UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Nichole Williams, et. al.

On behalf of themselves and all others similarly situated

Case No: 09-CV-1959 ADM JJG

Plaintiffs.

v.

Timothy F. Geithner, in his official capacity as Secretary of the U.S. Department of the Treasury, et al.

Defendants.

SECRETARY GEITHNER AND U.S. DEPARTMENT OF THE TREASURY'S BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS OR, IN THE ALTERNATIVE, FOR SUMMARY JUDGMENT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

FEDERAL CASES

FEDERAL STATUTES

INTRODUCTION

On February 18, 2009, acting under the authority of the Emergency Economic Stabilization Act ("EESA") and in order to curb the mounting number of home foreclosures in the United States, President Obama and Secretary of the Treasury Geithner announced the formation of the Making Home Affordable Program that would create incentives to encourage mortgage lenders to work with at-risk homeowners to provide loan modifications. Two weeks later, Secretary Geithner and the Department of the Treasury (hereafter collectively referred to as "Secretary" or "Treasury") issued guidelines for the Home Affordable Modification Program ("HAMP"), a comprehensive $75 billion program whose goal is to lower mortgage payments for at-risk borrowers, support loan modifications aimed at providing sustainable, affordable mortgage payments for up to three to four million borrowers, and provide incentives to investor/owners of loans, loan servicers, and homeowners to participate in the program.

Plaintiffs are four Minnesota homeowners who claim to have been eligible for, but failed to receive, HAMP loan modifications, and have filed this class action lawsuit against Treasury, the Federal National Mortgage Agency ("Fannie Mae"), the Federal National Home Loan Mortgage Corporation ("Freddie Mac"), the Federal Housing Finance Agency ("FHFA"), and three loan servicers, based on a theory of a protected property interest in loan modifications. They allege that Treasury has violated procedural due process, and they seek to enjoin all foreclosures in the State of

Minnesota until Treasury issues guidance or regulations requiring servicers to provide written notice detailing the reasons for denial, and implements an appeals process.

Plaintiffs bring a facial constitutional challenge to Treasury's implementation of the EESA statute through its financial agent, Fannie Mae, but they have not stated a claim upon which relief may be granted. Plaintiffs have failed to plead anything close to a protected property right rooted in either EESA or the contract between Fannie Mae and the private servicers. They have pointed to no case which would support such a property interest, and indeed, inferring such a property interest, under circumstances where no statute, regulation, or contract requires the government to grant the plaintiffs such entitlement, would be inconsistent with established constitutional law. Moreover, even viewing the First Amended Complaint in the light most favorable to the plaintiffs, they have failed to show a close nexus between action taken by the state and the alleged deprivation of the purported property interest in a loan modification.

Even if plaintiffs could sufficiently plead the requisite elements of a procedural due process claim (which they have not), Treasury has already provided the requisite process, requiring servicers to notify borrowers facing foreclosure about HAMP and to have procedures in place to respond to inquiries and complaints and give timely and appropriate responses and resolution. As of July 10, 2009, borrowers have access to the HOPE Hotline Escalation Team which provides an avenue for borrowers to complain about improper denials and receive an explanation for their denial. And on November 3, 2009, Treasury issued

additional guidelines related to the format, content, and timing of written notices that must be provided to borrowers who were evaluated for HAMP but not approved for a modification. *See* Supplemental Directive 09-08 (attached as Exhibit 9). Such notices will provide borrowers with (among other things) the primary reason or reasons for their non-approval, and other foreclosure alternatives for which the borrower may be eligible.

In sum, Plaintiffs' First Amended Complaint reflects policy disagreements about the type and form of notice Plaintiffs would like to see, concerns which have largely been addressed by the Treasury Department. In any case, Plaintiffs have not presented any constitutional claim cognizable in this Court. Ultimately, HAMP is a voluntary program which encourages loan modifications by private servicers, in keeping with Congress' stated directive in EESA. HAMP has been successfully implemented through private contracts, allowing for maximum speed and flexibility, and participating servicers have extended offers on over 750,000 trial modifications, with over 500,000 trial modifications now underway.[1] Whatever criticisms Plaintiffs may have with this approach and the type of notice and recourse provided to borrowers, the HAMP program does not violate the Constitution.

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[1] 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). *See* http://www.treas.gov/press/releases/tg315.htm. *Making Home Affordable Program Servicer Performance Report Through September 2009* (Oct. 8, 2009). *See* http://www.treas.gov/press/releases/docs/MHA%20Public%20100809%20Final.pdf.

FACTUAL BACKGROUND

I. THE EMERGENCY ECONOMIC STABILITY ACT OF 2008

On October 3, 2008, Congress enacted the Emergency Economic Stabilization Act of 2008 ("EESA"), P.L. 110-343, 122 Stat. 3765. The Secretary was authorized to implement a plan to "maximize assistance to homeowners" by "encourag[ing] the servicers of the underlying mortgages" to modify the loans, but only while "considering net present value to the taxpayer." 12 U.S.C. § 5219(a) (2008). The Secretary was also instructed to consent to modifications, but again only "where appropriate," still protecting the "net present value to the taxpayer" by undertaking "loss mitigation measures" which in any case still needed to be "reasonable." *Id.*, § 5219(c).

II. THE HOME AFFORDABLE MODIFICATION PROGRAM

A. The Introduction and Implementation of HAMP

On February 18, 2009, President Obama and Secretary Geithner announced the Making Home Affordable ("MHA") Program. One component of MHA is the subject of this lawsuit, the Home Affordable Modification Program. Declaration of Laurie A. Maggiano (hereafter "Maggiano Decl.") (Exhibit 1), ¶ 3.

Treasury announced the Home Affordable Modification Program ("HAMP") guidelines on March 4, 2009 which applied both to Government-Sponsored Entity ("GSE") loans, including loans owned by Fannie Mae and Freddie Mac, and to non-GSE loans, including loans owned by private banks or investors. *See* Pl. Am. Compl., ¶¶ 147-148; Pl. Exh. B. Although the HAMP guidelines for GSE loans were automatically incorporated into existing service agreements that the GSEs maintained

with their servicers, the non-GSE loans were structured differently. In order to receive TARP incentive (i.e., HAMP) funds for non-GSE loans, servicers of non-GSE loans had to enter into an agreement with Treasury's financial agent, Fannie Mae. In conjunction with Treasury, Fannie Mae helped draft a Servicer Participation Agreement for non-GSE loans. *See* Pl. Am. Compl., ¶¶ 116-117, 119, 121; Maggiano Decl., ¶ 7. Two of the non-GSE servicers who entered into agreements with Fannie Mae to participate in HAMP included defendants Ocwen Financial Corp., Inc. (April 16, 2009) and GMAC Mortgage LLC (April 13, 2009). *See* Pl. Am. Compl., ¶¶ 18-19, 33, 64. As part of the agreements, these servicers agreed to perform loan modifications as described in Treasury's Supplemental Directives. *Id.*, ¶ 33, 64. Recognizing the voluntary, rather than mandatory nature of the program, there is an opt-out provision for these servicers with regard to future changes to the program. *See* Maggiano Decl., ¶ 5, Exhibits B, C, at ¶10C.[2] Since issuing Supplemental Directive 09-01 (hereafter "SD 09-01") on April 6, 2009, Treasury has issued Directives 09-02 through 09-08, on April 21, July 6, July 31, August 13, September 11, October 8, and most recently, November 3, clarifying issues ranging from trial period guidance to required borrower notice.[3]

[2] Where plaintiffs' claims arise out of a written contract, a court may consider an indisputably authentic copy of the contract in deciding a motion to dismiss. *See Stahl v. U.S. Dep't of Agric.*, 327 F.3d 697, 700-01 (8th Cir. 2003).

[3] This Court may take judicial notice of matters that are part of the public record and consider them on a motion to dismiss. *See Porous Media Corp. v. Pall Corp.*, 186 F.3d 1077, 1079 (8th Cir. 1999); *see also Faibisch v. Univ. of Minn.*, 304 F.3d 797, 802-803 (8th Cir. 2002).

B. Policy Goals Behind the Supplemental Directives

HAMP is structured with three main goals. The first goal behind HAMP is to encourage the mortgage industry to adopt uniform standards for modification, both within and outside of the HAMP program, to ensure that modifications for qualified borrowers are entered into, and that they are, in fact, sustainable. *See* Pl. Am. Compl., ¶¶ 127-132. Pl. Exh. E. According to HAMP guidelines, although participating servicers should undertake reasonable efforts to obtain consent from investors, servicers are not required to make modifications where they are prohibited from doing so by pooling and servicing agreements. *See generally* Maggiano Decl., ¶ 9, n.3; Exhibits B, C at ¶ 2B.

Second, the program is designed to encourage servicers to reduce qualified borrowers' mortgage payments to an affordable level in relation to gross monthly income. *See* Pl. Am. Compl., ¶¶ 125-126; *see also* Maggiano Decl., ¶ 17.

The third key component of HAMP is that it offers "pay for success" incentives. HAMP does not require servicers to abrogate contractual obligations or expect investors to make modification decisions that are not economically viable. Treasury instead encourages voluntary participation by paying financial incentives to borrowers, servicers and investors if they remain committed to "successful" modifications. *See* Pl. Exh. E at 22-25; *see also* Maggiano Decl, ¶ 18; Exhibit 8.

C. The Flexibility and Discretion Retained by Non-GSE Servicers under Treasury's Supplemental Directives

From the beginning of HAMP, Treasury's Supplemental Directives have served as general guidelines for loan modifications. Pl. Am. Compl., ¶ 123. They were never meant to replace a mortgage servicer's entire slate of servicing practices. *See* Maggiano Decl., ¶ 16.

The central inquiry in evaluating whether a borrower would potentially qualify for a HAMP modification is determining if the cash flow of the modified loan would ultimately be greater than the unmodified loan, and hence, the "net present value" to the taxpayer would be positive.[4] Within reason, each private servicer can implement its own method for determining whether the cash flow from the modified loan would be "positive." Under the Supplemental Directives, Treasury has allowed servicers to customize the "base" NPV model to fit their unique portfolio of loans. *See* Exhibit 4 at 1.

Recognizing that EESA permits the Secretary to consent only to "reasonable requests for loss mitigation measures,"[5] the Supplemental Directives acknowledge the servicers' delicate balance in preserving the value of the investment. The Supplemental Directives describe a "loss mitigation waterfall" in which the servicers consider a range of possible ways to modify a loan, while still preserving the "net present value." For example, SD 09-01 acknowledges that there will be circumstances where pre-existing investor servicing agreements

[4] 12 U.S.C. §§ 5219(a), (c).
[5] 12 U.S.C. § 5219(c).

prohibit certain types of modification. Pl. Exh. E at 8; Exhibit D at 8. The understanding is that at a certain point, depending on the value of the loan and value of the property, a loan modification may become financially unreasonable.

D. Loan Servicer Participation in HAMP

Treasury, Fannie Mae, and Freddie Mac began working around the clock to implement the HAMP program, providing as much guidance as possible to loan servicers, investors, and homeowners within two weeks of announcement of the program, while recognizing that there would be additional refinement over the following several months. This rapid build-up included extensive outreach to borrowers and also required participating loan servicers to expand their operations. *See* Maggiano Decl., ¶¶ 21, 22. *See also* Pl. Exh. G at 14-15 (discussing Treasury outreach efforts); Congressional Oversight Panel, *October Oversight Report, An Assessment of Foreclosure Mitigation Efforts After Six Months* (Oct. 9, 2009) (hereafter referred to as "COP report") at 63-66 (describing "servicer ramp-up period").[6]

HAMP was launched for GSE loans on April 6. Pl. Exh. G at 14. On April 13, 2009, the first set of agreements were signed for non-GSE loans. *Id.* at 12. By July 14, 2009, twenty-seven servicers were enrolled in non-GSE agreements. *Id.* at 15. At the time of the filing of Plaintiffs' Complaint, thirty-one servicers had signed up for HAMP, Pl. Am. Compl., ¶ 111, and as of October 6, 2009, sixty-

[6] In a letter dated October 9, 2009, Plaintiffs submitted the COP Report to the Court as a "public record." It may also be found at http://cop.senate.gov/documents/cop-100909-report.pdf.

three servicers had signed up for the voluntary part of HAMP. COP Report at 44. Participating servicers have now extended offers on over 750,000 trial modifications, and over 500,000 trial modifications are already underway. *See supra* at 3 n.1.

Despite all of these efforts, both the President and Treasury have reminded the public that HAMP will not prevent all foreclosures. President Obama explained that HAMP would "not rescue the unscrupulous or irresponsible by throwing good taxpayer money after bad loans" and would "not save every home." Assistant Secretary of the Treasury Michael Barr reiterated that "even if HAMP is a total success, we should still expect millions of foreclosures …" Maggiano Decl, ¶ 44; Exhibits H, I.

III. TREASURY'S ONGOING COMPLIANCE EFFORTS AND CURRENT NOTICE AND PROCESS REQUIREMENTS

Since the program's inception, Treasury has made an ongoing, concerted effort to require servicers to notify borrowers about the HAMP program.

1. Websites for Borrowers and Servicers. On March 4, 2009, Treasury launched a new consumer-focused website. The website explains the program in layman's terms, provides self-assessment tools for borrowers, and prominently announces a toll-free phone number where borrowers can seek additional help from HUD-approved housing counselors. Since its launch, the website has had over 34 million page views. Treasury has also established a website for servicers, and engaged in an aggressive in-person marketing and outreach effort to borrowers. *See* Maggiano Decl., ¶¶ 35, 36.

2. Servicer's Duty of Notification to Borrowers. From the outset, Treasury has expected servicers to provide appropriate notice to borrowers about why they may not qualify for a HAMP modification. SD 09-01 states: "[s]ervicers must also have procedures and systems in place to be able to respond to inquiries and complaints about the HAMP [and] should ensure that such inquiries and complaints are provided fair consideration, and timely and appropriate responses and resolution." Pl. Exh. E at 13; Exhibit D at 13. Furthermore, SD 09-01 states that if a servicer determines that a borrower is not eligible for HAMP based on verified income, the servicer must notify the borrower that they are not eligible for HAMP on that basis and explore other foreclosure prevention options prior to proceeding with foreclosure action. Pl. Exh. E at 18; Exhibit D at 18.

On July 9, 2009, Treasury Secretary Geithner and HUD Secretary Donovan wrote a letter expressing their compliance concerns to currently-participating HAMP servicers. Exhibit F. On July 28, 2009, Treasury met with servicers about taking steps to increase transparency in the program, including reporting data publicly and allowing Freddie Mac to audit modification applications that have been denied. *See* Exhibit I at 6-7. On September 9, 2009, Assistant Secretary Barr stated that Treasury was in the process of establishing denial codes. *Id.* at 6. On September 11, 2009, Treasury issued SD 09-06, which requires servicers to furnish "Not Approved/Not Accepted Reason Codes" to Fannie Mae. *See* Exhibit 5 at 2. SD 09-07 was issued on October 8, 2009, requiring that within thirty days of receiving a borrower's application and supporting documentation, servicers

notify the borrower if he or she has failed to qualify for trial period modification and consider the borrower for another foreclosure prevention alternative. Exhibit 7 at 7. On October 22, 2009, Assistant Secretary Allison reiterated that servicers would have to provide notice to borrowers explaining why they were denied.[7]

On November 3, 2009, Treasury issued Supplemental Directive 09-08 ("SD 09-08"), which explicitly requires that servicers send notice to every borrower who has been evaluated for HAMP and was not offered a trial period plan or an official modification, or who is at risk of losing eligibility for HAMP because he or she failed to provide the required financial documentation. Exhibit 9 at 1. SD 09-08 also includes Exhibit A which provides "model clauses for borrower notices" detailing over twelve different reasons why borrowers might be denied. *Id.* at A-1-4. The model clauses illustrate the level of specificity that is deemed to be in compliance with language requirements of the program. *Id.* at A-1. In addition, if a borrower is denied because the net present value ("NPV") of the transaction is negative, the borrower notice must include an explanation of the NPV test and a list of the inputs used, which allows the borrower an opportunity to correct values that may impact the analysis of the borrower's eligibility. *Id.* at 2-3; A-2. The required notice also refers borrowers to the HOPE hotline which provides an avenue for borrowers to complain about improper denials and receive further explanation for their denial. *Id.* at 4.

[7] *See* http://www.treas.gov/press/releases/tg325.htm

3. "Second Look" Process. Treasury has made monitoring compliance of participating servicers a priority. On July 28, 2009, Treasury asked Freddie Mac, to develop a program to minimize the likelihood that borrower applications are overlooked or applicants are inadvertently denied a modification. In this "second look" process, Freddie Mac audits a sample of MHA modification applications that have been declined. *See generally* Maggiano Decl., ¶ 31. In certain cases, this auditing process has convinced servicers to re-evaluate HAMP applications and grant trial modifications that were previously denied. *Id.*, ¶ 32.

4. Hope Hotline Escalation Team. Treasury has been continually improving the process by which borrowers can complain about improper denials and/or receive an explanation for their denial. Since July 2007, Treasury and HUD have publicly endorsed a nationwide foreclosure hotline — known as the "Homeowner's HOPE™ Hotline" (888-995-HOPE). The Secretary took these measures to provide borrowers direct information and to escalate concerns if borrowers believe their application was denied improperly. *See* Maggiano Decl., ¶¶ 37, 39.

Treasury instructed Fannie Mae to work with this hotline to address HAMP-specific questions and establish a special team of trained counselors to help borrowers who felt they were not being treated fairly by participating servicers (the "HOPE Hotline Escalation Team"). On July 10, 2009, the HOPE Hotline Escalation Team became fully operational. Borrowers' calls get routed to trained counselors who explain the program requirements and help the borrower

determine if the servicer was correctly following the program rules. If the concern or complaint is not resolved, counselors contact the servicer using proprietary points of contact. If the question or concern remains unresolved after discussion with the servicer, the counselor can further escalate the case to a designated team at Fannie Mae. Fannie Mae representatives also have servicer ombudsmen at a more senior level with whom they work to resolve both individual complaints and "policy" or "systemic" problems. *See* Maggiano Decl., ¶ 39.

STANDARD OF REVIEW

Actions are subject to dismissal when the court lacks subject matter jurisdiction over the claims, Fed. R. Civ. P. 12(b)(1). Because jurisdiction is a threshold question, the court may look outside the pleadings in order to determine whether subject matter jurisdiction exists. *See Osborn v. United States*, 918 F.2d 724, 728-30 (8th Cir. 1990).

Claims should also be dismissed when a party fails to state a claim upon which relief can be granted, Fed. R. Civ. P. 12(b)(6). In reviewing a motion to dismiss pursuant to Rule 12(b)(6), the pleadings are construed in the light most favorable to the nonmoving party, and the district court must assume that all the facts alleged in the complaint are true. *Hamm v. Grose*, 15 F.3d 110, 112 (8th Cir. 1994).

When the court considers matters outside the pleadings in resolving a motion to dismiss, that motion is converted to a motion for summary judgment. *See BJC Health Sys. v. Columbia Cas. Co.*, 348 F.3d 685, 687-88 (8th Cir. 2003).

If there is no genuine issue as to any material fact, a party moving for summary judgment is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). On a motion for summary judgment, the Court views the evidence in the light most favorable to the nonmoving party. *Ludwig v. Anderson*, 54 F.3d 465, 470 (8th Cir. 1995). The nonmoving party may not "rest on mere allegations or denials, but must demonstrate on the record the existence of specific facts which create a genuine issue for trial." *Krenik v. County of Le Sueur*, 47 F.3d 953, 957 (8th Cir. 1995) (internal quotations and citation omitted).

ARGUMENT

I. Plaintiffs Lack Standing to Pursue Their Claims in this Court

Plaintiffs allege that the four named plaintiffs meet the basic eligibility requirements for a HAMP modification, *see* Pl. Am. Compl., ¶¶ 3, 38-42, 67, 77, 88, and that they each applied for a modification, *see* Pl. Am. Compl., ¶¶ 34-35, 65-66, 78, 91. However, plaintiffs have failed to allege that if a servicer were to undertake a net present value analysis, plaintiffs would actually be entitled to a HAMP modification. Plaintiffs' failure to plead that in the absence of the alleged unlawful conduct that they would actually receive a loan modification which would prevent the foreclosure or sale of their homes is fatal to their claims, and therefore, this court lacks subject matter jurisdiction.[8] The alleged lack of process

[8] Treasury's issuance of SD 09-08 requiring all HAMP servicers to send detailed, written notice to HAMP applicants who are denied a trial period plan or official modification with the specific reason(s) for denial has rendered plaintiffs' claims moot. Article III of the Constitution requires that courts only adjudicate actual,

does not qualify as an "injury-in-fact" that is "fairly trace[able]" to the actions of the Treasury Department which can be "redressed by a favorable decision," of this court by enjoining foreclosures and sheriff sales. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992).

"[A]t an irreducible minimum, Article III requires the party who invokes the court's authority to show that he [or she] personally has suffered some actual or threatened injury ***as a result of the putatively illegal conduct*** of the defendant." *Valley Forge Christian College v. Americans United for Separation of Church and State*, 454 U.S. 464, 472 (1982) (citation and internal quotation marks omitted) (emphasis added). While the Supreme Court "ha[s] always insisted on strict compliance with this jurisdictional standing requirement," the standing inquiry must be "especially rigorous when," as here, "reaching the merits of the dispute would force [a court] to decide whether an action taken by one of the other two branches of the Federal Government was unconstitutional." *Raines v. Byrd*, 521 U.S. 811, 819-20 (1997).

Plaintiffs have failed to plead that the current or potential future harm they have allegedly suffered or will suffer has been caused by Treasury's alleged failure to

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ongoing cases or controversies to ensure that "self-interested parties vigorously advocating opposing positions" present issues "in a concrete factual setting." *Potter v. Norwest Mortgage, Inc.*, 329 F.3d 608, 611 (8th Cir. 2003) (quoting *United States Parole Comm'n v. Geraghty*, 494 U.S. 388, 403 (1980)). When, as in this case, the issues presented "lose their life because of the passage of time or a change in circumstances … and a federal court can no longer grant effective relief, the case is considered moot," and this Court lacks subject matter jurisdiction. *Ali v. Cangemi*, 419 F.3d 722, 723-24 (8th Cir. 2005) (en banc) (internal quotation and citation omitted).

issue guidance with Plaintiffs' proposed policy changes (i.e., specific, detailed written responses and an onerous formal appeals process). Pl. Am. Compl., ¶¶ 186, 187. Indeed, Plaintiff Strohmayer has admitted that she was given the reason for her denial, Plaintiff Koppenberg has now been offered a HAMP trial modification plan, and all of the Plaintiffs now have access to the HOPE Hotline Escalation Team if they have not otherwise been given a reason. Nor do plaintiffs allege that the class of at-risk homeowners whose foreclosures they also seek to enjoin have suffered any harm at all. They have not alleged that all (or even any) of these other borrowers have responded to the notices, requested modifications, were actually eligible, and provided the necessary documentation. Nor do they show that all of the loan servicers for the State failed to provide reasons for denial for those eligible borrowers who did satisfy all their requirements. Further, requiring the Secretary to issue guidance will not preclude foreclosure for those who have not fully complied with HAMP requirements or do not qualify, who have failed to take advantage of the HOPE Hotline, or whose loans are not subject to modification due to investor refusal.

II. Plaintiffs' Constitutional Challenge Fails to State a Claim Upon which Relief Can Be Granted in this Court

A. Plaintiffs Cannot Show that They Have a Protected Property Interest in Loan Modifications

Plaintiffs allege that the HAMP program as administered unlawfully deprives them of a protected property interest in violation of the Fifth Amendment. As the Supreme Court held in *Board of Regents v. Roth*, 408 U.S. 564 (1972), to have a property interest in a benefit, a person must have more than "an abstract need or desire

… [or] unilateral expectation," but must instead have "a legitimate claim of entitlement." *Id.* at 577. The *Roth* Court explained that claims of entitlement "are defined by existing rules or understandings that stem from an independent source such as state law-rules or understandings that secure certain benefits," *id.*; however, until those benefits are secured, there can be no claim of entitlement. Here, the "rules or understandings" would include the statute, the contracts signed by private servicers and Fannie Mae, and supplemental directives issued by the Treasury Department, which were incorporated into those contracts. *See, e.g., Hill v. Group Three Housing Development Corp.*, 799 F.2d 385, 390 n. 7 (8th Cir. 1986) ("rules or understandings" in a section 8 housing program case included "the [federal] statute, the regulations, and the HUD handbook.").

Plaintiffs tellingly point to nothing in the EESA statute or the contracts that could support their claim of entitlement, nor do they identify any legal requirement in the supplemental directives that requires the government to take some action to modify their privately-serviced and privately-owned loans. Plaintiffs contend that HAMP is based on the goal of reaching a homeowner's monthly payment to 31% homeowner's monthly gross income, and mortgage loan servicers "are required to follow three basic steps for all distressed homeowners" in pursuing this targeted monthly payment. Pl. Am. Compl., ¶ 126. This assertion is beside the point; it has nothing to say about whether Plaintiffs have a protected property interest in a loan modification. Beyond describing an analytic process a participating servicer is supposed to undertake, *see, e.g.*, Pl. Am. Compl., ¶¶ 127-131, and pointing out that the process is limited to

individuals who meet certain eligibility requirements, *see, e.g.*, Pl. Am. Compl., ¶¶ 38, 67, 77, 88, 132, nowhere in Plaintiffs' Brief or their Amended Complaint do they specifically articulate an individual or class of people who are actually ***entitled*** to a specific modification on a specific mortgage, or the basis for this proffered entitlement.

What is more, Plaintiffs do not even claim they were necessarily entitled to HAMP loan modifications. *See generally Roth*, 408 U.S. at 576 ("The Fourteenth Amendment's procedural protection of property is a safeguard of the security of interests that a person has ***already*** acquired in specific benefits.") (emphasis added). They instead plead that Ms. Williams ***may*** have been entitled to a fifth modification to her loan under the HAMP criteria. With regard to Mr. Sendolo, it appears from the face of the Complaint that he could have been denied a loan modification for a range of lawful reasons. Both Ms. Strohmayer's and Ms. Koppenberg's situations are simply unclear given how few facts Plaintiffs have pled regarding their respective loans and finances.

Plaintiffs' failure to identify a textual basis for their asserted property right to a loan modification is unsurprising, because no such right exists. As explained previously, the HAMP program is completely voluntary and was created under the broad authority of sections 101 and 109 of EESA. In contrast to the earlier HUD-based Hope for Homeowners (*see* Housing and Economic Recovery Act of 2008, P.L. 110-289, §§ 1401-1404, 122 Stat. 2654, 2800-2810 (July 30, 2008)),[9] in which Congress

[9] Congress provided many more specific requirements in the Hope for Homeowners program, and HUD issued federal regulations implementing these

stipulated when and how loans must be modified, EESA has no language which requires the federal government to modify a particular type of loan or grant a particular type of modification. Congress provided only a basic framework for what the Secretary was required to do under EESA. Under this general guidance, Congress instructed the Secretary to develop servicing standards for servicers of its own loans to encourage modification of particular classes of loans, but only after consideration of "net present value to the taxpayer." 12 U.S.C. § 5219(a).

Congress also tasked the Secretary with establishing a loss mitigation process for considering what types of modifications to grant. Critically, however, Congress did not direct the Secretary to facilitate the modification of every loan. Rather, EESA requires only the Secretary to consent "where appropriate, and considering net present value to the taxpayer, to reasonable requests for loss mitigation measures." *Id.*, § 5219(c). Only by ignoring this qualifying language and plucking the single word "shall" out of context could Plaintiffs argue that the EESA grants them an entitlement to a loan modification. *Cf. Dubois v. Thomas*, 820 F.2d 943, 948-49 (8th Cir. 1987) (interpreting "shall" language in Federal Water Pollution Control Act to impose only discretionary, rather than mandatory duty).

The Treasury website belies any claim of entitlement to loan modifications: "If you can no longer afford to make your monthly payments you ***may*** qualify for a loan modification to make your monthly mortgage payments more affordable."

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qualifications for a modification. *See* 24 C.F.R. §§ 4001.01, et seq. (2009) (created in part by 73 Fed. Reg. 58420 (Oct. 6, 2008)).

(emphasis added). The website also informs homeowners that "[t]his site can help you determine if you are eligible, but only the servicer of your loan can tell you if you qualify." It adds: "to qualify you will generally need to show that you have adequate income to make the reduced payments on an ongoing basis and that modification is an appropriate option given the characteristics of your mortgage and the value of your home."[10] Modification may also be precluded if the investors holding the loan have ordered the servicer not to provide any modification. *See* Maggiano Decl., ¶ 9; Exhibits B, C at ¶ 2B.

The Treasury Department guidance regarding the contours of the HAMP program similarly undercuts Plaintiffs' asserted right to loan modifications. Like EESA itself, this guidance recognizes that servicers are only obligated to modify loans in certain circumstances and payment from Fannie Mae only occurs after borrowers have completed a trial period modification. For loans deemed either in default or at risk of imminent default under HAMP guidelines, the servicer must determine whether the net present value (NPV) of the modified loan exceeds the value of the unmodified loan (i.e., the value of the property if either the borrower "self-cures" or the property is foreclosed and sold). *See* Pl. Exh. E at 4-5; Exhibit 4 at 1. This is not as straightforward as it seems in part because there are administrative costs associated with modification and penalties owed to investors, not to mention the possibility that the borrower may nevertheless default on the

[10] *See* www.makinghomeaffordable.gov/modification_eligibility.html.

loan, even if it is modified. *See generally* Maggiano Decl., ¶¶ 23, 24; COP Report at 55-56.

The Secretary has acknowledged that there is no single, across-the-board best way to value loans. Rather than tether servicers to a particular NPV framework, the Secretary has ceded to servicers the authority to choose the NPV model (within certain parameters) that, in the servicer's judgment, best encapsulates the economic reality a particular mortgage owner faces. The Guidance issued by Treasury on June 11, 2009 acknowledges that because of customized NPV models, servicer modifications would "likely vary even when borrowers' circumstances appear to be similar" but the result will still be more "accurate" and a better "gauge of appropriate modifications" due to customized models. Pl. Exh. E at 3; Exhibit D at 3.

Plaintiffs' reliance on the Farmer's Home Administration (FmHA) cases undercut their claim to a constitutionally-protected interest in a HAMP loan modification. In *Gamradt v. Block*, this Court expressly rejected the argument that FmHA farm loan recipients had a protected property interest to which constitutional due process would apply. 581 F. Supp. 122, 132 (D. Minn. 1983). In *Shick v. Farmers Home Administration*, 748 F.2d 35 (1st Cir. 1984), the court similarly rejected plaintiffs' Fifth Amendment Due Process claim, holding that their constitutional allegations "are no more than conclusory claims that their constitutional rights had been violated by the FmHA." *Id.* at 39. And in *Allison v. Block*, the Eighth Circuit declined to reach the issue of whether the plaintiffs there were entitled to due process under the Fifth

Amendment, ruling instead on alternative statutory grounds. 723 F.2d 631, 633 n.1 (8th Cir. 1983).

Ultimately, Treasury's Supplemental Directives provide discretion to participating servicers who service non-GSE loans, and more importantly, they in no way mandate that the federal government provide some non-discretionary entitlement to plaintiffs. The Eighth Circuit has repeatedly stated that if there is discretion afforded to the government in granting some benefit, or a government policy is for the most part procedural, then no property right attaches. *See Hill*, 799 F.2d at 391-93 (concluding that the "class of otherwise eligible applicants" was not of "an unmistakably mandatory character," but were instead left to the property owner's "business judgment and discretion," thus preventing applicants from making a "legitimate claim of entitlement"); *Dunham v. Wadley*, 195 F.3d 1007, 1009 (8th Cir. 1999) ("[s]tatutes or policies that are only procedural, or that grant to a decision maker discretionary authority in their implementation … do not create protected property interests."); *Carolan v. City of Kansas City, Missouri*, 813 F.2d 178, 181 (8th Cir. 1987) (no protected property interest in building permit unless municipality lacks discretion and state law requires the issuance of a permit to applicant). Accordingly, neither EESA nor the servicer agreements nor the pertinent Treasury directives support Plaintiffs' assertion that they are entitled to a loan modification, and plaintiffs have failed to state a Due Process claim.

B. Plaintiffs Have Not Shown That The Initiation of Pre-Foreclosure Proceedings by Private Servicers and/or Sheriff Sales Are a Result of Action Taken by the Federal Government

It is axiomatic that the Fifth Amendment Due Process Clause applies only to the federal government and not to private parties. *See, e.g., Public Utilities Commission v. Pollak*, 343 U.S. 451, 461 (1952).[11] Plaintiffs allege that they were not given the requisite notice of the basis for their denials or an opportunity to appeal these denials in violation of the Fifth Amendment. But because "private action, no matter how egregious, can not violate the equal protection or due process guarantees of the United States Constitution," *Medical Institute of Minnesota v. National Ass'n of Trade and Technical Schools*, 817 F.2d 1310, 1312 (8th Cir. 1987), Plaintiffs must show that the harm they seek to remedy is attributable to Treasury, a burden which they have failed to meet in this case.

Plaintiffs are required to demonstrate a "sufficiently close nexus between the [Government] and the challenged action of the entity so that that the action of the latter 'may be fairly treated as that of the [Government] itself.'" *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982) (quoting *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 350-51 (1974)).[12] In this respect, the "mere fact that a business is subject to [governmental] regulation does not by itself convert its action into that

[11] The standard for finding federal government action under the Fifth Amendment is the same as that for finding state action under the Fourteenth Amendment. *Warren v. Government Nat. Mortg. Ass'n.*, 611 F.2d 1229, 1232 (8th Cir. 1980).

[12] *See also Gomez v. North Dakota Rural Dev. Corp.*, 704 F.2d 1056, 1058 (8th Cir. 1983) (holding that "extensive government regulation does not compel a finding of federal action.") (citing *Blum*, 457 U.S. at 1004).

of the [Government for Due Process purposes]." *Am. Manuf. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999) (quoting *Jackson*, 419 U.S. at 350). Rather, Due Process strictures apply to the conduct of private parties "only when it can be said that the [Government] is *responsible* for the specific conduct of which the Plaintiff complains." *Blum*, 457 U.S. at 1004 (emphasis in original). Government responsibility for a private decision, the Supreme Court has made clear, requires more than "[m]ere approval of or acquiescence in the initiatives of a private party." *Id.* To the contrary, the Government can be held responsible for a private decision "only when it has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the [Government]." *Id.*

Plaintiffs focus on the connection between contracts signed by private loan servicers with Fannie Mae and Treasury's Supplemental Directives, which are incorporated into these contracts, and emphasize that the Treasury-issued guidance spells out the requirements of the HAMP program. *See* Pl. Am. Compl. ¶¶ 123, 126. However, as explained below, the existence of government contracts and/or government guidelines to promote broader policy goals is altogether unremarkable and does not definitively show that "government action" has taken place for purposes of the Fifth Amendment. Plaintiffs have failed to plead that the government has "exercised coercive power" or "provided such significant encouragement" such that the alleged misconduct by the servicer can "be deemed

to be that of the State." *Am. Manuf.*, 526 U.S. at 52 (citing *Blum*, 457 U.S. at 1004-05).[13]

Regardless of whether or not Fannie Mae, as Treasury's financial agent, or Freddie Mac, as Treasury's compliance agent, may have potential contractual remedies against the private servicers based on purported violations of the servicer agreements, the government is not taking action resulting in the alleged injury in this case. The private servicers' decisions to foreclose on borrowers who have defaulted on their loans through power of sale agreements are "not in and of themselves powers of a governmental nature." *Warren v. Gov't Nat'l Mortgage Ass'n*, 611 F.2d 1229, 1234 (8th Cir. 1980). The U.S. Department of the Treasury plays an indirect role, at best, having contracted with Fannie Mae as a financial agent, who has, in turn, contracted with private servicers and required the servicers, by the terms of the contract, to follow the Supplemental Directives. Not finding government action in this case is in keeping with the idea that foreclosures of even government-owned properties are not necessarily subject to heightened scrutiny due to action taken by the "government." *See Warren*, 611 F.2d at 1234 (affirming district court decision that plaintiff had no Fifth Amendment due process right to notice and hearing prior to her foreclosure sale despite the fact that

[13] Plaintiffs also refer to Congress' decision to place Fannie Mae and Freddie Mac under FHFA's conservatorship as somehow abrogating their respective status as non-governmental entities. This argument misapprehends FHFA's stewardship role over Fannie and Freddie (which is akin to the FDIC's temporary conservatorship of failed banks). FHFA, Fannie Mae, and Freddie Mac are in the best position to explain why they are not state actors. *See* Fannie/Freddie Memo at 23-26; FHFA Memo at 16-18.

her note was owned by the Government National Mortgage Association, which at the time of the suit, was a corporate entity wholly-owned by the federal government and under the management and control of the Secretary of HUD).

But even assuming *arguendo* that Fannie Mae and Freddie Mac are government actors for purposes of HAMP administration, what Plaintiffs fail to explain is why the putative harm (e.g., the alleged denial of due process with respect to loan modification denials) is attributable to Fannie Mae or Freddie Mac. *See Wickersham v. City of Columbia*, 481 F.3d 591, 597 (8th Cir. 2007) (government action requires a "'close nexus' not merely between the state and the private party, but between the state and the alleged deprivation itself"). It is not enough to say that Government actors "dictate the terms of the relationship." The Servicer Participation Agreement was never intended to supplant loan servicers' business practices; it makes clear that loan servicers do not have to modify any loan if doing so would contravene its business practices, or would otherwise be financially imprudent. *See supra* at 6-8. In any case, SD 09-01 makes clear that "[s]ervicers must also have procedures and systems in place to be able to respond to inquiries and complaints about the HAMP [and] should ensure that such inquiries and complaints are provided fair consideration, and timely and appropriate responses and resolution." Pl. Exh. E at 13. In short, to the extent the ***government*** has mandated anything, it has mandated that servicers have greater, rather than fewer, procedural protections.

In addition, both the Supreme Court and the Eighth Circuit have rejected the argument that receipt of public funds necessarily transforms private action into government action. *See Blum*, 457 U.S. at 1010-1011; *Rendell-Baker v. Kohn*, 457 U.S. 830, 840-41 (1982); *Gomez*, 704 F.2d at 1058 (all holding that receipt of public funding does not make a program's administrative decisions acts of the state). In *Rendell-Baker*, for instance, discharged teachers argued that the manner in which they were dismissed unlawfully deprived them of due process. In support of their claim that their former employer, a school, was a state actor, the teachers noted that the school received virtually all of its funds from the state of Massachusetts. The Supreme Court rejected this argument, holding that that the school's receipt of public funds "does not make the discharge decisions acts of the State." *Rendell-Baker*, 457 U.S. at 840. Analogizing the school to "private corporations whose business depends primarily on contracts to build roads, bridges, dams, ships, or submarines for the government," the Supreme Court reasoned that such private contractors "do not become acts of the government by reason of their significant or even total engagement in performing public contracts." *Id.* at 840-41. So too here. Unlike the school in *Rendell-Baker* deemed not to be a state actor, the loan servicers here presumably receive only a small fraction of their total revenue from their participation in the HAMP program.

As the Eighth Circuit has insisted, "the one unyielding requirement is that there must be a 'close nexus' not just between the state and the private party, but

between the state and the alleged deprivation itself." *Wickersham*, 481 F.3d at 597; also *cf. Rendell-Baker*, 457 U.S. at 840-41 (private contractors' actions "do not become acts of the government by reason of their significant or even total engagement in performing public contracts"). A contrary result would effectively constitutionalize all of government contract law. For all of these reasons, Plaintiffs have failed to demonstrate the requisite nexus between the Secretary and private loan servicers' alleged denial of procedural protections needed to trigger Fifth Amendment protections, and therefore have failed to state a Due Process claim.

III. Treasury's Current Process is Constitutionally Sufficient

Plaintiffs claim that, to the extent that they are denied a loan modification, due process requires not only that they receive notice of the basis for the denial, as well as an opportunity for recourse, but a level of specificity and other protections far beyond that which is constitutionally required. Even assuming *arguendo* that Plaintiffs are correct in their assertion that some process is in fact due, the process currently in place is constitutionally sufficient, and whether the Court chooses to examine the pleadings alone, or the supporting exhibits as well, this Court should dismiss this case and/or grant judgment in favor of Treasury as a matter of law.

Both the Supreme Court and the Eighth Circuit have instructed that "due process is a flexible concept which requires procedural protections suited to the particular situation." *Collins v. Hoke*, 705 F.2d 959, 963 (8th Cir. 1983) (citing *Mathews v. Eldridge*, 424 U.S. 319, 334 (1976)); *Stanley v. Illinois*, 405 U.S. 645,

650-651 (1972) ("very nature of due process negates any concept of inflexible procedures universally applicable to every imaginable situation"). Under these precedents, "the specific dictates of due process generally require[] consideration of three distinct factors: First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail." *Daniels v. Woodbury County, Iowa*, 742 F.2d 1128, 1133 (8th Cir. 1984) (quoting *Mathews*, 424 U.S. at 335).

This balancing analysis, applied here, leaves no doubt that the procedures the Secretary has established regarding the administration of the HAMP loan modification program exceed the constitutional minimum[14] – specifically, Supplemental Directives 09-01, 09-07, and 09-08 require that borrowers be given

[14] With the possible exception of Ms. Koppenberg who has been offered a trial period plan, no Plaintiff has actually received a loan modification; none has ever received the benefits to which each claims he or she is entitled. This distinction is significant for due process purposes, as the Supreme Court has "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 of the Fifth or Fourteenth Amendment." *Lyng v. Payne*, 476 U.S. 926, 942 (1986). Although the Supreme Court has never squarely addressed the issue of whether applicants for government benefits come within the ambit of the Due Process Clause, the Supreme Court's reticence to agree that applicants are due *any* process certainly suggests that even if *some* process is due, the process which the Secretary has already established far exceed whatever threshold the Constitution might require under such circumstances.

explanations when they are denied HAMP modifications, and SD 09-08 requires that servicers provide borrowers with written notice detailing the reason(s) why they were denied a HAMP modification. The HOPE hotline provides a process by which adverse decisions can be explained, informally "appealed," and wrong decisions can be undone.

First, from the moment that HAMP was launched, SD 09-01 made clear that servicers had to have "procedures and systems in place to be able to respond to inquiries and complaints about the HAMP" program and issue denial letters to any borrower whom the servicer deemed ineligible for a HAMP loan modification, and determine whether other loan modification alternatives might be feasible. Exhibit D at 13, 18. Within thirty days of receiving a borrower's application and supporting documentation, servicers have also been required to notify the borrower if he or she has failed to qualify for trial period modification. Exhibit 7 at 7. Treasury has repeatedly stressed that servicers should provide greater transparency regarding why applicants for HAMP modifications were being denied. *See* Exhibit I at 6 (Barr Testimony); Exhibit 5 at 1-2 (SD 09-06).

Treasury issued additional guidelines on November 3, 2009 related to the format, content, and timing of written notices that must be provided to borrowers who were evaluated for HAMP but not approved for a modification. *See* Exhibit 9 at 1. Treasury has stated that servicers "must provide the primary reason or reasons for the non-approval." *Id.* at 2. Exhibit A of SD 09-08 provides "model clauses for borrower notices" detailing over twelve different reasons why

borrowers might be denied. *Id.* at A-1-4. The model clauses illustrate a level of specificity that is deemed to be in compliance with language requirements of the program. *Id.* at A-1. In addition, if a borrower is denied because the so-called NPV is negative, the borrower notice must include an explanation of the NPV and a list of the input fields, allowing the borrower an opportunity to correct values that may impact the analysis of the borrower's eligibility. *Id.* at 2-3, A-2. The required notice also refers borrowers to the HOPE hotline which provides an avenue for borrowers to complain about improper denials and receive a further explanation for their denial. *Id.* at 4.

Second, Plaintiffs' broad allegations about the lack of appeals and inability to undo a wrongful denial, *see* Pl. Am. Compl. ¶¶ 146-152, are conclusory statements with no basis in law or fact. Borrowers are able to challenge an adverse decision by calling the HOPE hotline and can seek to undo a wrongful disclosure through actions taken by HOPE hotline housing counselors. Treasury and HUD have publicly endorsed a nationwide foreclosure hotline operated by the nonprofit Homeownership Preservation Foundation ("HPF"). The Secretary's purpose in establishing this hotline was to allow borrowers to receive direct information and assistance in applying for the HAMP program, and to escalate concerns if borrowers believe their application was denied improperly. *See generally* Maggiano Decl., ¶¶ 37, 38. Since the HAMP-specific hotline became operational on July 10, 2009 (which was prior to the filing of Plaintiffs' Complaint), borrowers who have questions about MHA and HAMP generally, or

who have concerns or complaints regarding how a particular servicer handled their individual case, have been able to call the hotline and receive help. If the borrowers' question or concern remains unresolved after discussion with the servicer, the counselor can further escalate the case to a designated team at Fannie Mae. Fannie Mae representatives also have servicer ombudsmen at a more senior level who they work with to resolve both individual complaints and "policy" or "systemic" problems. *See generally* Maggiano Decl., ¶ 39.

Treasury also directed Freddie Mac to play a prominent role as compliance agent in trying to ensure that borrower applications are not overlooked and/or that applicants are inadvertently denied a modification. In this "second look" process, which began on August 3, 2009, Freddie Mac audits a sample of MHA modification applications that have been declined. *See* Maggiano Decl., ¶ 31. In certain cases, this auditing process has convinced servicers to re-evaluate HAMP applications and grant trial modifications which were previously denied. *Id.*, ¶ 32.

In view of all of these various safeguards that have already been implemented, Plaintiffs' argument that the Secretary has somehow failed to provide HAMP loan modification applicants with constitutionally adequate process is unfounded.

In this respect, the Eighth Circuit's opinion in *Woodsmall v. Lyng* is instructive. 816 F.2d 1241 (8th Cir. 1987). The plaintiffs in *Woodsmall* alleged that FmHA's failure to promulgate adequate standards for evaluating loan creditworthiness ran afoul of the Constitution. The Court assumed without deciding that the Woodsmalls

had a protected property interest in the establishment of creditworthiness standards, but noted that this property interest was not "as vital as is the interest of an eligible welfare claimant in receiving benefits." *Id.* at 1247. Contrasting housing loans with welfare entitlement programs, the *Woodsmall* Court conceded that "[t]he rural housing loan program addresses a basic need, but it is not the subsistence level need involved in welfare benefit programs." *Id.*

The Eighth Circuit noted in *Woodsmall* that "the Secretary ha[d] promulgated regulations that should address some of the concerns of borrowers whose creditworthiness places their loan applications in jeopardy." *Id.* at 1247-48. "Requiring more standards, the Court held, "would result in undue administrative burdens" and was therefore unwarranted under *Matthews* balancing analysis. *Id.* at 1248. Plaintiffs' claim for additional procedural safeguards in this case is even weaker than in *Woodsmall*, in view of the much greater procedural protections that the Secretary has already implemented to ensure that borrowers who are denied loan modifications are given reasons for denial as well as an opportunity to seek recourse. Accordingly, even if Plaintiffs' have a valid Fifth Amendment entitlement to due process, the procedures the Secretary has implemented satisfy the constitutional requirements.

CONCLUSION

For the reasons set forth above, Defendants respectfully requests that this Court dismiss both counts of this complaint for lack of subject matter jurisdiction

and/or for failure to state a claim upon which relief may be granted. Alternatively, the Court should grant summary judgment in favor of the Secretary and Treasury.

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