Nader, Epstein on Fannie Mae, Freddie Mac [TRANSCRIPT]

By Todd Sullivan
October 14, 2014

Full transcript:

Operator: Good day and welcome to today's Investors Unite Teleconference hosted by Investors Unite Executive Director Tim Pagliara with special guest Mr. Ralph Nader and featuring New York University Law Professor Dr. Richard Epstein. On today's call, Mr. Pagliara and Professor Epstein will provide an overview and analysis of current litigation challenging the Department of Treasury Conservatorship of Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC). I will now turn the conference over to Mr. Pagliara. Please go ahead.

Tim Pagliara: Well, good morning everyone. Thank you for joining us today. We have two distinguished guests. First we have nationally known consumer advocate, author and presidential candidate Ralph Nader. Second, joining us is New York University law professor Richard Epstein. Professor Epstein is a very influential legal scholar and a Laurence A. Tisch professor of law at New York University School of Law. He's also an adjunct scholar at the Cato Institute, the Peter and Kirsten Bedford Senior Fellow at Stanford University's Hoover Institution, the James Parker Hall Distinguished Service Professor Emeritus of Law and a Senior Lecturer at the University of Chicago Law School and a policy advisor for The Heartland Institute. He also serves as a consultant to several institutional investors that are concerned with Judge Lamberth's recent decision. A constitutional law expert, Professor Epstein's most recent publication is The Classical Liberal Constitution: The Uncertain Quest for Limited Government. So we're going to have a great program for you this morning and an opportunity for you to ask questions after both of our guests speak, but before I turn the program over to them, I want to give you two brief updates.

First, today we posted a clip of former Federal Housing Finance Administrator Ed DeMarco's speech at a recent Washington, D.C. forum. We posted it to the website and here's what it says and the DeMarco clip goes like this. "During my tenure, I believe that the Federal Housing Finance Agency had a responsibility not just to operate the conservatorships according to the law, but to be attentive to the direction the administration and lawmakers were going." Now, let

me read you what HERA says about DeMarco's role in the Federal Housing Finance Administration. "Federal Housing Finance powers as conservator as outlined in HERA is to take such action as may be, one, necessary to put the regulated entity in a sound and sovereign condition, and two, action that is appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." So our point for putting this up on the website is that here we have an unelected bureaucrat like DeMarco deciding what he thought HERA meant and admitting that he thought he could expand upon the law himself based upon conversations he had with members of Congress. The fact is that if Congress wants to change the law, it can do so, but it's not okay for DeMarco to make laws on his own and with select members of Congress. This is outrageous. It ought to be outrageous to Congress; it ought to be outrageous to the American people, and this is exactly what the litigation is about – the Federal Housing Finance Administration violating its duties as a conservatorship, the unconstitutional taking of shareholder property with no compensation. So you can find this clip of DeMarco on our website, www.InvestorsUnite.org and the accompanying information.

The second point and update that I want to give you today is that yesterday there was a column in The Wall Street Journal defending the administration committing the largest unconstitutional taking in the history of this country. So putting aside the obvious bias against Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) and shareholder rights that The Wall Street Journal has shown throughout this whole process, I'd like to set those records straight about something that John Carney said that was completely inaccurate. He said that the third amendment sweep was required because Fannie Mac and Freddie Mac were insolvent and needed another bailout. The government had to turn over documents, part of this administrative record, in some of the litigation so far and none of those documents show anything to support their claim. In fact, there were no projections or financial analyses whatsoever showing Fannie Mae and Freddie Mac needed more money or that the conservatorship financing from the treasury would be exhausted. This is probably because the government knew they were already profitable in 2012 and would be for the foreseeable future, and I'll remind you, these are still publicly-traded entities. They still have to file quarterly and annual statements with the Securities and Exchange Commission, and it was less than three months after the implementation of the third amendment sweep that they delayed their filing with the Securities and Exchange Commission, and in the filing when they finally made it in April of 2013, they made the statement publicly on the record, under oath, that they were profitable and they would be profitable for the foreseeable future.

So what Carney said was that there was absolutely nothing to support what he put in his column on the record. The only justification for the sweep is that it was self-serving, it's unsupported, it's an after-the-fact declaration by the Treasury and the Federal Housing Finance Administration in 2013 a year after the sweep began and the government had already been sued to undo the sweep as improper. The story never existed before the litigation. In fact, the government's own documents tell a very different story from the one they're putting out now. We know that the government first considered taking all of the Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) profits in 2010 when they discussed their policy not to let private shareholders share in future earnings. The New York Times put this memo on their website when Gretchen Morgenson reported on it. Blackstone told the Treasury Department in 2011 that Fannie Mae and

Freddie Mac would be profitable and that they would have to deal with the private shareholders. It was only after we saw two quarters of profits in 2012 that the government moved to seize those profits immediately before the enterprises started making enough money to repay the government in full. Now the profits are being taken without any knowledge or any acknowledgement that the Treasury is paid back, and keep this riddle in your head: who borrows $189.5 billion dollars at 10% interest and pays it back in an average of three and a half years? Answer: somebody that didn't need it in the first place.

So at this point, I'd like to turn the call over to our two guests. Each of them will speak for a few minutes on how they see the state of play given last week's decision by Judge Lamberth and then we'll open it up for questions. So now I want to turn it over to you, Mr. Nader, and you have the floor, sir.

Ralph Nader: Thank you very much. I'm going to make the equitable argument which often nourishes legal change whether it's in the courts or in Congress. This issue is not going to go away with one district court decision by any means. We've been involved in investor rights activity since the 1960s as advocates, not as investors, but in this situation, I'm both an advocate in the old style as well as a shareholder, and my shares in Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) were invested before the conservatorship. So that's my perspective and it's a very simple set of events that occurred. Before the conservatorship in the spring and summer of 2008, Mr. Lockhart, the head of OFHEO, followed a few weeks later by Chairman Bernanke and Treasury Secretary Paulson, reassured Fannie Mae and Freddie Mac investors – and this is rightly reported – that the two companies were adequately capitalized, inferring of course that there's nothing to worry about. Within a few weeks, the conservatorship was initiated and the shares plummeted to pennies. This was deception of the first order. If any corporate executives engaged in this, even the slumbering SEC would've moved to action, so there is an accountability issue there in terms of the shareholders.

The second event was the unilateral announcement by OFHEO and DeMarco that they were going to delist the shares for the New York Stock Exchange. The Stock Exchange hadn't indicated any desire. The shares really weren't below the figure when the danger signals occurred. I think Freddie may have dropped below a dollar, but there was no indication that a demand for delisting was coming. The delisting immediately cost shareholders hundreds and hundreds of millions of dollars because the stock value plummeted after that, and when DeMarco delisted without really any explanation, when he was finally asked, it was to head off legal costs for an eventual delisting, a rather weak argument to be sure, but this is an example of the unbridled discretion that the government thinks it has just because it has carved out something called the conservatorship instead of the bankruptcy.

The third event that was important was the use and abuse of the Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) shareholders. For example, when the government bailed out Citigroup Inc (NYSE:C) and American International Group Inc (NYSE:AIG), they did not vaporize the shareholders. They bailed them out and they gave the remaining shareholders an opportunity to recover. Nobody's asking for Fannie Mae and Freddie Mac shareholders to be subsidized, just to

allow them to exist in whatever future transformation, whether it's a public utility model or what. Just ask them to exist so they have a chance to recover some of their losses or to benefit from the value, but the government using and abusing the shareholders, by that I mean they needed the shareholders in Fannie Mae and Freddie Mac to get under the 80% barrier, which you all know if they got above the 80%, they would have to assume the huge liabilities of Fannie Mae and Freddie Mac which would increase the federal deficit. The federal deficit issue looms behind a lot of this. Now, the government really is viewing Fannie Mae and Freddie Mac as a cash cow to keep the deficit lower than it ordinarily would be. So here they used the shareholders. The shareholders are necessary to keep the government's share under 80%, but they're constantly threatened with being vaporized or stripped of all value completely.

So under equitable law or equitable theory, there's a responsibility there. You cannot simply use the shareholders and then vaporize them later after you've bled the companies of all various profits and returns to the Treasury to pay off the taxpayer which some people think has already been done, some people think is a little questionable, but certainly if it hasn't been done, it's on the way. The comparison with Citigroup, AIG and other New York firms that were clearly bailed out directly and indirectly with Citigroup shareholders and AIG shareholders now beginning to recover is another factor in making an equitable argument for allowing the shareholders of Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) to survive. That's generally the argument. For anybody who's predicting that this is the end of the matter, that Lamberth has made a decision in a cul-de-sac, I think it's not the full concentric circle that you'll hear from Professor Epstein and the other federal judge who admires Lamberth is going to go his way. I think that's a very shortsighted view. This is not going to go away. This is a horrible precedent, by the way, for any future Treasury Department action, any future problem of trying to deal with an economic collapse that started with the financial shenanigans of Wall Street. We'll leave it at that.

Tim Pagliara: Well, that's terrific. Thank you, Mr. Nader. Dr. Epstein, you had a really great piece in Forbes last week. What I'd like to do, if you would, please expand upon that article and how you see the legal landscape shaping up in light of last week's ruling and some of these other developments.

Richard Epstein: Sure, I'm happy to do so. Look, this is, as Ralph said, going to be a very long and complicated saga. Right now there are many other lawsuits involved. There is the one before the Court of Federal Claims before Judge Margaret Sweeney. There is a lawsuit in Iowa and lord knows, there're probably another 10 and 20, so it's not as though a single district court opinion is necessarily going to set the sights, although it certainly has had much more influence I think by virtue of being first than its merits would otherwise justify, but I do think it's important to go back and try to understand the statutory framework with which these particular decisions have been made as well as the particular run-up to the particular case, to this case, and some of the litigation. The first thing to note is in fact that there's a very complicated statutory system with respect to the bailout and the two separate sets of duties. One set of duty falls upon Ed DeMarco and now Mel Watt with respect to FHFA and then there's a second set of duties and rights that fall to the Treasury Department and the way in which these two things start to interact I think is a subject of real importance.

The first thing to understand is that what happens is on the bailout side from Treasury, what the basic statute provides is that the Treasury Department has the power in order to benefit the taxpayers – that's what it says – to enter into transactions with any corporation that is in need of some kind of a bailout. The second provision right after that announces that it can't force themselves down on these corporations; they have to get an agreement and they don't talk about whether or not economic duress or some such thing might be involved. I quite agree with Ralph in the AIG case which I regard as very weak by AIG. What happened is they were in a very bad situation, Treasury gave them a very tough deal, they had their own board and they accepted the deal and it turns out they probably would've gone under unlike Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) because they were on the hook for a whole variety of obligations with respect to these derivative contracts which would've come immediately payable. They have given collateral out to Goldman Sachs and to several other companies and so it wasn't a question as it is with respect to Fannie Mae as to whether or not you can liquidate in time the mortgages or other assets that you have in order to meet any current liabilities. I think they were probably a cooked goose under these circumstances because the financial underlying situation there was so different from the one that we have here.

So anyhow, this government has this power and then it starts to tell you the things that it has to take into account. Many of these things have to do with the time of the payback, it hast to do with the nature of the securities given, but it also has to do with the obligations which is to make sure that when these bailouts are finished, the companies can be returned in an orderly fashion to the private market. So essentially what the bailout is designed to do is to make sure that these things get back on their feet. The bailout is not, from the government's point of view, to try to liquidate these things, and so they have this particular power. Now, normally what would happen is they would negotiate with the private directors of the corporation, but Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC), unlike AIG, is a chameleon. It's a government-sponsored enterprise and the more you hear about that term, the more you realize that the status is the source of endless confusion. So if you then look at the case, what they did is they essentially made it very clear that they were going to take over this organization in 2008 and the deal comes through and you look at that particular bailout, you may like it or you may not like it, there're some difficulties with it, but at least with respect to the current litigation on the third amendment, the basic assumption is that this particular arrangement was perfectly okay, that what happened is that the government took a 10% preferred which became then senior preferred, the old preferred became a new junior preferred that was still common and then the government took the right to acquire 79.9% of the common shares at about $0.00001 cent per share which is not a lot of money at all, to put it mildly.

So this thing goes through for about four years. The original bailout takes place in early September and then on August 17, what we do is we have this thing re-jiggered by the third amendment. I want to stress there is no thing remotely comparable to a third amendment with respect to the situation with AIG and it's also the case that the AIG had its own board all the way through and when the option came up to join with Starr International in the suit against the Federal Reserve Board of New York, it declined to do so which I think was in fact the right decision. So what the third amendment does is it starts to change everything, but instead of having an amendment which is negotiated by a board of trustees or a director whose sole duty of

loyalty is, at it is under corporate law, to the Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) shareholders, what happens is Ed DeMarco and afterwards Mel Watt both announce that they're representing the shareholders.

But they're not representing the shareholders. They're conservators. Their job is to maintain these particular assets and they're supposed to bargain in a fashion which is adverse to that of the Treasury Department in an [Unintelligible] arrangement, but DeMarco is himself a former Treasury Department employee and what he does in effect with this thing is to sign away the entire company. What happens is this third amendment comes out late afternoon on a Friday, there's no evidence whatsoever of any financial work that has been done, any due diligence, any study by anybody telling this thing and it becomes inconceivable that whatever the position is of Fannie Mae and Freddie Mac, whether it's profitable or not profitable, it cannot be in the interest of the shareholders to say "We're giving you everything that we own in exchange for nothing in return." John Carney spins this term which says "Look, it's really terrible because the government was in this dangerous cycle. If they didn't get the 10% in cash, then you could defer the dividend and make it up to 12% and it turns out therefore you could dig a deeper and deeper hole," but he forgets to mention – because he's going to get the economics right – every time you decide to defer a payment, this is actually going to be an implicit cost with respect to the junior preferred and to the common stock because they're going to have to pay back more money on the principal loan before they could get anything, so it's not really in their interest to want to do this indefinitely because if it happens indefinitely, they're going to be out of money.

So what you should try to do is to figure out whether or not there's any particular problem in this particular case which warrants you to move. At this point, I mean the salient facts that matter the most are that Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) took its last draw in late 2011. Freddie took it in 2011, Fannie Mae took it in early 2012, so you have about a six-month period in which there are no further draws which makes it odd to say that there's a debt spiral and then within the next year it becomes perfectly clear that $100 billion in excess money is paid over to the Treasury which suggests that the financial situation did not change on August 18; it was probably that way before this was done, and as Ralph said, if you don't publish your financials on time, it means that you're trying to conceal something rather than to reveal something. So the government I think has to be put to the proof as to whether or not anything that it says is remotely true on the facts and I think it's not, but even if this thing were in serious trouble, that is a problem on the Treasury side; it's not a trouble on Fannie Mae and Freddie Mac's side. What those conservators have to do is to bargain hard to get whatever they can for the shareholders and then work out some modification that makes sense, but there's no evidence that any modification turns out to be needed.

So what you do here is you have somebody who is in a very strong position, they have the cash to pay off the 10% interest which is about $18 billion a year and they wanted to, they had a deferral option which Judge Lamberth in an incomprehensible way says it's a penalty when in fact if you look at the full [Unintelligible] which he doesn't bother to quote, it ends with the observation that in the event that we defer payments, the dividend rate shall mean 12%. That doesn't sound like a penalty; it sounds like a definition of provision which is exactly what it is.

You want to put a penalty in there, you make them pay the money that they owe like you do on a standard mortgage, and then on top of that, you add a penalty of additional cash. A deferment option at no cost except the 2% interest isn't a penalty; it's an option.

So given all of this situation, what does he do? Well, what he does in effect is what the government urges him to do in its brief, and I have to say, I thought the government brief was particularly poor in terms of its candor and its sense. The basic proposition that it wants to make are two: the first one has to do with the way in which you conceptualize this case and the government basically says there's no case for anybody to bring because if you look at the basic HERA statute, what it says is that the conservator succeeds to all the rights not only of the board of directors themselves, but also the shareholders, and "Since we have all the rights of the shareholders," they say, "nobody could possibly sue us." Well, I mean if in fact it really was meant to be the case that you had all the rights of the shareholders, then the statute would be clearly unconstitutional because what you've done is you've taken all the value of the shares and the only question would be what the valuation was. It cannot be that when you strip assets from a private corporation, that you are immune from all sorts of liabilities with respect to the takings clause. If you can do that, the government could announce any corporation in fact has to surrender its assets by passing a statute which makes it the conservator of General Motors or Apple or any other company on the face of the globe. So it can't mean that and the correct way to read this particular statute as other courts have done is to say, "Look, when it comes to pursuing claims against third parties, we want the conservator to have a lot of pop." You can then bring all this stuff back into the company and then we can decide what to do in accordance with the senior preferred stockholder agreement which was entered into in 2008.

So what you do is you say, "Well, there's no conflict of interest. You have all those rights, but if there is a serious conflict of interest, then the shareholders are in a position to protest what you've done and you have to account for them." You can call this either a breach of fiduciary duty or a takings claim, but in either case what happens is given the manifest of dealing between two branches of the federal government with each other, all the monies that they call a dividend have to be re-characterized. You first get the 10% and there're now lots of money to pay that off, and then in effect, the rest of them should be treated as a return of capital so that the underlying debt goes down. We don't want to say and it would be wrong to say that since they paid over now about $150 billion on this thing, that the government has taken $150 billion. No, they've paid back the debt and whatever the shares turn out to be worth, that's what they're worth after you pay off the rest of the debt and put the company back to the private market in accordance with the original bailout plan.

So what the judge does is essentially he doesn't even let them speak in court because of this exaggerated reading of the statute. He then has to face the takings claim and basically what he says there is incomprehensible unless you know something about the mysteries of the law, at which point it just becomes wrong. What he says in effect is that there is no cognizable interest in this particular case which is meriting protection. The question you want to ask is what do we mean by a cognizable interest? Cognizable means something which is known or observed, and the term has a perfectly sensible meaning at common law which bears no relationship to the situation here. So typically what happens is there are large numbers of cases in the world where somebody does something that somebody else doesn't like and he is, in some broad sense of the

word, harmed by it, and yet we realize that to take notice of that particular interest in the court, i.e., to call it cognizable, will shut down the entire universe.

So to give you an illustration, if I built a house on my land which blocks you a view, it's not a cognizable interest because otherwise nobody would ever be able to develop real estate at any time. If I go into business and competition with you and take away your customers by offering them better prices and better products, your losses are not cognizable because otherwise, essentially any incumbent firm would have a monopoly position over its customers. So you say that something is not a cognizable interest when to protect it would lead to very socially destructive results where the norm that one tends to judge this against is whether or not you're trying to advance or retard a competitive market, the theory being that competition is in fact the optimal way to allocate various kind of resources. Well, that's what one means by it. Now, what happens in this particular case is the government does the following game. It says that "We've got control over this entity because we now are running Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) through FHFA. We've now run this sweep, so what we've done is we've taken away all the dividends and we've taken away all the liquidation preferences." Well, there's nothing else that a corporation has other than these three kinds of interest, but it says "You know what? We haven't taken anything because we've left you with titles to the shares."

Well, if that were all that it would take, then the government could do this with respect to anything, and there's a very instructive case that you all ought to read from very early on called Pumpelly against The Green Bay Company in which what the United States government does is it floods somebody's land permanently and then it says it doesn't owe any compensation for the destruction because it didn't bother to take the title. What the court says quite rightly is not taking title is a terrible way to allow for massive evasions of constitutional responsibility because when the government takes anything, it could always announce it leaves the title in the private owner and then takes all the beneficial interest for itself. Well, that's what it's done here. Right now the shares trade at a positive price, but the only value that the shares have depends upon the ability to knock out the third amendment. If in fact the third amendment is good law, then the shares trade at 0.0 price because there's absolutely nothing whatsoever of value that's left in the corporation.

So if you can't do this title cognizable interest game with respect to real estate, you cannot do it with respect to corporations, and when the government puts forward this argument, it is just an open invitation for a complete kind of lawless behavior which his really hard to understand. I mean property law is difficult, I'm certainly going to concede that. I've spent the last 40-odd years of my career trying to understand how all these systems get put together, but the crude misunderstandings that pervaded the government's brief and that pervaded Lamberth's opinion are not entitled to the slightest bit of respect. So I think I've said enough now and I'm happy to turn this open and leave it for questions if that's what you would like. Tim, back to you.

Tim Pagliara: Alright. Well, thank you, Dr. Epstein. We'll be queuing up questions and as soon as you're ready, Operator, jump in and we'll do that. In the meantime, just a general question for you while they're getting that ready, Dr. Epstein, the third amendment sweep, there's been over $200 billion returned back to the treasury. You took notice of the fact that it is reducing the

federal budget deficit. We've got a court action going on. They say Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) aren't worth anything, yet they're keeping the $189.5 billion on the books as an asset. Comment just a minute on the accounting of this and how it differs from the private sector. I mean I'm fascinating these are still publicly-traded companies that do filings with the Securities and Exchange Commission and how they're able to ignore the traditional rule of law and accounting practice.

Richard Epstein: I mean, look, one of the things that starts out, this goes back to the position that the government has in our simple justice system and this was true not only here, but it was also true for example in the Chrysler bankruptcy where everything was done in an irregular fashion. When people ask me just to evaluate this case, what I tell them as follows is that the government case, in my judgment here, unlike the AIG case, is utterly meritless and therefore it has no greater than a 50% chance of winning. This I think is that the government always gets to play by separate rules vis-à-vis everybody else, and that is certainly evident in this kind of litigation where Judge Lamberth judged out of his way to read everything in their particular favor and it turns out that the government generally wanted [Unintelligible] to go before its own regulatory agencies also [Unintelligible] treated in a much more benevolent fashion. What one really has to understand, this is a kind of comprehensive syndrome here which is, as I like to put it in other litigation that I've been involved in, if the government does one thing right and you do one thing wrong, they win. If you do something perfect and the government makes a complete set of blunders, then you have a 50% chance of winning.

So all you're seeing here is this manifest preference starting to play itself out. Now, it doesn't work in every case because at the same time that Judge Lamberth has done this, Judge Sweeney has taken a very different position. The argument made against her by the same lawyers who were involved in this case is "Look, we think we can show that there were cahoots between Mr. DeMarco and Mr. Geithner when they put these things out, that they were in elaborate collaboration with one another. At that point, the FHFA loses its status as an independent entity and becomes an arm of the government," and they said, "We think that we can prove, although the discovery on this may be delayed, that what they allege on their motion to dismiss that these companies were insolvent is a question of fact that you have to prove up, and we're therefore entitled to take depositions of it."

So what's going to happen in this particular situation, just to continue the story for a second, is Lamberth's decision is now under immediate appeal by Perry Capital at the very least – I don't know what Fairholme will do – and at the same time this discovery is going forward with some very aggressive [requests]. My hope is that the discovery gets out very quickly because what that will do is change the shape of the thing on the appeal. What Judge Lamberth said is it's not unreasonable for people to be upset about the fact that $150 billion has gone out of corporate coffers, but he says "I can't do anything about this, my hands are tied, but if in fact there's rampant collusion between two branches of government, then in fact I think people will start to take a rather different view of this" because the precedents on the book are already there, the most famous one being the Winstar case which was actually argued by Chuck Cooper in 1996 where it had an identical kind of clause and what they said essentially is when you're dealing with contracts which is what a senior preferred shareholder agreement is, you use ordinary rules

of contract constructions and those rules would certainly cover fiduciary duties and contract modification, and it cannot be an equitable bargain when you give away everything in exchange for nothing. There's no possible way that the shareholders could win under any future state of affairs given the third amendment, and to say therefore that it managed to make an agreement that include its position along with that of the government which is what the modifications are supposed to do, becomes just a farfetched brief.

Operator: Pardon the interruption, we do have a question from Jody Chen from Bloomberg. Please go ahead, your line is open.

Tim Pagliara: Go ahead, Jody.

Jody Chen: Hi guys, thanks for the time. I was curious, Tim and Ralph – I'm not sure, Richard, if you would have a similar answer to a similar question – have you guys been buying more shares after this massive decline we've seen in the past week or so or are you sitting still or selling a bit? How have you been approaching what seems to be something you guys are reading as an overselling of these shares considering there're still a lot of legal cases and [Crosstalk]?

Ralph Nader: No, I haven't made any trades since the purchase before the conservatorship agreement.

Tim Pagliara: This is Tim, and I do follow the rules of the Securities and Exchange Commission and so I can't comment on that.

Richard Epstein: By the way, I have absolutely no knowledge or financial interest in any share of either Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) at any time. I simply look at the legal documents and comment on them. I'm not a trader or an investor or anything of the sort.

Jody Chen: Why not? It sounds like you seem to…

Ralph Nader: Ralph here, I just want to inject. There's another party here which is the affordable housing people and I mean they see the survival of Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) in different terms in terms of not getting rid of them and destabilizing the whole housing market, and that's why you're going to see, shall we say, a non-economic interest by the affordable housing people in order to make the government proceed under due process and fairness the way Professor Epstein has been talking about in terms of any eventual reorganization of Fannie Mae and Freddie Mac so that the already skittery housing market doesn't take another blow.

Richard Epstein: By the way, just let me add something to that. Everyone can have very different views on affirmative action [Unintelligible] affordable housing, and so let me make the following question. There are two pieces of this thing and this is typically in discussions given to one ignoring the other. The piece that gets all the attention is the implicit guarantee that the government makes which allows Fannie Mae / Federal National Mortgage Assctn Fnni Me

(OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) to lend it below market rates which is true, but if you look at the Community Redevelopment Act, this is a huge requirement that you make 55% of your loans to certain people in preferred categories and so forth with no increase in risk we're told, which of course is a fantasy. So what happens is the guarantee to some extent is the offset for this lending policy which the federal government puts on. There's a real lesson here. I do not like mixed entities because you never know whether it's fish or fowl and one could always say "Oh, this is a government entity" or "This is a private entity," but one of the reasons why it is that the situation with respect to AIG was resolved much more smoothly was that it was a private corporation and everybody understood that.

In this particular case, the equities early on are much more clouded because you have all the extra burdens of being a government-sponsored entity and all the extra benefits of being a government-sponsored enterprise and as far as I'm concerned, that muddiness creates this indistinct notion and leaves the government people with the efficiency, "Well, we really own this stuff anyhow," wink, wink, at which point the third amendment tries to make good on that particular claim. It is a matter of incredible audacity. If they had tried to do that I think with the AIG situation, there would've been a huge uproar which would've taken place, but in this situation, what makes this so appalling in my judgment is that it's perfect bipartisan. Lamberth is a republican appointee to the district court and the reforms [Unintelligible] to both republicans. We're trying in the mortgage reforms to wipe out all the equity holders and Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC), and what's going to happen of course is that they want to recapitalize the market going forward and they stiff the claims in this particular case, it will be the end of private funding of mortgage markets. They could perfectly well restructure Fannie Mae and Freddie Mac with the authority that they have right now without going to Congress because if you go back and you look at the certificates of these shares and you look at the agreement, there's a lot of room there for people to try to change the nature and the organization of these companies which would permit them to actually raise private capital, but it's not going to happen.

Operator: Pardon the interruption. At this time, if you'd like to ask a question, please press * and 1 on your touchtone phone. You may withdraw your question at any time by pressing the # key. We do have a question from Isaac Boltansky from Compass Point. Please go ahead, your line is open.

Isaac Boltansky: Hey, good morning. Thanks for holding this call. I have two very quick questions and the first I think is for Dr. Epstein. You mentioned the idea of using the discovery process from Judge Sweeney's court to better inform the appeal. Can you speak for a moment about the timing and how that works? I'll just ask my second question [Crosstalk] and then I'll mute my line. Tim and Ralph as well, if you don't mind, can you spend just one moment talking about what your legislative strategy will be in 2015 and beyond, especially if there is a change in leadership in the Senate? I've heard you before say that litigation can influence legislation. I'd like to get your view on how that would work in 2015.

Richard Epstein: Well, I'll answer my question first because it's actually part answer to the second question. What happens is the appeals process is drawn out of necessity because you have to file papers, give answers before you get oral argument. If at the same time that's going forward, you'll get public statements in a deposition which reflect on some of the propositions that were taken [Unintelligible] by Judge Lamberth, it's going to be very hard for a court on an appeal not to take judicial notice of something which is perfectly evident. Under the circumstances, you could argue about its admissibility and so forth, but it's going to be very difficult to keep it out and the same thing is going to be true with respect to the political process even more so because politics is an open-ended game. It's not like the restrictive rules that you have for appellate jurisdiction, and the stuff that you learn may influence the discussions that take place. I don't think the change in control of Congress actually makes that much difference here between the parties because there's been no difference between the Democrats and the Republicans on this issue to date anyhow.

Ralph Nader: This is Ralph Nader. Good question.

Tim Pagliara: Go ahead, Ralph.

Ralph Nader: Yes. I think what it's going to come down to politically, even though the realtor lobby is on the sidelines and nominally supportive of Crapo-Johnson, is that if it moves to the Congress and the issue basically is the stability of the housing market and you've got Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) doing their job everyday in terms of the secondary market and so forth, the whole realtor lobby which is, as you know, very powerful and decentralized all over the country, will come to realize that to try to replace Fannie Mae and Freddie Mac with some unknown entities and all the huge transitional problems there is very, very risky and the market will reflect that way beyond Fannie Mae and Freddie Mac shares. In the process of restructuring – and Secretary Paulson actually, in his book mentioned a public utility model and as Professor Epstein said, there are a lot of ways to make sure that Fannie Mae and Freddie Mac do not misbehave the way they did before the reorganization. There are a lot of ways to do it and just to preserve the shareholders, it's no big deal.

I mean no one's asking for a subsidy as part of any restructuring legislation. It's just to maintain their right to hang on and to recover such as may be the case. It's very significant that in the litigation between Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) and Bank of America Corp (NYSE:BAC) and Citi Corp and so on, who's been winning? To see that this ideological attack on Fannie Mae and Freddie Mac as if to blame them for everything – they're the progenitors of the whole risk pattern and the subprime market, etcetera, but in the litigation that's been going on and in the settlement between Fannie Mae and Freddie Mac and the big banks in New York, who's been winning? It's been Fannie Mae and Freddie Mac.

Isaac Boltansky: They've been winning pretty much everything.

Ralph Nader: From my standpoint, you've got administrative, you've got legislative and you've got judicial, and there are potential for settlements at each of the three levels. The legislative

settlement to this is hopelessly deadlocked. I mean Crapo-Johnson is nothing but bipartisan confusion. The judicial part of this is just getting teed up and so the last week, we presented a paper with Dr. Cliff Rossi about a path out of conservatorship that really dealt with the administrative authority that Director Watt has to bring these entities out of conservatorship and maybe it's going to take some bold moves like that and some congressional reform as a follow-up, but this situation needs to be acted upon, it needs to be dealt with by the next Congress. A change in leadership will help and for our members that are listening and members of the press, we met with several members of Congress while we were on the hill last week and I have a sense that the wild card in this is that you could see the administrative legislative part of this act in a favorable way for reform prior to even the courts dealing with it. So next question.

Operator: Once again, members of the media are allowed to ask a question by pressing * and 1 on your touchtone phone. We do have a question from Jody Chen from Bloomberg. Please go ahead, your line is open.

Jody Chen: Hi guys again. Thanks. I was wondering, with this recent decision, how much of a shift in the calculus of whether this is going to be something that could be won in the courts or in Washington has occurred. I mean it sounds like to some degree – Mr. Epstein, you were saying – the government does have a lot of power in the courts and they often win even if they shouldn't. Is this a big red flag that says this is going to have to be something done politically? I had a quick follow-up after that, so just curious of your thoughts on that.

Richard Epstein: I think that basically what Ralph said is correct. All avenues will be open at all times, nobody could bottle this thing down. The question is whether or not some other court looking at this will take the same view. We already have seen in effect that Judge Sweeney takes a very different view of the case because she allowed discovery. What should be remembered about the Lamberth decision is there was no discovery allowed and he did not even have an oral argument between the two parties. The [Unintelligible] was coming out beforehand and this guy's moving so slowly, he's lost control over the litigation because he isn't this orderly schedule that Judge Sweeney's on. I think virtually nobody expected that it would come out this way and so emphatically, and it certainly is a real gut punch to Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) shareholders, but as Ralph said, this thing is going on in multiple courts. It's a single district court opinion, you do have an appeal and I think as the record becomes clearer, you can make fairly strong arguments that they surely misbehaved. I mean if you just listen to what Tim said about the progression of the negotiations that took place beforehand, none of this makes its way into anything that [Unintelligible] and Lamberth said that is what happens when he denies standing and denies the fact of taking, he's able to issue a fact-free decision, and if you issue fact-free decisions, that renders you much more vulnerable to somebody who puts forward a fairly detailed and exhaustive count of the record saying "How can you go ahead and ignore all of this stuff?"

So I think in effect that clearly it affects the probabilities and estimations of the judgment, but I would think it would be a big mistake to think of this as a knockout punch. This is a lawsuit worth potentially billions of dollars, it will cost a few million dollars to prosecute, but it is not one which is extremely expensive to do. It's not like BP trying to figure out all the thousands of

claimants for oil spills and stuff and indirect damage claims. This is a manageable, focused lawsuit hitting on a single event and it's [Unintelligible] and I think it would be madness for the parties who are attacking it to abandon it given the huge stakes that are involved. I mean the litigation cost in this case, they couldn't even begin to amount to 1% of the potential gains. That would require you to have to spend several hundred million dollars on this and even at current rates for Washington lawyers with their fevered imaginations, they couldn't run up the bill that high.

Operator: We do have another question from Hieron Patel, an Investors Unite member.

Hieron Patel: Hi, my name's Hieron. I just had a question. Do you know approximately how long it would take for the Sweeney case to litigate? I understand that the jurisdiction of discovery would be complete by approximately March and…

Richard Epstein: It could be at least two years, but the question stuff will come in the interim, and it's the releases that are, in many cases, more important. So I mean if this big battle as to whether or not the government can keep all the information that it hands over by way of documents secret because it doesn't want it go out and it made what I thought to be a genuinely preposterous claim which that the deliberation that it had several years ago had to be kept in confidence because otherwise what would happen is it could roil the market, this is basically government by a kleptocracy. Of course one wants to be able to put this stuff out there so that one can see what is relevant, and I think it's extremely important for the political debate. My sense is that when you actually get the full record out, the tip of the iceberg which was the Morgenson revelations about the December 2010 meetings and the recent discussions about the Blackstone presentation in 2011 to the government are part of a very consistent pattern. I mean listen to Tim. He sounded rather angry about it which of course is an appropriate response.

I suspect there's a lot more in this particular case because we know that if you're doing a standard corporate number and you wish to enter into a major self-dealing transaction, you have to have exhaustive documentation both of the procedural fairness and the substance of parity in the position. Well, there was no procedure that was followed that have been made public and there can't be any parity because all the money flows in one direction. I mean when Jason Carney says that this was really necessary to stabilize the market, you have to explain why it is that gutting all of the shareholder value of a company somehow will reassure people that this market is working just fine, where in fact what it does is it indicates that all markets are now subject to very heavy high-handed government intervention in which there's no apology and no backing off. The government's position in this is not saying "Gee, maybe we overstated it." They basically regard themselves as the rescuers of the human race and the financial market by these kinds of actions, and frankly, I don't think that if you had the testimony put forward by Tim Geithner about what happened in 2012, he's going to come off sounding as good as Henry Paulson did when he testified yesterday in the AIG case.

Tim Pagliara: Dr. Epstein, can I have a follow-up? What are the conditions that Judge Sweeney would recognize that would finally cause her to release this record publicly? What's a timeframe for that and what are the things that would hold her to the gag order she's got right now?

Richard Epstein: I think what will eventually persuade this is when she starts looking at the documents, she'll have to ask the question. There're some important public deliberative functions which can only take place in private, so if you turn them over, people will not have sufficient candor in the way in which they do things, or is this an effort to have massive cover-up with respect to what's going on? I mean this is not an unprecedented issue. If you think back to something which has similarities unfortunately with the whole Watergate stuff, you could've argued that it's a complete and absolute presidential privilege which extends to all of his aides and that was rejected in those cases. The president has a privilege, but the staff did not and it was qualified and it was overridden, and in this case, I think she will make the judgment that the revelations that you start to see in this thing are so important that they should be matters of public because how else do you comment on what governments do unless you have some access to what they're having?

Operator: Pardon the interruption. We'll take our last question from Fred Fraenkel from Fairholme. Please go ahead, your line is open.

Fred Fraenkel: Hi, gentlemen. I wanted to thank Mr. Nader for all his comments and his perspective, and Professor Epstein, I want to tell you I've read every word you've written on this and I think you're unbelievably bright, learned and have sound judgment of one of the issues that not all the people that sit on the bench are necessarily in the same position and seem to have some vested interests, so you're always up against that in legal proceedings. I just want to make one quick observation and then I have one question for Professor Epstein. I was a bank analyst 40 years ago with Dick Bove who's still a bank analyst and I consider him the dean of all bank analysts, and he's made a case which I wouldn't say is screaming in the woods, but I would say it's not widely perceived that we are already in a tremendously degraded situation as an economy because of the effect of taking out all of the capital of Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) for the last many quarters and that he expects a housing emergency in this country next year. I don't think anything would prompt administrative action more quickly than the recognition that there really is a problem in having the two biggest [Unintelligible] in the world, but demeaned of all their retained earnings over an extended period of time.

Not only are we in the housing emergency relative to mortgage availability, but certainly relative to the next cycle. I mean this does become a self-fulfilling prophecy if the two pump-priming mechanisms for coming out of recessions still World War II are devoid of any capital to do that in the next cycle, then the government would have to act in a way that would be a transition to something completely different and that would be, obviously from our vantage point, a huge shame, but the question I wanted to ask Professor Epstein was the downward spiral argument is constantly made against trying to prove that they didn't need the money which we certainly know from all of our analysis they didn't, but it's never seemed to have made the light of day and certainly didn't in this judge's decision that there always and continue to be a pick option for them to not have to pay cash and not be in that spiral. I've been on many boards and anytime financing came about where we had a pick option, we certainly considered it, so it's against the backdrop where you say there isn't a board, there's just a conservator single vantage point that wasn't considered. The question is why isn't this pick option being raised legally?

Richard Epstein: It was. I mean that was the preposterous point – is if you look at it, Judge Lamberth puts it in a series of [Unintelligible] footnotes and he announces this was not an option at all, but he announces that this was a penalty even though if you read the full sentence it says exactly the opposite. As I said in my opening remarks, if you're talking about a penalty, you have to pay the cash and then you have to pay something above and beyond interest and in this case you're allowed to defer, so you have two choices rather than one. Therefore, essentially if you are the Fanny and Freddie guy and you're simply looking after the welfare of your parties, you have to make the choice as to whether or not you want to do this or whether you want to pay it off. Now, the government in effect may well have advanced different monies and you turned around and took some of the capital that advanced and used it to pay off and that's an odd cycle, but in effect, if the government decided that it didn't want to make those kinds of advances which it was obliged to do anyhow under contract, then you would start to take the deferred option and pay it off as quickly as you can. What happens is this is a line of credit that you can draw down. It's not in the interest of Fannie Mae / Federal National Mortgage Assctn Fnni Me (OTCBB:FNMA) and Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC) shareholders to say "We can't touch this line of credit whatsoever." That's the government's claim. If they want to pull out from the line of credit which they extended to $400 billion, they're going to have to pay something for that.

Now, it turns out that this, to some extent, isn't irrelevant because the total amount that was actually lent was $188.5 billion which was within the original $200 billion capital. I mean it's close to it. You may want to have that extra stuff, but this is the basic judgment that you make of the government. If you decide to increase the cap to either $300 billion or $400 billion and in fact you are saying to the markets, "We think we can actually make this thing work. We're not going to try and put the plug on it," and if it wants to pull the plug on this thing, it can't do so by a contract modification. It has to do so via foreclosure proceedings and then on the other side they should be allowed to present evidence that this thing is not in danger, but what happens here is you get no hearing. You get the Carney columns and you get the government briefs, but there's actually no authoritative disposition on this particular type of issue which is again, in every home mortgage foreclosure, you have to give a judicial hearing and if in fact you recovery your principal interest in course, then the rest of it goes to the holder of the equity. None of those procedures were followed in this case. You're just dealing with a completely different set of rules tailored and favored to the government without any sensible or substantive justification.

Ralph Nader: So if I may add to Professor Epstein – this is Ralph Nader – whenever the government carves out an area of activity which is what the conservatorship is and never recognizes any boundaries whatsoever as to what it can do, it's almost, per se, unconstitutional. There is no boundary that the government has recognized about what it can do in this area. Would you agree with that?

Richard Epstein: Yes, I mean because they basically have said exactly the opposite. They say, A, "We don't have any duty to answer anybody. Nobody has any standing to challenge us even though you've been wiped out, and in effect, that any decision we make is fine because you don't have any cognizable interest in the shares that exist in this particular company." Well, if you have no standing and no property, then in effect, there is no hook that you have into the government, so there's no limit on what it can do. Judge Lamberth calls this "enormous

discretion," but the correct term is "total abject and complete discretion," but that's the discretion of an owner and the one thing we know when we look at HERA and the obligations that it puts on the government when it makes the loans and the obligation it puts on FHFA when it administers the situation is those things are replete with loans. The most striking feature about this opinion in many cases are the explicit statutory sections that Judge Lamberth never bothers to cite, and these are the same sections which the government never quotes to distinguish. In fact, in this long article that I wrote about this, what is striking is every kind of government quotation from statutes are clipped in such a way as to turn their meaning upside down.

Operator: Pardon the interruption. I'll now turn the conference over to Tim Pagliara. Please go ahead.

Tim Pagliara: Professor Epstein, thank you for your insight and wisdom. Mr. Nader, it's always great to have you on the program for your insight. We're committed to continue to give you this kind of information at Investors Unite. There's a lot of background noise and as both speakers today suggested, the background noise has very little to do to the reality of how these cases will eventually be decided and we're here to bring you the facts and the truth and separate the wide, divergent opinions that exist out there. So again, thank you both for participating this morning and we will keep you posted. Watch our website, www.InvestorsUnite.org. Thank you for your attention this morning.

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