IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

NICHOLE WILLIAMS, et al.	)	
	)	
Plaintiffs,	)	
	)	
v.	)	No. 09-CV-1959 ADM JJG
	)	
TIMOTHY F. GEITHNER, et al.	)	
	)	
Defendants.	)	

MEMORANDUM OF LAW OF DEFENDANTS FEDERAL NATIONAL MORTGAGE ASSOCIATION (d/b/a FANNIE MAE) AND FEDERAL HOME LOAN MORTGAGE CORPORATION (d/b/a FREDDIE MAC) IN SUPPORT OF MOTION TO DISMISS THE FIRST AMENDED COMPLAINT

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INTRODUCTION

Defendants Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac") have a public mission to support liquidity and stability in the secondary mortgage market, ensuring in these troubled economic times that individuals still have access to the mortgage credit needed to purchase homes they can afford. In accordance with this mission, both companies have engaged in significant efforts to keep people in their homes and prevent foreclosures. One way Fannie Mae and Freddie Mac pursue these efforts is through the Home Affordable Modification Program ("HAMP"). Under HAMP, private mortgage servicers, acting pursuant to contracts, modify the terms of qualifying mortgage loans under specified guidelines, with the goal of making repayment sustainable and affordable. After approximately seven months, HAMP is off to a successful start. Offers for more than 750,000 trial modifications have been made, and over 500,000 such trial modifications are underway.[1] The Treasury Department estimates that "HAMP has already been more successful than any previous similar program in modifying mortgages

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[1] Decl. of Noah A. Levine ("Levine Decl.") Ex. 9 (U.S. Dep't of Treasury, *Obama Administration Releases New Data On Making Home Affordable Program, Achieves Key Milestone Weeks Ahead of Schedule* (Oct. 8, 2009), *available at* http://www.treas.gov/press/releases/tg315.htm); Levine Decl. Ex. 10 (U.S. Dep't of Treasury, *Making Home Affordable Program Servicer Performance Report Through September 2009* (Oct. 8, 2009), *available at* http://www.treas.gov/press/releases/docs/MHA%20Public%20100809%20Final.pdf).

for at risk borrowers to sustainably affordable levels, and helping to avoid preventable foreclosures."[2]

Plaintiffs are Minnesota homeowners who claim that the servicers of their private mortgage loans denied their applications for HAMP modifications without sufficient process. Plaintiffs seek to require broad, fundamental changes to the HAMP program. Invoking the Due Process Clause and class-action procedures, Plaintiffs ask this Court to impose upon Defendants an inflexible, constitutionalized system of intricate procedures for servicers' HAMP determinations, including detailed denial notices and opportunities for appeal to neutral decisionmakers.

Plaintiffs' theory, if credited, would revolutionize constitutional law. HAMP is unlike any program courts have found to implicate a property interest protected by the Due Process Clause. It is neither a government entitlement program nor a contract by which the government has assumed legal obligations to borrowers; the "benefit" allegedly at issue is reformation of a private contract rather than a direct payment or job. Plaintiffs also seek wrongly to apply the Due Process Clause to private, nongovernmental action. The HAMP modification denials about which Plaintiffs complain are made by private mortgage servicers, not the government. What is more, neither Fannie Mae nor

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2 Levine Decl. Ex. 7 (Testimony of Michael S. Barr, Assistant Secretary for Financial Institutions, Department of Treasury, before the Subcommittee on Housing & Community Opportunity of the House Committee on Financial Services, on Stabilizing the Housing Market (Sept. 9, 2009) ("Barr Testimony"), *available at* http://www.treas.gov/press/releases/tg280.htm.)

Freddie Mac are government actors, so their HAMP Guidelines cannot constitute government action.

For these reasons, and those below, Defendants respectfully request that the Court dismiss Plaintiffs' First Amended Complaint for failure to state a claim. In addition, as no Plaintiff alleges that Freddie Mac owns or guarantees his or her loans, Freddie Mac respectfully requests that the Court dismiss the claims against it for lack of standing.

STATEMENT

I. FANNIE MAE AND FREDDIE MAC

Fannie Mae and Freddie Mac are private companies chartered by Congress, often referred to as government-sponsored enterprises ("GSEs"). The companies support the secondary mortgage market by purchasing residential mortgages from private mortgage lenders in arm's length transactions. They then hold the mortgages in their investment portfolios or securitize them into mortgage-backed securities that can be bought and sold in the secondary mortgage market. The companies contract with private mortgage servicers to collect payments from borrowers, pay real estate taxes and insurance, and handle other administrative details related to the companies' mortgage loans.[3]

On September 6, 2008, pursuant to the Housing and Economic Recovery Act of 2008 ("HERA"), Pub. L. No. 110-289, § 1367(a)(1), 122 Stat. 2654, the Director of the

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[3] *See generally* Levine Decl. Ex. 5 (Fannie Mae 10-Q Report, Second Quarter 2009 ("Fannie Mae 10-Q")), at 1, 151; Decl. of Michael J. Ciatti ("Ciatti Decl.") Ex. 2 (Freddie Mac 10-Q Report, Second Quarter 2009 ("Freddie Mac 10-Q")), at 1, 112. The court may rely on these public securities filings for background facts in considering this motion

Federal Housing Finance Authority ("FHFA") appointed FHFA as conservator of Fannie Mae and Freddie Mac. HERA authorizes the conservator to undertake actions to preserve and conserve Fannie Mae's and Freddie Mac's assets and property and to restore the two companies to a sound and solvent condition. *See* 12 U.S.C. § 4617. The conservator has delegated to the management of Fannie Mae and Freddie Mac, respectively, authority to conduct day-to-day operations, and the stock of the two companies continues to be publicly traded.[4]

II. THE HOME AFFORDABLE MODIFICATION PROGRAM

A. The Emergency Economic Stabilization Act

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act ("EESA"), Pub. L. No. 110-343, 122 Stat. 3765, authorizing the Secretary of the Treasury to purchase up to $700 billion in "troubled assets" to stabilize credit markets. Sections 109 and 110 further provide for the Secretary and certain federal agencies, including FHFA in its role as conservator for Fannie Mae and Freddie Mac, to engage in foreclosure mitigation efforts. Specifically, EESA requires the Secretary and FHFA to implement plans "that seek[] to maximize assistance for homeowners and use [their] authority … to encourage the servicers of the underlying mortgages, considering net present value to the taxpayer, to take advantage of … available programs to minimize

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to dismiss. *See Little Gem Life Scis., LLC v. Orphan Med., Inc.*, 537 F.3d 913, 916 (8th Cir. 2008).

[4] Levine Decl. Ex. 8 (FHFA, Fact Sheet: Questions and Answers on Conservatorship (Sept. 7, 2008) ("*Conservatorship Q&A*"), *available at* http://www.fhfa.gov/webfiles/35/FHFACONSERVQA.pdf).

foreclosures." *Id.* §§ 109(a), 110(b)(1). Section 110 also provides that modifications under any FHFA plan "may include" a "reduction in interest rates," a "reduction of loan principal," or "other similar modifications." *Id.* § 110(b)(2).

Beyond these general aspirational goals, EESA leaves to the Secretary and FHFA all decisions regarding the homeowner-assistance plans—*i.e.*, how to "seek[] to" assist homeowners, "encourage" servicers, or "consider[] net present value to the taxpayer." *Id.* §§ 109(a), 110(b). Congress did not require that the plans benefit any identified category or number of borrowers or loans, or that the plans utilize any specific forms of assistance. EESA instead affords the Secretary and FHFA full discretion to structure foreclosure mitigation initiatives, including their size, duration, and scope.

B. The Home Affordable Modification Program

Working with FHFA, in late 2008 Fannie Mae and Freddie Mac initially implemented a foreclosure assistance program called the Streamlined Modification Program ("SMP"). *See* First Am. Compl. ("FAC") Ex. C, at 34. In February and March 2009, after President Obama took office, the companies, Treasury, and FHFA unveiled HAMP, which replaced SMP. *See* FAC ¶¶107-122. HAMP does not involve direct loans or payments to mortgage borrowers. Instead, HAMP works by providing financial incentives to mortgage servicers and investors to modify the terms of private mortgages where foreclosure may be avoidable and modification would be in the financial interests of the involved parties. FAC Ex. B.

HAMP has two primary components. *First*, the Treasury Department uses EESA funds to offer incentives to private mortgage servicers and investors to modify qualifying

mortgage loans that are not owned, securitized, or guaranteed by Fannie Mae or Freddie Mac ("non-GSE loans"). FAC ¶¶118-121. *Second*, at the direction of FHFA in its role as conservator, Fannie Mae and Freddie Mac each have instructed their servicers to modify qualifying loans that Fannie Mae and Freddie Mac own, securitize, or guarantee ("GSE loans"), also in exchange for incentive payments. FAC ¶123.

Treasury's HAMP program is largely voluntary. Participating servicers enter into contracts with the government—Servicer Participation Agreements ("SPAs")—under which they commit to perform loan modifications pursuant to Treasury guidelines incorporated into the contracts.[5] The guidelines contain initial eligibility criteria, prescribe factors that servicers must consider to determine whether a modification is available, and set forth steps the servicers must take to set the terms of any modification.[6] Treasury has contracted with Fannie Mae and Freddie Mac to perform functions in the non-GSE program—Fannie Mae enters into the SPAs with servicers on Treasury's behalf and Freddie Mac conducts auditing and compliance functions. *See* FAC ¶¶116-117.

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[5] The template SPA is Exhibit 3 to the Levine Declaration and is available at https://www.hmpadmin.com/portal/docs/hamp_servicer/servicerparticipationagreement.pdf. The Court may rely on that document, and similar documents below, in considering this motion to dismiss because Plaintiffs refer to them in their FAC (¶¶119, 121), and they are central to Plaintiffs' claim. *See Moses.com Secs., Inc. v. Comprehensive Software Sys., Inc.*, 406 F.3d 1052, 1063 (8th Cir. 2005).

[6] The current Treasury Guidelines are found in Supplemental Directive 09-01 ("SD09-01") (Apr. 6, 2009), which is available as FAC Exhibit E and at https://www.hmpadmin.com/portal/docs/hamp_servicer/sd0901.pdf. The Court may rely on this document, and similar documents below, because they are attached to Plaintiffs' FAC. *See Great Plains Trust Co. v. Union Pacific R.R.*, 492 F.3d 986, 990 (8th Cir. 2007).

Under Fannie Mae and Freddie Mac's HAMP programs (FAC ¶123), the two companies have directed their servicers to modify qualifying loans that are owned or securitized by Fannie Mae or Freddie Mac according to guidelines (collectively, "GSE Guidelines"). The GSE Guidelines are incorporated into and implemented through Fannie Mae and Freddie Mac's respective general servicing guidelines and contracts.[7] The GSE Guidelines are generally consistent with Treasury's Guidelines, setting forth the basic eligibility criteria, the conditions for modification availability, and the specific modification protocols.

C. HAMP's Operation

Treasury's Guidelines and SPAs. Treasury's Guidelines set forth several initial eligibility criteria, including:

- The loan is a first-lien mortgage loan originated on or before January 1, 2009;
- The loan is secured by a one-to-four unit property, one unit of which is the borrower's principal residence;
- The property has not been abandoned or condemned;
- The current unpaid principal balance is within specified limits ($729,750 for a one-unit property);
- The loan is delinquent or an imminent default is reasonably foreseeable;
- The loan has not previously been modified under HAMP;

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[7] *See* FAC Ex. C (Fannie Mae Announcement 09-05R (Apr. 21, 2009) ("FaM09-05R")); FAC Ex. D (Freddie Mac Single-Family Seller/Servicer Guide) ("FrMGuide"), at Ch. C65). Freddie Mac's entire guide is publicly available via AllRegs at http://www.freddiemac.com/sell/guide, and excerpts cited in this memorandum not otherwise attached to the FAC are included as Exhibit 1 to the Ciatti Declaration.

- The borrower has a monthly mortgage payment greater than 31 percent of monthly income, and has insufficient assets to make the payment; and
- The borrower documents a financial hardship.

SD09-01, at 2-3. Servicers may make "imminent default" determinations according to their own internal standards. *Id.* at 4.

Eligibility for participation does not automatically qualify a borrower for a HAMP modification. The above criteria determine only "[i]nitial eligibility." FAC ¶132. Treasury's Guidelines then outline additional conditions that determine whether a participating servicer must offer a HAMP modification. Specifically, no modification is required where:

- one is prohibited by an investor servicing agreement, and the servicer's reasonable efforts to lift the prohibition are unsuccessful. Likewise, modification is not required where the servicer is unable to obtain any other third-party consents, waivers, or delegations required by contract or law. *See* SD09-01, at 1; SPA ¶2.B.
- the projected net present value ("NPV") of the borrower's modified loan payments would be less than the projected NPV if the loan were not modified (an "NPV-negative" result). Servicers with sufficiently large books of business may modify NPV models using their own loan experience. *See* SD09-01, at 4-5.
- application of a required modification "waterfall" (specified reductions of the interest rate, extensions of the loan term, and forbearance of a portion of principal) will not achieve the targeted monthly mortgage payment of 31% of the borrower's gross monthly income. *See* SD09-01, at 8-10.

If the loan qualifies for modification after application of these factors, the servicer must provide a Trial Period Plan, under which the borrower must make the reduced payments, generally for three months. *See* SD09-01, at 15. If the borrower remains current throughout the trial period and provides required documentation, and the servicer

verifies the borrower's eligibility, only then must the servicer provide a permanent modification. *See id.* at 14-15, 17-18.

The SPAs and Treasury's Guidelines incorporated therein govern the obligations of the servicer to Treasury (through Treasury's agent, Fannie Mae). Nothing in the SPA extends the servicer's obligations to a potentially eligible borrower, or indicates that a borrower is considered an intended beneficiary of the contract with a right to enforce it or the incorporated guidelines against the servicer. To the contrary, the SPA indicates that the SPA "shall inure to the benefit of and be binding upon the parties to the Agreement and their permitted successors-in-interest." SPA ¶11.E.

The GSE Guidelines and Servicing Contracts. The GSE Guidelines generally employ the same initial eligibility criteria as Treasury's Guidelines, and similarly provide that eligibility does not automatically qualify applicants for a HAMP modification. *See* FaM09-05R, at 2-3; FrMGuide, at Ch. C65.4. *First*, if application of the modification waterfall cannot achieve the 31% target monthly payment, then no modification is provided. *See* FaM09-05R, at 10-11; FrMGuide, at Ch. C65.6(b). *Second*, although modifications are allowed for some NPV-negative loans, no modification is allowed where the remaining interest-bearing portion of the loan after forbearance of principal would be less than the value of the home securing the mortgage. *See* FaM09-05R, at 11; FrMGuide, at Ch. C65.6(a) (NPV test). *Finally*, borrowers are required to complete a trial period to receive a permanent modification. *See* FaM09-05R, at 16-17, 20-21; FrMGuide, at Ch. C65.7(a).

Fannie Mae and Freddie Mac implement their respective guidelines through each company's pre-existing, private seller and servicing contracts, which preserve the two companies' discretion to revise their instructions to servicers over time. *See* Levine Decl. Ex. 1 (Fannie Mae Mortgage Selling & Servicing Contract ("Fannie Mae Servicer Contract"))[8] § I.C (incorporating by reference Fannie Mae-issued Guides to Lenders, including subsequent amendments at Fannie Mae's discretion); FrMGuide, at Ch. 1.2(a) (incorporating any amendment to Volume 2 of the Guide, which encompasses HAMP activities, into Freddie Mac's master servicer contract). Nothing in the companies' servicer contracts or servicing guidelines evidences any intent to allow borrowers to enforce them against the servicers. To the contrary, the Fannie Mae Servicer Contract states that "[t]hese rights and remedies are for our benefit and that of our successors and assigns" (§ XIV), and its Servicing Guide disclaims any intent to create third-party beneficiary rights. *See* Levine Decl. Ex. 2 (Fannie Mae Single Family 2006 Selling Guide, Pt. 1, Ch. 2, § 201)[9] ("No borrower or other third party is intended to be a legal beneficiary of the Mortgage Selling and Servicing Contract or to obtain any such rights or entitlements through our lender communications….").

D. HAMP's Continued Evolution

HAMP was not envisioned as a permanent entitlement program, but rather as a short-term initiative that would require servicers to build out supporting infrastructure to

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8 Available via AllRegs at https://www.efanniemae.com/sf/guides/ssg.

9 Available via AllRegs at https://www.efanniemae.com/sf/guides/ssg.

render it fully operational.[10] In the seven months since the HAMP Guidelines went into effect, the program is showing success. Offers for more than 750,000 trial modifications have been made, with more than 500,000 such trial modifications underway. *See supra* page 1 & n.1. Treasury also continues to undertake efforts to improve HAMP, including:

- Working with servicers to expand capacity;
- Requiring servicers to report reasons for modification denials to both Treasury and borrowers;
- Developing a centralized point for HAMP modification applications and for borrowers to check on the status of their applications; and
- Asking Freddie Mac to undertake a "second look" process "to minimize the likelihood that borrower applications are overlooked or that applicants are inadvertently denied a modification."

Barr Testimony, *supra* n.2.

III. THE FIRST AMENDED COMPLAINT

Plaintiffs are four Minnesota residents who allege that they were denied HAMP modifications by the private servicers of their mortgage loans. Two plaintiffs allege that their loans are subject to the non-GSE modification program (FAC ¶¶26, 57, 120), and two allege that Fannie Mae owns their loans (FAC ¶¶76, 84). (Since the filing of the First Amended Complaint, one of the latter two, Ms. Koppenberg, has been offered a trial

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[10] The Congressional Oversight Panel recently acknowledged that "HAMP requires a significant infrastructure—both at Treasury and within participating mortgage servicers—that cannot be created overnight.… Once the program is fully operational, Treasury officials have stated that the goal is to modify 25,000 to 30,000 loans per week." Congressional Oversight Panel, *October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months* 4 (Oct. 9, 2009), *available at* http://cop.senate.gov/documents/cop-100909-report.pdf.

modification under HAMP.) No Plaintiff alleges that he or she has a loan owned, securitized, or guaranteed by Freddie Mac.

Plaintiffs assert an "entitlement" to HAMP modifications only on the ground that they satisfy five threshold eligibility criteria. FAC ¶38; *see also id.* ¶¶39-42, 67, 77, 88. None alleges that he or she satisfies, or is likely to satisfy, all the criteria on which qualification for a HAMP modification is determined. Yet Plaintiffs seek to have the Court dictate the procedures to govern the HAMP denial process.

ARGUMENT

I. MOTION TO DISMISS STANDARD

Rule 12(b)(6) is designed "to eliminate actions which are fatally flawed in their legal premises and destined to fail, thereby sparing litigants the burden of unnecessary pretrial and trial activity." *Young v. City of St. Charles*, 244 F.2d 623, 627 (8th Cir. 2001). A complaint should therefore be dismissed if the alleged facts do not entitle the plaintiff to a legal remedy. *See Koehler v. Brody*, 483 F.3d 590, 596 (8th Cir. 2007). The factual allegations must "raise a right to relief above the speculative level," not "merely create[] a suspicion [of] a legally cognizable right of action." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). As the Supreme Court recently emphasized, courts should accept as true well-pleaded allegations, but not wholly conclusory allegations or legal conclusions drawn from the facts alleged. *See Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949-1950 (2009).

II. PLAINTIFFS FAIL TO STATE A CLAIM BECAUSE THE FIRST AMENDED COMPLAINT DOES NOT ADEQUATELY ALLEGE A DEPRIVATION OF A PROTECTED PROPERTY INTEREST BY A GOVERNMENT ACTOR

Plaintiffs' novel theory that the Due Process Clause requires procedural protections when *private* mortgage servicers' determinations are made pursuant to guidelines in those servicers' contractual relationships with parties *other than Plaintiffs* lacks merit for two primary reasons. *First*, the Due Process Clause does not apply to HAMP determinations because neither EESA nor HAMP vests homeowners with any legally enforceable property interest in a HAMP modification. (Part II.A.) *Second*, Plaintiffs allege that private mortgage servicers—not any government actors—are responsible for the alleged property deprivation. (Part II.B.)

A. Plaintiffs Have No Cognizable Property Interest For Purposes Of The Due Process Clause

The Due Process Clause safeguards "the security of interests that a person has already acquired in specific [government] benefits," but it does not apply to every prospective advantage potentially afforded by government actions. *Board of Regents v. Roth*, 408 U.S. 564, 576 (1972). To constitute a property interest for purposes of the Clause, "a person clearly must have more than an abstract need or desire … [or] a unilateral expectation" of receiving a particular government benefit; "[h]e must, instead, have a legitimate claim of entitlement to it." *Id.* at 577. Property interests are not created by the Constitution itself but, "'[r]ather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law.'" *Town of Castle Rock v. Gonzales*, 545 U.S. 748, 756 (2005). The question is not

simply whether there is an expectation of certain government treatment, but whether the individual has an enforceable right to that treatment. *E.g.*, *id.* at 757; *O'Bannon v. Town Court Nursing Ctr.*, 447 U.S. 773, 788 n.21 (1980).

For several reasons, HAMP is quite different from any program courts have found to support a protected property interest. In contrast to cases that have considered federal entitlement statutes—*e.g.*, *Goldberg v. Kelly*, 397 U.S. 254 (1970)—here no statute or regulation requires the modifications in question. In contrast to cases that have found property interests pursuant to contracts—*e.g., Roth*, 408 U.S. 564—here the contracts are not between the government and the person asserting the property interest, constraining the government's discretion to act towards that person. And unlike cases focusing on government payments or employment, here the "benefit" at issue is modification of a contract between private parties. Finally, in contrast to government entitlement programs that have been considered to create a protected property interest, HAMP was purposely designed as a rapid, flexible, and constantly developing response to a shifting economic crisis.

1. Neither EESA nor HAMP confer any legally enforceable entitlement to a HAMP modification

Plaintiffs claim a property interest granted by statute, yet EESA's text precludes any assertion of a legal entitlement to a loan modification. Sections 109 and 110 use the term "shall," but only to require that the Secretary and FHFA "implement plan[s] *that seek[] to* maximize assistance for homeowners" and use their authority "*to encourage* the servicers of the underlying mortgages, *considering* net present value to the taxpayer, to

take advantage of … available programs to minimize foreclosures." EESA §§ 109(a), 110(b) (emphases added). Neither section compels assistance to any identifiable category of borrowers or loans, or mandates the form or scope of any mitigation measures to be provided. All such issues are left to the discretion of the Secretary and FHFA. That discretion, standing alone, bars any assertion that EESA creates a legal entitlement for borrowers to receive HAMP loan modifications. *See, e.g.*, *Castle Rock*, 545 U.S. at 756 ("Our cases recognize that a benefit is not a protected entitlement if government officials may grant or deny it in their discretion."). In short, EESA is "not worded in such a way that a [borrower] could reasonably expect to enforce [it] against [government] officials." *Kentucky Dep't of Corrs. v. Thompson*, 490 U.S. 454, 464 (1989).

Nor is HAMP itself structured such that a borrower could reasonably expect to require the government to provide a loan modification. No statute, regulation, or contract requires the government (or Fannie Mae or Freddie Mac, which Plaintiffs try to treat as state actors) to provide the HAMP modifications in question. HAMP is not built upon any mandatory statutes or regulations at all, but rather has been developed and implemented exclusively by contract. Treasury, Fannie Mae, and Freddie Mac have operated essentially as commercial actors, requiring private mortgage servicers who contract with them to effectuate loan modifications under certain circumstances. The contracts by which the incentives are provided preserve the discretion of Treasury, Fannie Mae, and Freddie Mac to terminate the programs altogether or amend the program

terms going forward, without legislation, rulemaking, or similar process.[11] Indeed, FHFA, Fannie Mae, and Freddie Mac first implemented a different foreclosure mitigation initiative (the SMP) prior to HAMP, and could adopt a different program again.

For all of these reasons, when it comes to the specific property interest to which Plaintiffs assert an entitlement—the receipt of a loan modification—no statute, regulation, or contract "purport[s] to limit the Government's right[s]," "define the Government's obligations[,] or limit its powers in any way." *O'Bannon*, 447 U.S. at 785 & n.18. This absence of any restriction requiring the government to continue providing the program on an ongoing basis is fatal to Plaintiffs' Due Process Clause theory, because ultimately, "[t]he ground for a constitutional claim, if any, must be found in statutes or other rules defining the *obligations* of the [relevant government] authority." *Connecticut Bd. of Pardons v. Dumschat*, 452 U.S. 458, 465 (1981) (emphasis added); *see also Memphis Light, Gas & Water Div. v. Craft*, 436 U.S. 1, 11 (1978) (no property interest in provision of government services that can be terminated at will); *Bishop v. Wood*, 426 U.S. 341, 347-348 (1976) (same regarding at-will government employment). Here, there is no such ground.

Furthermore, even if *servicers* might be in a position to enforce the contracts against Treasury, Fannie Mae, or Freddie Mac (*e.g.*, after modifying a loan in compliance

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[11] *See* SPA §§ 6(D), (E) (authorizing termination upon Treasury's direction or HAMP's termination); *id.* § 10 (authorizing amendments that materially impact eligibility requirements, incentives, and servicers' obligations on prospective basis); Fannie Mae Servicer Contract § I.C (incorporating guidelines as they are subsequently amended in Fannie Mae's discretion); FrMGuide, at Ch. 1.2(a) (same as to Freddie Mac).

with relevant guidelines), nothing in the relevant contracts confers any right on *borrowers* to enforce the contracts against either Treasury, Fannie Mae, and Freddie Mac—on the one hand—or the servicers—on the other. Notably, Plaintiffs do not claim such a right; for example, they do not allege that they are third-party beneficiaries of the contracts. Nor could they. As the Supreme Court has explained, contracts are presumed to benefit only the parties who make them, and third-party beneficiary status is particularly rare with regard to government contracts because of the complications that would ensue from private enforcement by members of the general public. *See German Alliance Ins. Co. v. Home Water Supply Co.*, 226 U.S. 220 (1912); Restatement (2d) Contracts § 313.

Here, there are no allegations suggesting intent to vest individual borrowers with enforceable rights or status as third-party beneficiaries under HAMP Guidelines. To the extent that the contracts address the issue, they claim no such purpose. *See supra* Statement, Part II.C. Indeed, courts generally have rejected assertions that mortgage servicing guidelines bestow enforceable rights upon affected borrowers, absent some express indication of intent to vest borrowers with such a right. *See, e.g.*, *Roberts v. Cameron-Brown Co.*, 556 F.2d 356, 360-361 (5th Cir. 1977) (HUD servicing handbook for low-income housing assistance program). As to Fannie Mae and Freddie Mac specifically, courts repeatedly have held that the companies' servicing contracts create no third-party beneficiary rights. *See*, *e.g.*, *In re Thorien*, 2008 WL 5683488 (Bankr. D. Idaho Nov. 6, 2008) (Freddie Mac); *Blair v. Source One Mortgage Servs. Corp.*, 1997 WL 732407 (E.D. La. Nov. 20, 1997) (Freddie Mac); *Deerman v. Federal Home Loan*

Mortgage Corp., 955 F. Supp. 1393 (N.D. Ala. 1997), *aff'd*, 140 F.3d 1043 (11th Cir. 1998) (table); *Hinton v. Federal Nat'l Mortgage Ass'n*, 945 F. Supp. 1052 (S.D. Tex. 1996), *aff'd*, 137 F.3d 1350 (5th Cir. 1998) (table).

Finally, even if Plaintiffs had alleged third-party-beneficiary status, no constitutionally protected property interest would be implicated. Even as to parties in direct contractual privity, for instance, federal courts have been reluctant to hold that a government contract gives rise to a protected property interest: "a wholesale federalization of state public contract law seems far afield from the great purposes of the due process clause." *Unger v. National Residents Matching Program*, 928 F.2d 1392, 1398 (3d Cir. 1991). A third-party-beneficiary theory would stretch the Constitution even further, locating Plaintiffs' alleged property interest in contracts that the government (and Fannie Mae and Freddie Mac) have entered into with *private parties other than Plaintiffs*. In this respect, Plaintiffs' theory requires another leap courts have been reluctant to take—recognition of a protected property interest based on an indirect advantage that one would receive by virtue of limitations on the government's actions toward another. *See, e.g.*, *Castle Rock*, 545 U.S. at 766-767 (domestic violence victim's interest in enforcement of protective order too indirect to warrant due process protection); *O'Bannon*, 447 U.S. at 788 & n.21 (distinguishing between individual's assertion of property interest based on "direct relationship" with government, and improper assertion of property interest based on government's relation with another).

In short, where the government "relies on financial incentives [to lenders] to accomplish a welfare objective and does not purport to confer enforceable federal rights

directly on the [affected] borrowers," the lack of a judicially enforceable duty precludes any claim to a protected property interest for due process purposes. *Rank v. Nimmo*, 677 F.2d 692, 697, 702 n.14 (9th Cir. 1982) (housing guarantee program). Plaintiffs' theory would wrongly and exponentially expand the scope of the Due Process Clause, requiring procedural protections to be afforded for the interests of all sorts of asserted third-party beneficiaries of government contracts. The Court should reject this theory.

2. A HAMP modification is too uncertain to constitute a property interest for purposes of the Due Process Clause

The fact that HAMP guidelines condition the receipt of any modification on so many complex factors, as well as the discretion of third parties, also rebuts Plaintiffs' assertion of a property interest. The Due Process Clause extends to certain entitlements "upon which people rely in their daily lives," *Roth*, 408 U.S. at 577, but no reliance interest can exist when the alleged "property" at issue is merely a subjective hope of obtaining a prospective advantage that is uncertain, due to its having been conditioned on *either* the satisfaction of many complex determinations *or* the discretion of third parties. *See, e.g.*, *Reed v. Village of Shorewood*, 704 F.2d 943, 948 (7th Cir. 1983) (defining property as "what is securely and durably yours under state (or … federal) law, as distinct from what you hold subject to so many conditions as to make your interest meager, transitory, or uncertain").

Any alleged entitlement to a HAMP modification is too uncertain to qualify for protection under the Due Process Clause. Under the Treasury program, qualification for a modification depends not only upon the voluntary choice of servicers to participate, but

also upon the wholly discretionary decisions of investors in the relevant loans to permit the modifications. That discretion alone precludes recognition of a property interest. *See, e.g.*, *Castle Rock*, 545 U.S. at 756. Borrowers with non-GSE loans also may be denied participation in HAMP if their loan is neither delinquent nor subject to "imminent default," with servicers permitted to make the latter determination under each servicer's own distinctive internal standards. Servicers also must evaluate several additional criteria to determine whether a non-GSE loan qualifies for modification, including an NPV test (which may be based on a servicer's unique performance data) and application of the waterfall to determine if the target 31% monthly payment is achievable. Finally, even if these factors yield a qualifying modification, the borrower must successfully complete a trial period before the servicer must offer a permanent HAMP modification. Many of the same uncertainties and complexities are present in Fannie Mae and Freddie Mac's HAMP programs. *See supra* Statement, Part II.C.

In short, there is no sense in which potentially eligible borrowers could assert a legitimate claim of expectation of or entitlement to a HAMP modification. To the contrary, any claim to a modification is highly indeterminate given the number of actors and complex conditions involved. "Such indeterminacy is not the hallmark of a duty that is mandatory." *Castle Rock*, 545 U.S. at 763. Whether borne of discretion or otherwise, such substantial """uncertainty" … preclude[s the] existence of a federally protectable property interest.'" *Id.* at 764 (citation omitted); *see also Greenbriar Village, LLC v. Mountain Brook, City*, 345 F.3d 1258, 1266 (11th Cir. 2003) (uncertainty as to duration

of rights precludes claim of entitlement); *Natale v. Ridgefield*, 170 F.3d 258, 263 (2d Cir. 1999) (uncertainty as to legal rules precludes claim of entitlement).

3. Plaintiffs, as prospective applicants for HAMP modifications, have no property interest

Finally, Supreme Court precedent squarely forecloses Plaintiffs' assertion that, based on their alleged satisfaction of five "[i]nitial eligibility" criteria (FAC ¶¶3, 132), the Due Process Clause entitles them to a bar on foreclosure on their properties until they have received detailed notice of their HAMP denial and an opportunity to appeal the denial to a neutral decisionmaker. The Supreme Court rejected a similar argument in *American Manufacturers Insurance Co. v. Sullivan*, 526 U.S. 40 (1999). There, the plaintiffs asserted a property interest in workers' compensation benefits and contended that, having shown "eligibility" for the benefits, the Due Process Clause barred deprivation of the benefits absent notice and opportunity to be heard. *Id.* at 47-48. The Court disagreed, holding that no property interest had been established. *Id.* at 59-61. The key distinction between the plaintiff's theory and the Court's due process precedents, the Court observed, was that the plaintiffs were not yet receiving the benefits and thus had not yet established their entitlement to the payments pending provision of the process they claimed was due. In contrast, in cases like *Goldberg v. Kelly*, 397 U.S. 254 (1970), and *Mathews v. Eldridge*, 424 U.S. 319 (1976), "an individual's entitlement to benefits had been established, and the question presented was whether predeprivation notice and a hearing were required before the individual's interest in *continued* payment of benefits could be terminated." *Sullivan*, 526 U.S. at 60 (emphasis in original). The plaintiffs in

Sullivan had at best "established their initial *eligibility*," but not their ultimate qualification for or entitlement to the benefits. *Id.* at 61 (emphasis in original). "Consequently, they do not have a property interest." *Id.*

Plaintiffs' argument here fails for the same reason. Plaintiffs have not yet been found to qualify for a HAMP modification, so they do not—and cannot—assert any property interest in the "continued" receipt of such a HAMP modification and the consequent avoidance of foreclosure. *Sullivan*, 526 U.S. at 60; *see also Lyng v. Payne*, 476 U.S. 926, 942 (1986) (rejecting due process claims, and explaining: "[w]e have never held that applicants for benefits, as distinct from those already receiving them, have a legitimate claim of entitlement protected by the Due Process Clause"); *Roth*, 408 U.S. at 576 (Clause protects "interests that a person has already acquired in specific benefits"); *Duncan v. Dep't of Labor*, 313 F.3d 445 (8th Cir. 2002) (applying *Sullivan* in the context of federal workers compensation programs); *DeJournett v. Block*, 799 F.2d 430, 431 (8th Cir. 1986) ("[N]either the Supreme Court nor this court has held that the filing of a FmHA loan application in itself provides applicants … with a 'legitimate claim of entitlement[.]'"). Plaintiffs allege only initial eligibility and, on that ground, seek to bar foreclosure unless and until they have been provided written notice of HAMP denial and an opportunity to appeal that decision. *Compare* FAC ¶132 ("[i]nitial eligibility") *with Sullivan*, 526 U.S. at 61. *Sullivan* bars that claim.

B. No Government Actor—And At A Minimum, Neither Fannie Mae Nor Freddie Mac—Is Responsible For The Deprivation Of Property That Plaintiffs Allege

Plaintiffs' complaint also falters on a separate and independent point. The Fifth Amendment's prohibition on deprivation of property without due process applies only to government actors, not private parties. *See Public Utils. Comm'n v. Pollak*, 343 U.S. 451, 461 (1952). As a result, "'the party charged with the deprivation must be a person who may fairly be said to be a state actor.'" *Sullivan*, 526 U.S. at 50. Here, however, Plaintiffs do not charge any government actor with the deprivation of the purported property at issue—*i.e.*, the denial of their HAMP applications. To the contrary, Plaintiffs are quite explicit in alleging that *private* mortgage servicers denied those applications. *See* FAC ¶¶43, 68, 80, 96.

The determination of whether a "state actor" engaged in the relevant "deprivation" begins with the identification of "'the specific conduct of which the plaintiff complains.'" *Sullivan*, 526 U.S. at 51. The Supreme Court has made clear that the state-action analysis does not permit a generalized review of the overall process, but demands focus on the specific conduct that allegedly deprived the plaintiff of property. *Id.*; *Blum v. Yaretsky*, 457 U.S. 991, 1005 (1982). Here, Plaintiffs allege that they were deprived of loan modifications without notice or an opportunity to appeal. FAC ¶¶173-185. Both the FAC and the workings of the HAMP program leave no doubt that the complained-of conduct is private servicers' denial of Plaintiffs' HAMP applications. Plaintiffs' attempt to impose constitutional procedures on actors not subject to the Constitution fails to state a claim.

Plaintiffs can fare no better by asserting that a servicer's decision, though not state action itself, should nevertheless be "attributed" to the government by virtue of the Treasury or GSE Guidelines. Private companies, even when extensively regulated and operating under government programs, are not deemed government actors for constitutional purposes. *See Sullivan*, 526 U.S. at 52; *see also Rank*, 677 F.2d at 702 ("foreclosure by a private lender of a mortgage in a federal mortgage guaranty program does not involve federal action sufficient to invoke the due process clause of the Fifth Amendment"). A servicer's decision whether to approve a HAMP modification remains, in the end, private conduct.

The GSEs' issuance of HAMP guidelines cannot properly be characterized as state action in the first instance. The federal courts repeatedly have held that Fannie Mae and Freddie Mac are not government actors. *See American Bankers Mortgage Corp. v. Federal Home Loan Mortgage Corp.*, 75 F.3d 1401, 1409 (9th Cir. 1996); *Union Nat'l Bank of Little Rock v. Federal Nat'l Mortgage Ass'n*, 860 F.2d 847, 853 n.13 (8th Cir. 1988); *Northrip v. Federal Nat'l Mortgage Ass'n*, 527 F.2d 23 (6th Cir. 1975); *Liberty Mortgage Banking, Ltd. v. Federal Home Loan Mortgage Corp.*, 822 F. Supp. 956, 958-960 (E.D.N.Y. 1993). The recent placement of Fannie Mae and Freddie Mac in conservatorship has no effect on the state-action inquiry for purposes of constitutional claims against the companies. During the conservatorship, the stock of the two companies continues to trade publicly and the companies' officers continue to exercise their normal duties under the delegated authority of the conservator. *See supra* Statement, Part I. Fannie Mae and Freddie Mac might be considered governmental

entities only if the federal government exercised "*permanent* authority" over the two companies, as opposed to "*temporary* control … as a private corporation whose stock comes into federal ownership might be." *Lebron v. National R.R. Passenger Corp.*, 513 U.S. 374, 398, 400 (1995) (emphases added). HERA does not contemplate FHFA's permanent control and operation of a regulated entity in conservatorship. Rather, HERA contemplates that FHFA, as conservator, will do what is needed to return the regulated entity to financial health. *See* 12 U.S.C. § 4617(a)(2) (conservatorship for purpose of "reorganizing" or "rehabilitating" a regulated entity); *id.* § 4617(b)(2)(D) (powers of conservator include taking such action as may be necessary "to put the regulated entity in a sound and solvent condition"); *see also Conservatorship Q&A*, *supra* n.4 ("Upon the Director's determination that the Conservator's plan to restore the Company to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship."). HERA also allows for the possibility that a conservatorship will terminate by the appointment of a receiver, *see* 12 U.S.C. § 4617(a)(4)(D), together with the transfer of assets to a limited-life regulated entity, *see id*. § 4617(b)(2)(E).

The GSE Guidelines accordingly do not convert the mortgage servicers' private decisions to deny HAMP modifications into state action. The guidelines are themselves private action, and take effect by virtue of their incorporation into Fannie Mae and Freddie Mac's private contracts with their servicers.

As for Treasury's Guidelines applicable to the non-GSE loans, even if those guidelines could be read to convert private servicers' decisions into state action (they do

not, for the reasons above), Fannie Mae and Freddie Mac are not alleged to be—and cannot be—responsible for any of the putative state action at issue. Plaintiffs do not allege that the two companies make the decisions that deny a borrower's application for a HAMP modification; Plaintiffs allege that servicers do. *See, e.g.*, FAC ¶¶43, 68, 80, 96. Nor are Fannie Mae or Freddie Mac ultimately responsible for Treasury's Guidelines under which the servicers make the HAMP decisions; the Treasury Department is responsible.[12] Accordingly, even if Plaintiffs could demonstrate the government's involvement in denials of HAMP modifications for non-GSE loans, they have no claim against Fannie Mae or Freddie Mac in that context.

III. PLAINTIFFS' CLAIMS AGAINST FREDDIE MAC FAIL BECAUSE PLAINTIFFS LACK STANDING

To establish the requisite Article III standing, Plaintiffs must show "direct contact" with Freddie Mac such that their alleged injury flows directly from Freddie Mac's conduct. *See McClain v. American Econ. Ins. Co.*, 424 F.3d 728, 731 (8th Cir. 2005). Plaintiffs have failed to establish the necessary "direct contact" with Freddie Mac because there are no allegations that Freddie Mac owns or guarantees any of Plaintiffs' loans and, as a result, Plaintiffs cannot trace their alleged injury to the content or application of Freddie Mac's HAMP Guidelines. *See Buetow v. A.L.S. Enters., Inc.*, 564

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12 *See* Levine Decl. Ex. 4 (Conflicts of Interest Mitigation Exhibit to Financial Agency Agreement Between the U.S. Dep't of Treasury and Fannie Mae), at F-2, ("Treasury is solely responsible for developing the Program Guidelines and both GSEs must follow the Program Guidelines" when carrying out their responsibilities in the non-GSE program), *available at* http://www.financialstability.gov/docs/ContractsAgreements/

F. Supp. 2d 1038, 1044-1046 (D. Minn. 2008) (dismissing claims on standing grounds because plaintiffs alleged no direct contact with defendants "sufficient to establish any injury traceable to their conduct"); *Easter v. American W. Fin.*, 381 F.3d 948, 961-962 (9th Cir. 2004) (holding that "[a]s to those [defendants] which have never held a named plaintiff's loan, Borrowers cannot allege a traceable injury and lack standing").

Plaintiffs do not acquire standing against Freddie Mac merely by bringing their claim as a class action—one of the named Plaintiffs must still have standing against Freddie Mac for the case to proceed. *See Hall v. Lhaco, Inc.*, 140 F.3d 1190, 1196 (8th Cir. 1998) (explaining that when a named plaintiff "does not have standing to pursue his claim … it is immaterial whether any member of the potential class would have standing to pursue" the claim); *Mull v. Alliance Mortgage Banking Corp.*, 219 F. Supp. 2d 895, 908-909 (W.D. Tenn. 2002) (noting that "even assuming that this court were to certify plaintiffs as a class, this would not cure the fact that named plaintiffs do not have standing against any defendant who does not actually hold their loans").

Finally, Plaintiffs cannot establish standing based on Freddie Mac's role as compliance agent for HAMP (FAC ¶17). Plaintiffs fail to allege that Freddie Mac, as compliance agent, has the ability to modify Treasury's HAMP Guidelines. Indeed, as Treasury has recognized in its Financial Agency Agreement with Fannie Mae, "Treasury is solely responsible for developing the Program Guidelines and both GSEs must follow

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Fannie%20Mae%20FAA%20021809%20.pdf; *see also* FAC ¶¶116-117; *supra* Statement, Part II.B.

the Program Guidelines" when carrying out their responsibilities in the non-GSE program. *See supra* n.12. Therefore, the Court should dismiss Plaintiffs' claims against Freddie Mac pursuant to Federal Rule of Civil Procedure 12(b)(1) and/or Federal Rule of Civil Procedure 12(b)(6).

CONCLUSION

For the foregoing reasons, Fannie Mae and Freddie Mac respectfully request that the Court dismiss Plaintiffs' First Amended Complaint.

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