorship, would be mandatory—if the Director found Fannie or Freddie, or both, to be insolvent or unable to meet obligations as they come due.¹⁰¹

It is widely recognized that the word "or" creates alternatives.¹⁰² Thus, a plain reading of the statute evidences that Congress intended conservatorship as an alternative (not as a substitute) for receivership.¹⁰³

There is further support for this proposition. When Congress drafted HERA, it used the language of the Federal Deposit Insurance Act ("FDIA") as a model.¹⁰⁴ 12 U.S.C. § 1821(d) (FDIA) and 12 U.S.C. § 4617(b) (HERA) utilize vastly similar language, subsections, and headings.¹⁰⁵ The FDIA explicitly provides mechanisms for the FDIC to act as a receiver or conservator; once again, the two terms were designed

⁹⁹ See 12 U.S.C.A. § 4617 (West 2008).

¹⁰⁰ See 12 U.S.C.A. § 4617(a)(1)(West 2008); 12 U.S.C. § 4617(a)(1)(2012) (emphasis added).

¹⁰¹ See § 4617(a)(4); see also Michael Krimminger & Mark Calabria, *The Conservatorships of Fannie Mae & Freddie Mac: Actions Violate HERA & Established Insolvency Principles*, CATO INST. 2, 22 (2015), <https://perma.cc/LSU2-B27M>.

¹⁰² ANTONIN SCALIA & BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 116 (2012).

¹⁰³ See *id.*

¹⁰⁴ See Krimminger & Calabria, *supra* note 99, at 19. The FDIA grants the FDIC authority to act as a receiver or a conservator for failed depository institutions. See 12 U.S.C. § 1821(c)(2013). Thus, the FDIA made sense conceptually as language that Congress would want to replicate in HERA.

¹⁰⁵ See Krimminger & Calabria, *supra* note 99, at 19.

and understood as alternatives, not substitutes.¹⁰⁶ These similarities bear on the meaning and understanding of HERA’s text—statutes in *pari materia* are to be interpreted together.¹⁰⁷

It seems clear that HERA intended to maintain two distinct options for the FHFA: to take the GSEs under conservatorship or receivership if needed. This was the “bazooka” that Secretary Paulson was referring to,¹⁰⁸ and it was predicated off of the same authority that the FDIC had over failed banks. This also shows, of course, that conservatorship and receivership were not meant to be interchangeable provisions in HERA.

iv. Herron’s *Shortcomings*

Despite the manifest differences between conservatorship and receivership in HERA, the *Herron* court overlooks these distinctions and conflates the two terms to give the impression that the state-action question comes out the same regardless of whether the FHFA is a receiver or a conservator of Fannie and Freddie. Yet, the result differs materially.

In attempting to analogize the FHFA’s authority over Fannie to the FDIC’s authority as a receiver over failed banks, the court wrote that, “[t]hus, like [the] FDIC when it serves as a conservator *or* receiver of a private entity, [the] FHFA when it serves as conservator step[s] into the shoes of the private corporation, Fannie Mae.”¹⁰⁹

The court is playing fast and loose with “receivership” and “conservatorship.” Recall that the case announcing the “steps into the shoes” metaphor, *O’Melveny & Myers*, dealt with a situation where the FDIC acted as a receiver of a failed savings and loan institution.¹¹⁰ In *O’Melveny*, the Court interpreted §1821(d)(2)(A)(i)—which gives the FDIC authority to act as a receiver of failed institutions—to stand for the proposition that when the FDIC does flex its receivership muscles, it steps “into the shoes” of the private company.¹¹¹

¹⁰⁶ See 12 U.S.C. § 1821(c)(2012).

¹⁰⁷ Scalia & Garner, *supra* note 100, at 252 (2012).

¹⁰⁸ See Chris Isidore, *Paulson in Hot Seat over Fannie, Freddie*, CNNMONEY (July 15, 2008) <https://perma.cc/5HYZ-9QVV> (“If you have a bazooka in your pocket and people know it, you probably won’t have to take it out.”).

¹⁰⁹ *Herron v. Fannie Mae*, 857 F. Supp. 2d 87, 94 (D.D.C. 2012) (emphasis added).

¹¹⁰ *O’Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 86 (1994)

¹¹¹ See *id.* (“[S]ection 1821(d)(2)(A)(i), . . . appears to indicate that the FDIC as

Herron's analogy, of course, falls one step short, as it deals with a situation where the FHFA acts as a *conservator*, not as a receiver, of Fannie. This was deliberate ordering; conservatorship was not intended as a substitute of receivership.¹¹² Thus, the court's commingling of the two terms leads the analogy astray and renders the reliance on *O'Melveny* woefully inadequate. As if recognizing this difficulty without wanting to admit it, the court inserts "or receivership" in numerous places after the word "conservatorship" when describing the FHFA's relationship with Fannie, such as

The conservator *or* receiver takes over the day-to-day operations . . . [t]he purpose of the conservator *or* receiver is to restore the entity to fiscal feasibility or to liquidate . . . [t]he conservator *or* receiver steps into the private status of the entity . . . when the Federal Deposit Insurance Corporation ("FDIC") takes over as conservator *or* receiver for a failed bank, it obtains the rights and powers of the bank's shareholders, officers, and directors.¹¹³

However, the FHFA's role with Fannie was decidedly clear—the FHFA was using its power as a *conservator* to return Fannie to a safe and solvent condition.¹¹⁴ It was not a receiver.

Subsequent cases in the United States District Court for the District of Columbia (on issues unrelated to the state-action doctrine) have rightfully recognized the distinction between conservatorship and receivership as applied to Fannie and Freddie, and the fact that both entities are under the conservatorship, not receivership, of the FHFA.¹¹⁵

receiver 'steps into the shoes' of the failed S & L.'").

¹¹² See discussion *supra* Part II.B.

¹¹³ See *Herron*, 857 F. Supp. 2d at 93-94 (emphasis added). There are several further examples. Although the argument is often made, by analogy, that the FDIC assumes the same powers whether appointed as a receiver or conservator, this generalized statement is misleading. The powers of the FDIC as a conservator differ from powers granted to it when acting as a receiver. See Insurance Funds 12 U.S.C.A. § 1821(d)(2)(D)(i)(West 2013).

¹¹⁴ See Press Release, Henry M. Paulson, Jr., Treasury Sec'y, U.S. Dep't of the Treasury, Statement on Treasury and FHFA Action to Protect Fin. Mkts. & Taxpayers (Sept. 7, 2008), <https://perma.cc/L89X-8CC9>

¹¹⁵ See *Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 227 (D.D.C. 2014) (the "FHFA has acted within its broad statutory authority as a conservator.").

It is clear that Fannie and Freddie are in conservatorship, a fact that the *Herron* court failed to make clear. Nevertheless, a further question arises: are the conservatorships merely temporary, as *Herron* alleges?

B. The Second Problem: The Conservatorships are Indefinite, Not Temporary

This Section sets out the second problem in *Herron*—the court’s mistaken labeling of the relationship between Fannie, Freddie and the FHFA as “temporary.” This part argues that the conservatorship is indefinite, and as a result Fannie and Freddie are engaged in state-action.

Lebron stated that a corporation, in order to be a state-actor, must (i) be created in order to further governmental objectives, and (ii) under the permanent control and authority of the government.¹¹⁶ It is the second prong of this conjunctive test that *Herron* rightfully focuses on¹¹⁷ but it errs in its conclusory characterization of the relationship as a mere “temporary” one.

The misstep occurs when the *Herron* opinion equates conservatorship with temporariness. Specifically, the court asserts that although the duration of the conservatorship is indefinite, the FHFA’s control over Fannie Mae is temporary.¹¹⁸

It is not exactly clear how a relationship that is indefinite, as *Herron* admits, can also be temporary, especially in light of the levers of control that the FHFA exerts over the GSEs.¹¹⁹ In fact, from birth and onwards, the understanding between Fannie, Freddie, and the FHFA was that the conservatorship was *not* temporary. In the first Form 8-K¹²⁰ filed after the conservatorship had commenced, the 8-K specified that “[t]he delegation of authority [would] remain in effect until modified or

¹¹⁶ See *Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374, 400 (1995).

¹¹⁷ *Herron* implicitly assumed that the first part of the test, whether the corporation was formed in order to further governmental objectives, was clearly satisfied. *Cf. Herron v. Fannie Mae*, 857 F. Supp. 2d 87 (D.D.C. 2012) (focusing the legal analysis only on the second part of the test).

¹¹⁸ *Id.* at 95.

¹¹⁹ See discussion *supra* Part II.C.

¹²⁰ A Form 8-K is required, pursuant to the Securities and Exchange Act of 1934, when a business transaction that would be of note to investors takes place. See Sample, Form 8-K, SEC, <https://perma.cc/B8L4-B7RQ>.

rescinded by FHFA, as conservator.¹²¹ Additionally, the document asserted, “[the] conservatorship *has no specified termination date.*”¹²²

At the very least, there has been an understanding, admitted by the FHFA itself, that the conservatorship is no longer temporary, even if it originally endeavored to be so.¹²³ The Inspector General for the FHFA stated that it has become “obvious” that the conservatorships are not temporary measures.¹²⁴ Buttressing this point, the FHFA states on its own website that, in evident opposition to the very essence of conservatorship, “[t]here is no inherent duration in a conservatorship.”¹²⁵

Thus, there is a serious problem with *Herron’s* blanket statement that it is *clear* that the relationship is temporary. But there is also an issue with the subtext of *Herron’s* argument: namely, that conservatorship *implies* temporariness. The facts on the ground quite clearly point to an opposite conclusion; in this case, the conservatorship of Fannie and Freddie implies permanence. Despite the fact that Fannie and Freddie have paid back their original loans, the federal government altered the terms of the Preferred Stock Purchase Agreement in 2012.¹²⁶ The effect of the amendment was to sweep 100% of the GSEs’ profits into the Treasury’s general account.¹²⁷ This action has been dubbed “perpetual conservatorship.”¹²⁸

This point becomes stark when considering that the conservatorship of Fannie and Freddie was an extraordinary event,

¹²¹ See *Fannie Mae, Form 8-K filed with the SEC* at 2 (Dec. 24, 2008), <https://perma.cc/89H9-AK3W> (showing that conservatorship of Fannie Mae has no specified termination date).

¹²² *Id.* (emphasis added).

¹²³ Fed. Hous. Fin. Agency, Office of the Inspector Gen., *Enterprise Reform*, 2, 5 <https://perma.cc/3EDX-CYXX> (stating that it has become “more obvious that the conservatorships would not be temporary”)

¹²⁴ *Id.*

¹²⁵ *Frequently Asked Questions*, FED. HOUS. FIN. AGENCY, *supra* note 89.

¹²⁶ See FHFA Office of the Inspector Gen., *Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements*, 1 (2013), <https://perma.cc/WZC2-4HLJ> (“On August 17, 2012, Treasury and the . . . [FHFA], acting as the Enterprises’ conservator, amended the PSPAs 2012 Amendments.”)

¹²⁷ Fed. Hous. Fin. Agency, Statement of FHFA Acting Dir. Edward J. DeMarco, Changes to Fannie Mae and Freddie Mac Preferred Stock Purchase Agreements (Aug. 17, 2012), <https://perma.cc/CZ6Q-FQZJ>.

¹²⁸ Michael H. Krimminger, *FHFA’s Permanent Conservatorship Ignores the Law*, AMERICAN BANKER (Dec. 17, 2014), <https://perma.cc/2PXG-2AKQ>.

granting the FHFA atypical levels of control.¹²⁹ As the United States District Court for the District of Columbia recognized in a related, later case, the authority that HERA granted to the FHFA over Fannie and Freddie took place during an unprecedented economic downturn and the powers granted to the FHFA were unusually broad and encompassing.¹³⁰ Thus, the *Herron* court's analogy of Fannie and Freddie to any other conservatorship or receivership undertaken by the FDIC ignores the special facts in this circumstance.

There is clear evidence that even in 2008, the conservatorship was *not* temporary. *Arguendo*, even if the conservatorship was intended to be temporary in 2008, it is clear that conditions have developed that render the conservatorships indefinite, not "temporary." This is by the FHFA's own admission. As explored below, as a result of being subject to an indefinite conservatorship under the umbrella of the FHFA, the GSEs should be deemed state-actors.

IV. WHY AN "INDEFINITE CONSERVATORSHIP" COMPELS THE CONCLUSION THAT FANNIE AND FREDDIE ARE ENGAGED IN STATE-ACTION

This Part argues that there are two reasons why an "indefinite conservatorship," as opposed to a temporary conservatorship, or indefinite receivership, compels the conclusion that Fannie and Freddie are engaged in state-action. First, as proposed in Section A, a conservatorship can be analogized with a principal-agent relationship; a principal-agent relationship is a proxy for state-action that the Court has articulated on several occasions.¹³¹ Second, Section B sets out the reasons why "indefiniteness" also points toward finding that Fannie and Freddie are engaged in state-action. Taken together, then, an "indefinite

¹²⁹ The FHFA replaced the GSEs' boards, purchased nearly 80% of the stock and guaranteed the liquidity of mortgages that had been rubber-stamped by the GSEs. See FHFA Dir., Statement of FHFA Dir. James B. Lockhart at News Conference Announcing Conservatorship of Fannie Mae and Freddie Mac, (Sept. 7, 2008), <https://perma.cc/D96Q-3AE9>

¹³⁰ See *Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 225 (D.D.C. 2014). The *Perry* case is also important because it consistently distinguishes between conservatorship and receivership, noting quite explicitly that the FHFA is a conservator, not a receiver, of the GSEs. See *id.* at 227. The *Perry* court then goes on to note the subtle but important distinctions between receivership duties and conservatorship duties. See *id.* at 227-28.

¹³¹ See *e.g.*, *Hollingsworth v. Perry*, 133 S. Ct. 2652, 2667 (2013); see also *Illinois v. Perkins*, 496 U.S. 292, 294 (1990).

conservatorship,” fusing both of these arguments, mandates the conclusion that Fannie and Freddie are undertaking state-action.

A. Conservatorship Embodies Agency Concepts,
Which is a Proxy for State-Action

The state-action answer shifts depending on whether the FHFA is described as a conservator or a receiver of Fannie and Freddie. Conservatorship imports a principal-agent relationship. A finding of a principal-agent relationship necessarily renders a finding of state-action on behalf of Fannie and Freddie.

It helps to visualize the distinction. A receiver “steps into the shoes” of a target company. That is, the receiver merges with the company. The two entities are viewed as one. The receiver owes fiduciary duties to the shareholders directly.¹³²

A conservator, by contrast, is more accurately characterized as being in a separate, bilateral relationship with the target company. The conservator owes duties to the company, and the company owes duties to the shareholders, respectively. This is one reason why the Third Amendment to the Preferred Stock Purchase Agreement has been so contentious.¹³³ By requiring Fannie and Freddie to pay a quarterly dividend to the Treasury equal to the entire net worth of each entity, there is an implicit recognition that the government and the GSEs are *not one of the same*—they exist separately from one another.¹³⁴ The existence of two distinct entities¹³⁵ brings up questions of agency law.

In terms of agency law, it is helpful to think of the government, acting through the FHFA, as the principal, and Fannie or Freddie as the agent. Fannie and Freddie act on behalf of the conservator, subject to the conservator’s right of control.¹³⁶ Fannie and Freddie’s actions are done at

¹³² See Roisman, *Protecting Homeowners*, *supra* note 7, at 176-77.

¹³³ Several institutional investors filed suit immediately after the amendments were implemented. See Robert Terra & Tony Fratto, *Fannie, Freddie Investors File Suit Challenging U.S. Treasury's 2012 "Sweep Amendment"* GIBSON DUNN & CRUTCHER 1, 1 (2013), <https://perma.cc/ZNF3-CGNG>.

¹³⁴ Perry Capital LLC, 70 F. Supp. 3d at 217-18.

¹³⁵ A statement made by Clayton S. Rose, a director of Freddie, highlighted the distinctness of the entities when he noted that Freddie Mac owed primary duties to the FHFA, not to Freddie’s shareholders. Michael J. De La Merced, *Freddie Official Says He Has No Duty to Shareholders*, THE N.Y. TIMES: DEALBOOK (Feb. 9, 2011), <https://perma.cc/QK7K-257L>.

¹³⁶ Right of control is a central component of agency law. See RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. f (1)(2006) (“An essential element of agency is

the behest of the FHFA, and there is little doubt that the FHFA directly controls the manner and means by which Fannie and Freddie accomplish their directives.¹³⁷ The FHFA dictates the management of both Fannie and Freddie, stating by its own admission that “[u]nder conservatorship, FHFA is responsible for the overall management of both institutions.”¹³⁸ It is widely recognized that an agent owes the principal a menu of fiduciary duties, such as loyalty, accounting for profits arising out of agency¹³⁹ and a duty of care, among others.¹⁴⁰ Freddie Mac effectively admitted that they owed fiduciary duties running upwards to the FHFA, stating on an investor call in 2011 that “[a]s a legal matter, our responsibilities and our duties run to the conservator here.”¹⁴¹

There is another way that the conservatorship plays a role in bringing Fannie and Freddie under the government’s control. The government’s warrant to purchase 79.9% of Fannie’s or Freddie’s stock brings with it dominant-shareholder type fiduciary obligations.¹⁴² Fiduciary¹⁴³ obligations impart a responsibility on the part of the fiduciary

the principal's right to control the agent's actions.”).

¹³⁷ Such control can be demonstrated by indirect indicia and circumstantial evidence. *See* A. Gay Jenson Farms Co. v. Cargill, Inc., 309 N.W.2d 285, 290 (Minn. 1981) (citing *Rausch v. Aronson*, 1 N.W.2d 371 (1941)). In Fannie and Freddie’s case, control of the board and its position as controlling shareholder certainly satisfies any notions of “control and influence.” *Id.*; *see also* FED. HOUS. FIN. AGENCY, STRATEGIC PLAN 2009-2014 1, 21, <https://perma.cc/8EDT-2RHF>

¹³⁸ *See id.*

¹³⁹ *See, e.g.*, FED. HOUS. FIN. AGENCY, THIRD AMENDMENT TO AMENDED AND RESTATED SENIOR PREFERRED STOCK PURCHASE AGREEMENT (2012) (entitling the government to 100% of Fannie’s and Freddie’s profits); *see also* Restatement (Second) of Agency § 388 (1958) (“[A]n agent who makes a profit in connection with transactions conducted by him on behalf of the principal is under a duty to give such profit to the principal.”).

¹⁴⁰ *See* RESTATEMENT (SECOND) OF AGENCY § 379 (AM. LAW INST. 1958) (“[A] paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard.”); *see also* RESTATEMENT (SECOND) OF AGENCY § 387 (AM. LAW INST. 1958) (“[A]n agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency.”).

¹⁴¹ Michael J. De La Merced, *Freddie Official Says He Has No Duty to Shareholders*, THE N.Y. TIMES: DEALBOOK (Feb. 9, 2011), <https://perma.cc/QK7K-257L>.

¹⁴² *See* discussion *supra* Part III.B.2; *see also* Frequently Asked Questions, *supra* note 89.

¹⁴³ *Fiduciary*, BLACK’S LAW DICTIONARY (10th ed. 2014). (“Someone who is

to act in the best interests of the corporation or principal (despite the government's insistence to the contrary¹⁴⁴). This stock option was part and parcel of the conservatorship.¹⁴⁵ This *alone* is enough to render a finding of state-action. In *Brentwood Academy*,¹⁴⁶ eighty-four percent membership plus control of the board of directors sufficed for state-action purposes.¹⁴⁷

Thus, whether by traditional principal-agent accounts, or via dominant shareholder type obligations, the conservatorship relationship has helped weave fiduciary duties between the federal government and the GSEs. As detailed next, the existence of fiduciary duties is used as a proxy for state-action in other areas.

In 2013, the Supreme Court addressed a thorny issue of standing in *Hollingsworth*.¹⁴⁸ The Court held that in order to satisfy standing, a person suing in the shoes of the government had to have a common-law agency duty in relationship to the government.¹⁴⁹ That is, the plaintiff had to be an agent of the government in order to satisfy the standing requirement. This type of requirement is, in many ways, a state-action requirement.¹⁵⁰ More importantly, the Court endorsed the use of

required to act for the benefit of another person on all matters within the scope of their relationship.”).

¹⁴⁴ Note the following exchange between Clayton S. Rose, a director of Freddie Mac, and William A. Ackman, the head of Pershing Square Capital Management, during a 2011 earnings call:

Mr. Ackman: So you can make decisions that are adverse to shareholders?

Mr. Rose: Correct.

Mr. Ackman: And there's no liability to you?

Mr. Rose: Correct.

See Michael J. De La Merced, *supra* note 132. This blatant shunting of obvious corporate duties goes to deliberateness, and to the extent of it.

¹⁴⁵ See *Frequently Asked Questions: Treasury Senior Preferred Stock Purchase Agreement*, U.S. DEP'T OF THE TREASURY (Sept. 11, 2008)

<https://perma.cc/5DJU-RML5> (“Treasury deliberately chose a large number to give confidence to the markets.”). The purchase of the shares, designed to calm the markets, was the first step in the FHFA's plan to return Fannie and Freddie to sound and solvent conditions, which is the objective underlying the conservatorship. See *Herron v. Fannie Mae*, 857 F.Supp. 2d 87, 95 (D.D.C. 2012).

¹⁴⁶ *Brentwood Acad.*, 531 U.S. at 288.

¹⁴⁷ John Dorsett Niles et. al., *Making Sense of State Action*, 51 SANTA CLARA L. REV. 885, 904 (2011).

¹⁴⁸ See generally *Hollingsworth v. Perry*, 133 S. Ct. 2652 (2013)

¹⁴⁹ See *id.* at 2666.

¹⁵⁰ Seth Davis, *Standing Doctrine's State Action Problem*, 91 NOTRE DAME L.

fiduciary duties as a way to suss out a principal-agent relationship, stating “[p]etitioners are not subject to the control of any principal, and they owe no fiduciary obligation to anyone.”¹⁵¹

This is precisely the argument that is being advanced here. Fannie and Freddie are subject to the control of the FHFA, and owe fiduciary duties to them. Under *Hollingsworth*, state-action is clear and unambiguous.

Standing doctrine is not alone in using principal-agent determinations as a proxy for state-action. Agency law is typically used as a proxy for state-action when issues arise under *Miranda v. Arizona*¹⁵² and its progeny. The state-action question that boils up in this context is usually whether an ostensibly private party is a “state-actor” for the purposes of administering a *Miranda* warning. That is, if a private party acts as an *agent* for the state, then such warnings must be given to an accused prior to any custodial interrogation.¹⁵³

The factors used in ascertaining whether a private party was acting as an agent of law enforcement includes (1) whether the government knew of and acquiesced in the intrusive conduct; and (2) whether the party performing the search intended to assist law enforcement efforts or further his own ends.¹⁵⁴ This test, of course, bears a strong resemblance to several aspects of the classical definition of what constitutes agency—a manifestation of assent from the principal to the agent “that the agent shall act on the principal’s behalf.”¹⁵⁵ Literature on this topic supports this point—agency law is often invoked as a primary consideration in determining whether private conduct should be characterized as state-action.¹⁵⁶

REV. 585, 588-89 (2016) (citing *Hollingsworth*, 133 S. Ct. at 2666) (“Citing the Restatement (Third) of Agency, the Court [in *Hollingsworth*] reasoned that Proposition 8’s proponents lacked standing because ‘[u]nlike California’s attorney general,’ they ‘answer[ed] to no one’ and thus were ‘plainly not agents of the State.’ Something more than the meaning of Article III’s ‘Judicial Power’ is at stake when the Court finds it necessary to incorporate the Restatement (Third) of Agency into standing law.”)

¹⁵¹ *Hollingsworth*, 133 S. Ct. at 2657.

¹⁵² 384 U.S. 436 (1966).

¹⁵³ See *Illinois v. Perkins*, 496 U.S. 292, 294 (1990).

¹⁵⁴ *United States v. Reed*, 15 F.3d 928, 931 (9th Cir. 1994).

¹⁵⁵ SEE RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2006).

¹⁵⁶ See, e.g., Kristi North, Comment, *Recess is Over: Granting Miranda Rights to Students Interrogated Inside School Walls*, 62 EMORY L.J. 441, 446-49 (2012) (discussing the state-action doctrine); Eleftheria Keans, *Student Interrogations by School Officials: Out with Agency Law and in with Constitutional Warnings*,

However, even *Hollingsworth* admits that a common law agency relationship is a necessary, but not sufficient prerequisite to the finding of state-action.¹⁵⁷ The Court discussed the crucial aspect of *control*, stating that the ability to elect or remove an officer is an important factor in finding state-action for the purposes of standing.¹⁵⁸ Thus, the next section argues that the concept of “indefiniteness” plays an important role in establishing this control—ultimately proving that Fannie and Freddie are engaged in state-action.

B. Indefiniteness Establishes Control and Ultimately State-Action

The notion that the conservatorships of Fannie and Freddie are indefinite,¹⁵⁹ as opposed to temporary,¹⁶⁰ proves that they are engaged in state-action. “Indefiniteness” fulfills the second prong of *Lebron*,¹⁶¹ the requirement that the government have “permanent control” over the GSEs. This subsection argues that “permanence” and “indefiniteness,” despite carrying different connotations, should be understood to set the *same* standard for the state-action inquiry. They are linked together by a common thread—whether the activity is conducted pursuant to active governmental policy-making.¹⁶² Fannie and Freddie are engaged in state-

27 B.C. THIRD WORLD L.J. 375, 383 (2007) (using agency law as a proxy for state-action).

¹⁵⁷ A litigant is generally required to show that they have a “direct stake in the outcome.” *Arizonans for Official English v. Arizona*, 520 U.S. 43, 64 (1997). The Court in *Hollingsworth* then goes on to describe various aspects of agency that could qualify one to stand in for the state: elected at regular intervals, provisions for removal, existence of fiduciary duties. *See Hollingsworth*, 133 S. Ct. at 2666-67. Thus, the existence of an agency relationship may be required, but an agency relationship that only imports fiduciary duties and has no elective/removal component to the position may fail the test enunciated in *Hollingsworth*.

¹⁵⁸ *See id.* at 2666.

¹⁵⁹ *See generally* Krimminger & Calabria, *supra* note 99.

¹⁶⁰ *See* discussion *supra* Part II.B.

¹⁶¹ Recall that the second prong of the *Lebron* test requires that the government “retains for itself permanent authority to appoint a majority of that corporation’s directors.” *Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374, 399 (1995).

¹⁶² This also functions as a limiting principle. There has been great concern when the state-action doctrine is read to effectively cover any state enforcement of private conduct. *See Shelley v. Kramer*, 334 U.S. 1, 13 (1948). Scholars of different stripes have worried about expansive state-action holdings. *See, e.g.,*

action because they are under the policy-making direction of the government.

The word “permanent” is misleadingly restrictive. No agency in the federal government is necessarily permanent.¹⁶³ Amtrak itself was expressly subject to the provision that Congress may repeal, alter or amend its chapter at any time.¹⁶⁴ In this sense, the “permanence” requirement proves too much; it effectively shields almost any regulatory agency from state-action.¹⁶⁵

But there is a concept underlying the “permanence” requirement of *Lebron* that resonates. It is the same concept underlying “indefiniteness” in the conservatorship context. Both words imply a policy-making role: that there is some active governmental purpose behind either “permanent” or “indefinite” control. In this regard, both words essentially get at the same principle: state-action includes activity that is steered by governmental policy-making, “control,”¹⁶⁶ while cabining out activity that is not under a policy-making directive. This principle limits some of the harsher effects of a strict demarcation line at the word “permanent” (which might otherwise exclude “indefinite” control), while still keeping the state-action doctrine within structural limits.

ROBERT BORK, *THE TEMPTING OF AMERICA* 152 (The Free Press, 1990) (upholding of a private person’s right to eject a guest from her dinner party for untoward speech could constitute state-action in violation of the ejected guest’s first amendment rights); ERWIN CHEMERINSKY, *CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES* 540 (Aspen Publishers 4th ed., 2011) (“Shelley remains controversial because ultimately everything can be made state action under it.”).

¹⁶³ Roisman, *supra* note 7, at 185. For an excellent discussion of the vacuousness of the permanence requirement, *see id.* at 185-88.

¹⁶⁴ *Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374, 398 (1995) (citing 45 U.S.C. § 541 (1994)).

¹⁶⁵ This is one of the chief problems with the “permanency” inquiry. It brings in almost no agency activity. Roisman, *supra* note 7, at 185 (“The word [permanent] should not be used as a shibboleth to immunize FHFA from responsibility for compliance with the Constitution.”).

¹⁶⁶ The *Lebron* Court goes out of its way to highlight the degree of control the government exerted over Amtrak. *See Lebron*, 513 U.S. at 390-91 (discussing the government’s control of Amtrak’s board of directors). This focus caught the eye of the *Herron* court as well. *See also Herron v. Fannie Mae*, 857 F. Supp. 2d 87, 93 (D.D.C. 2012) (discussing the relevance of the fact that the government appoints the majority of Fannie’s board of directors).

Looking at the underlying policy is in part compelled by dicta in *Lebron* itself. The Court stated, “[t]he Government exerts its *control* not as a creditor but as a *policymaker*. . . .”¹⁶⁷ To draw a helpful distinction, let’s use the example of a “pass-through conservatorship.”¹⁶⁸ To analogize to the Fannie and Freddie situation, in a pass-through conservatorship, the FHFA would not be seeking to preserve Fannie and Freddie. Rather, a pass-through conservatorship simply uses the conservator, the FHFA, as a bridge between creditors of the entity, and the entity itself.¹⁶⁹ In this scenario, the federal government is not donning its policy-making hat.¹⁷⁰ It is acting much more as a facilitator between creditors and the underlying company. It isn’t entwined in the management of the entity.¹⁷¹ A pass-through conservatorship would thus not be involved in state-action because there would be much less policy-making steering the activities of Fannie and Freddie. In a nutshell, it would be *passive* involvement.

Moreover, whether or not the government has a policy-making role is moored in other operative areas of the state-action doctrine. For example, state-actors, such as agencies, receive what is known as *Parker* immunity, which is a form of immunity from antitrust lawsuits.¹⁷² In considering whether or not an agency qualifies as a state-actor, and thus should receive the benefit of *Parker* immunity, the first question is whether the challenged action is “clearly articulated and affirmatively expressed” as state policy.¹⁷³ Policy-making in this context is central—it is *sine qua non* to state-action.

Thus, the governmental policy underlying the disputed action is a crucial consideration in resolving the overarching state-action question. As *Lebron* notes, the objective of the plan matters.¹⁷⁴ The objective

¹⁶⁷ *Lebron*, 513 U.S. at 399.

¹⁶⁸ See JOHN L. DOUGLAS & RANDALL D. GUYN ET AL., RESTRUCTURING AND LIQUIDATION OF U.S. FIN. INST 229, 235-36 (2009), <https://perma.cc/KX4F-QR83>.

¹⁶⁹ See *id.* at 236.

¹⁷⁰ The FHFA is not acting as a “bridge” with Freddie and Fannie. It appoints its board, receives 100% of its profits and effectively controls the majority of outstanding shares. See Press Release, *supra* note 126 and accompanying text.

¹⁷¹ See Douglas & Guyn, *supra* note 164, at 236 (contrasting pass-through conservatorships with the “genuine conservatorships” of Fannie and Freddie).

¹⁷² See generally *Parker v. Brown*, 317 U.S. 341 (1943).

¹⁷³ *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980) (citing *New Motor Veh. Bd. of Cal. v. Orrin W. Fox Co.*, 439 U.S. 96, 109 (1978)).

¹⁷⁴ See *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 399 (1995).

underlying conservatorship is the restoration of Fannie and Freddie to a sound and solvent condition.¹⁷⁵ It is a policy that contemplates major and deliberate federal policy-making. Or in other words, control. This control is not theoretical. It has been exercised, by virtue of sweeping 100% of Fannie's and Freddie's profits into Treasury, by being a dominant shareholder, and by appointing a majority of the Board of Directors.¹⁷⁶ Under any sensible understanding of the *Lebron* doctrine, this must be considered state-action.

V. CONCLUSION

As *Department of Transportation v. Association of American Railroads* tells us, one must look at an ostensibly private entity's *de facto* status, as opposed to relying on peremptory labels.¹⁷⁷ Using this lens, is clear that Fannie and Freddie are under the conservatorship of the federal government, not under receivership.¹⁷⁸ It is also clear that the conservatorships are far from temporary; they are indefinite.¹⁷⁹ Taken in sum, these two findings draw a clear contrast with the reasoning used in *Herron*, and support the conclusion that, in their "indefinite conservatorship" state, Fannie and Freddie are engaged in state-action.¹⁸⁰

This conclusion has important ramifications. Fannie and Freddie are important tools for the government when deficits are high and budgets are tight, as they are off-balance sheet.¹⁸¹ Therefore, one can only expect their usage to grow in the coming years.¹⁸²

And yet, to this day, Fannie and Freddie are not considered arms of the federal government. As a result, they are free to utilize foreclosure procedures that require no notice, a practice that is a blatant abrogation of the procedural due process guarantees in the Fifth and Fourteenth Amendments.¹⁸³

¹⁷⁵ See generally *Herron v. Fannie Mae*, 857 F. Supp. 2d 87 (D.D.C. 2012).

¹⁷⁶ See *supra* note 134 and accompanying discussion.

¹⁷⁷ See *Dep't of Transp. v. Ass'n of Am. R.R.s*, 135 S. Ct. 1225, 1233 (2015).

¹⁷⁸ See discussion *supra* Part II.A.

¹⁷⁹ See discussion *supra* Part II.B.

¹⁸⁰ See discussion *supra* Part III.

¹⁸¹ BIGGS & HELMS, *supra* note 48, at 209.

¹⁸² See John Dalton, *There's Still Time to Fix Fannie and Freddie*, HOUSING WIRE (Jan. 12, 2016), <https://perma.cc/L4UM-XAJA> (proposing that the federal government create all-encompassing housing vehicles that would control even more of the housing market when compared with current day Fannie and Freddie).

¹⁸³ See *Goldberg v. Kelly*, 397 U.S. 254, 257 (1970) (stating that the Due

Thousands of homes have or will be foreclosed upon by Fannie, Freddie, or servicers acting on their behalf. Recognizing that Fannie and Freddie are engaged in state-action would resolve whether they are subject to the robust and protective constitutional safeguards that celebrate liberty by constraining government.¹⁸⁴

Process clause of the Fourteenth Amendment requires both prior notice and a hearing).

¹⁸⁴ Grant S. Nelson, *Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law*, 37 PEPP. L. REV. 583, 610 (2010) (“[in the] long run, however, hundreds of thousands of home mortgages will have to be foreclosed in spite of these good faith mitigation attempts. It is then that the federal interest will be served by a uniform foreclosure process.”).

