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IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

OAKLAND DIVISION

People of the State of California, *ex rel.* Kamala D. Harris, Attorney General,

Plaintiff,

v.

Federal Housing Finance Agency; Edward DeMarco, in his capacity as Acting Director of Federal Housing Finance Agency,

Defendants.

– and consolidated cases –

Case No. 10-cv-03084 CW/LB

Consolidated Case Nos.:

10-cv-03270-CW/LB
(Sonoma County/Placer County)

10-cv-03317-CW/LB
(Sierra Club)

10-cv-04482-CW/LB
(City of Palm Desert)

Memorandum of Points and Authorities in Support of Plaintiffs' Joint Motion for Summary Judgment

Date: April 19, 2012
Time: 2:00 p.m.
Courtroom: Courtroom 2, 4th Floor
Judge: Hon. Claudia Wilken
Trial Date: N/A
Action Filed: July 14, 2010

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INTRODUCTION

Defendant Federal Housing Finance Agency (FHFA or Agency) issued directives that, nationwide and in California, have chilled and in some instances halted state law authorized programs expressly designed to foster energy and water efficiency and renewable energy (commonly referred to as Property Assessed Clean Energy or PACE programs). If this were any other federal agency, there would be no question that that agency would be required to comply with the Administrative Procedure Act (APA), including the notice-and-comment requirements that apply to substantive rules, and to determine whether its actions require an Environmental Impact Statement (EIS) under the National Environmental Policy Act (NEPA). FHFA, however, has contended that it is excused from the normal procedural rules that apply to virtually all other agencies. The Agency contends that its anti-PACE actions cannot be "restrain[ed] or affect[ed]" by this Court by operation of the Safety and Soundness Act, 12 U.S.C. section 4617(f). An essential element of this defense is that the challenged action be taken by the Agency "as a conservator." As this Court already has determined, however, "[s]ubstantive rule-making is not appropriately deemed action pursuant to the FHFA's conservatorship authority." (Order at 19:18-19 [Case No. 10-cv-03270, Docket No. 136].) Because Plaintiffs challenge the Agency's substantive rule-making actions, the statutory protection asserted by the Agency is inapplicable, and Plaintiffs are entitled to summary judgment as a matter of law.

STATEMENT OF UNDISPUTED FACTS

I. BACKGROUND ON THE AGENCY

Defendant FHFA is a federal agency that regulates and supervises the Federal National Housing Association (Fannie Mae), the Federal Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks. (Answer to California First Amended Complaint (Cal. FAC) 6:16 [Case No. 10-cv-3084, Docket No. 137].) Fannie Mae and Freddie Mac (the Enterprises) are federally chartered, private corporations that facilitate the secondary market in residential mortgages by freeing up capital for additional mortgage lending. (Motion to Dismiss 5:14-16 [Case No. 10-cv-3084, Docket No. 49]; Answer to Cal. FAC 5:25, 6:7-8.) Fannie Mae and Freddie Mac finance the purchase of residential mortgages through the issuance of financial

products (*e.g.*, notes, bonds, stocks and securities), the repayment of which is secured by the "pool" of the mortgages previously purchased. (Answer to Palm Desert Compl. 4:1-2, 4:10-11 [Case No. 10-cv-04482, Docket No. 77].) Together, the Enterprises own or guarantee approximately one-half of the home loans in the U.S. and California. (Answer to Cal. FAC 6:7-8.) On September 6, 2008, the Agency became the conservator of Fannie Mae and Freddie Mac. (Motion to Dismiss 5:17-18; Excerpts of Admin. Record (EAR), Ex. E (FHFA 02731).) As FHFA reported to Congress, "[a]s conservator, FHFA has the powers of the management, boards, and shareholders of the Enterprises." (EAR, Ex. E (FHFA 02732).) Plaintiffs are aware of no evidence that the Agency is, or ever has been, the conservator of the Federal Home Loan Banks.

II. PROPERTY ASSESSED CLEAN ENERGY (PACE) PROGRAMS IN CALIFORNIA

Local governments in California traditionally have used their assessment powers to finance improvements that serve a public purpose, such as the paving of roads. (Answer to Cal. FAC 7:14-16; Answer to Sonoma Co. Compl. 6:3-5 [Case No. 10-cv-03270, Docket No. 155].) Assessments are paid over time through charges that appear on the property tax bill, with the obligation to pay remaining installments transferring to the new property owner on sale. (Answer to Sonoma Co. Compl. 6:19-20) Under longstanding California law, assessments create liens that have priority over mortgages. (Answer to Cal. FAC 7:19; Answer to Sonoma Co. Compl. 6:19-20, 17:1-2.)

Under California law, local governments may finance the installation on private property of various energy- and water-saving improvements using the assessment mechanism. (Answer to Cal. FAC 8:4-8; Answer to Sonoma Co. Compl. 6:23-24; *see also* Plaintiffs' Request for Judicial Notice (RJN) ¶ 4, Ex. 4 (California Assembly Bill 811 (Cal. Stats. 2008, ch. 159), Cal. Streets & Hwys. Code § 5898.12).) Such programs are commonly referred to as "Property Assessed Clean Energy" or PACE programs. (EAR, Ex. P (FHFA 00374).) In California, liens that result from PACE assessments, like other assessments, have priority over mortgages. (Answer to Cal. FAC 8:4-8; Answer to Sonoma Co. Compl. 7:1-3 *see also* EAR, Exs. O, Q (FHFA 00372, 01228.) In the event of a mortgage default, any delinquent PACE assessments (not the entire amount financed) are paid before the mortgage. (Answer to Sonoma Compl. 6:19-20, 7:1-3.)

In passing its PACE law, the California legislature made the following findings:

> • Energy conservation efforts, including the promotion of energy efficiency improvements to residential, commercial, industrial, or other real property are necessary to address the issue of global climate change ….
>
> • The upfront cost of making residential, commercial, industrial, or other real property more energy efficient prevents many property owners from making those improvements…. [I]t is necessary to authorize an alternative procedure for authorizing assessments to finance the cost of energy efficiency improvements.
>
> • [A] public purpose will be served by a contractual assessment program that provides the legislative body of any city with the authority to finance the installation of distributed generation renewable energy sources and energy efficiency improvements that are permanently fixed to residential, commercial, industrial, or other real property.

(Answer to Cal. FAC 18:1-4; RJN, ¶ 4, Ex. 4 (Cal. Streets & Hwys. Code § 5898.14).)

The passage of California's PACE law, AB 811, spurred the development of PACE programs across the State. (Answer to Cal. FAC 8:12-19.) The City of Palm Desert established its Energy Independence Program by a resolution adopted on August 28, 2008. (Answer to Palm Desert Compl. 7:1-5). Sonoma County launched its Energy Independence Program in March 2009. (Answer to Sonoma Co. Compl. 9:9). Placer County first established its "money for Property Owner Water & Energy Efficiency Retrofitting" program (or "mPOWER Program") in January 2010. (Declaration of Jenine Windeshausen ("Windeshausen Decl.") ¶¶ 8-10.)

III. FEDERAL SUPPORT OF PACE PROGRAMS

The White House and federal agencies, including most prominently the U.S. Department of Energy (DOE), encouraged the development of PACE. (Answer to Cal. FAC 10:4-10, 10:18-20; EAR, Ex. B (FHFA 00399-00412).) Among other things, DOE expressly supported the use of hundreds of millions of dollars of federal American Recovery and Reinvestment Act funds for PACE programs. (Answer to Cal. FAC 10:11-17; Answer to Palm Desert Compl. 14:5-9.) In early 2010, a number of local governments across California were poised to launch their own PACE programs, supported in part by federal dollars administered through the California Energy Commission. (Declaration of Karen Douglas (Douglas Decl.) ¶¶ 4-12).) By February 2010, the California Energy Commission already had awarded $110 million in Recovery Act State Energy

Program funding to support California PACE programs. (*Id.* at ¶ 12.) In addition, DOE developed "best practices guidelines" for PACE programs. (Answer to Sonoma Co. Compl. 11:25; EAR, Ex. H (FHFA 00979-00985).)

IV. THE AGENCY'S ANTI-PACE DIRECTIVES

In June 2009, the Agency began to call PACE into question, stating to the mortgage lending industry that PACE posed risks to homeowners and the housing finance system. (EAR, Ex. A (FHFA 00665-00666).) In the early stages of PACE, the Enterprises treated PACE assessments like all other assessments. For example, in its September 18, 2009, lender letter, interpreting the Enterprises' Uniform Security Instruments, Fannie Mae stated that until further guidelines are issued, "lenders should treat [PACE] payments as a special assessment in underwriting a borrower where the security property is subject to an existing [PACE] loan." (Cal. FAC ¶ 24, Ex. A (Letter at p. 2) [Case No. 10-cv-03084, Docket No. 33]; Answer to Cal. FAC 9:18-21.) The letter further stated that mortgage "[s]ervicers should treat [PACE] as any tax or assessment that may take priority over Fannie Mae's lien." (*Id.*) On May 5, 2010, however, Fannie Mae and Freddie Mac each issued a letter to the mortgage industry characterizing PACE financing as "loans" and stating that such "loans," which would have a senior status to the mortgage, were prohibited under the Enterprises' Uniform Security Instruments. (Cal. FAC ¶¶ 27-28 and Ex. B; Answer to Cal. FAC 11:2-7, 11:13-16; EAR, Exs. F, G (FHFA 01268-01269).)

On July 6, 2010, FHFA issued its "Statement on Certain Energy Retrofit Loan Programs" (hereinafter "July 2010 Directive"). FHFA's July 2010 Directive contains three elements. First, the Agency makes several summary and general assertions about the risks purportedly posed by PACE. For example, the Agency asserts: "First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors"; PACE programs "present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation" and "disrupt a fragile housing finance market and long-standing lending priorities"; and "the absence of robust underwriting standards to protect homeowners and the lack of energy retrofit standards to assist homeowners,

appraisers, inspectors and lenders determine the value of retrofit products combine to raise safety and soundness concerns." (Cal. FAC, Ex. C; Answer to Cal. FAC 19:2-7.) Second, the Agency affirms the assertion in the May 5, 2010 lender letters that "programs with first liens run contrary to the Fannie Mae-Freddie Mac Uniform Security Instrument," and further states that without exception or caveat, "[t]hose lender letters remain in effect." Lastly, the Agency directs Fannie Mae, Freddie Mac, and, in addition, the Federal Home Loan Banks, to undertake what it calls "prudential actions." (*Id.*) These include, for example, "[e]nsuring that loan covenants require approval/consent for any PACE loan." (*Id.*)[1]

Before issuing its July 2010 Directive, the Agency did not comply with the Administrative Procedure Act's notice-and-comment requirements; did not prepare an environmental assessment (EA) or environmental impact statement (EIS); and did not request or obtain data concerning the real-world operation of existing PACE programs, *e.g.*, comparative default rates for properties participating in PACE. (Cal. FAC ¶¶ 66, 74; Answer to Cal. FAC 22:19-23, 23:15-20; Declaration of Rodney A. Dole in Support of Motion for Preliminary Injunction (Dole Decl.) ¶ 17 [Case No. 10-cv-03270, Docket No. 37].)

On August 31, 2010, Fannie Mae and Freddie Mac each issued a new lender letter addressing PACE. (Declaration of Scott M. Border in Support of Motion to Dismiss (Border Decl.), Exs. 20, 21 [Case No. 10-cv-3084, Docket No. 51].) Both letters expressly state that they were issued in response to the Agency's July 6, 2010 Directive. (*Id.*) The Fannie Mae letter states that for PACE "loans" originated on or after July 6, 2010, the Enterprise "will not purchase mortgage loans secured by properties with an outstanding PACE obligation unless the terms of the PACE program do not permit priority over first mortgage liens." (Border Decl. Ex. 20 at p. 2.) The Freddie Mac letter contains a similar prohibition. (Border Decl. Ex. 21 at p. 1.)

[1] The California Attorney General sought confirmation from the Agency that Fannie Mae's and Freddie Mac's May 5, 2010 lender letters did not apply in California on the ground that under state law, PACE operates not through loans but rather through assessments. (Cal. FAC ¶ 47, Ex. D; Answer to Cal. FAC 25-27.) In response, the FHFA sent a cover letter and a copy of its Directive stating its intent to "pause" PACE programs. (Cal. FAC, Ex. C; Answer to Cal. FAC 19:2-7.)

On February 28, 2011, during the pendency of this litigation, the Agency's Chief Counsel sent a letter addressed to the General Counsels for Fannie Mae and Freddie Mac (hereinafter, "February 2011 Directive"). (Defendants' Notice of New Authority, Ex. A [Case No. 10-cv-03084, Docket No. 95].) In the letter, the Chief Counsel purports to be acting as conservator of the Enterprises. (*Id.* (Letter ¶¶ 2-3).) The February 2011 Directive cited the July 2010 Directive and the August 31, 2010 letters issued by the Enterprises in direct response to the July 2010 Directive. (*Id.*) The February 2010 Directive then directed that the "Enterprises shall continue to refrain from purchasing mortgage loans secured by properties with outstanding first-lien PACE obligations …." (*Id.* (Letter ¶ 3(1)).) Nothing in the anti-PACE Directives suggests that they are temporary or apply only until such time as the Agency can complete a rule-making process.

V. EFFECT OF THE AGENCY'S ANTI-PACE DIRECTIVES

The Agency's anti-PACE Directives have harmed PACE programs across the nation and in California. In response to the Agency's July 2010 Directive, DOE publically announced that "prudent management of the Recovery Act compels DOE and Recovery Act grantees to consider alternatives to programs in which the PACE assessment is given a senior lien priority." (Answer to Cal. FAC 14:17-22; Douglas Decl. ¶ 15.) The California Energy Commission then cancelled its previous State Energy Program/Recovery Act awards intended to support PACE programs. (Douglas Decl. ¶ 18.) Millions of dollars of federal Recovery Act funds that would have gone to support California PACE programs were awarded for other purposes. (Douglas Decl. ¶ 19.)

The Agency's actions have also affected PACE programs that were not directly dependent on federal Recovery Act monies. Sonoma County has established one of the most successful PACE programs in the country, called the Sonoma County Energy Independence Program. In Sonoma County, between the period of April 21, 2009, and August 26, 2009, over 20 properties participating in PACE had refinanced without difficulty; more recently, several properties have reported to the County that they have not able to sell or refinance their property without being required to pay off the full assessment. (Dole Decl. ¶ 20.) As of October 2010, the County reported that PACE applications now average 60 per month instead of 116. (Declaration of Liz Yeager in Support of Motion for Preliminary Injunction (Yeager Decl.) ¶ 18 [Case No. 10-cv-

03270, Docket No. 38.) As a result of this decline, the County has had to lay off two PACE program employees. (*Id.*) Sonoma County's PACE Program Manager predicts:

> [P]articipation in the program will continue to decline if the FHFA/Fannie Mae/Freddie Mac restrictions remain in place, and more and more SCEIP participants are affected. I do not believe SCEIP would be able to continue as a viable program if the County is not able to stabilize the messaging, and assure participants that the [PACE] assessment will not present an obstacle when they need to refinance or sell their property.

(Yeager Decl. ¶ 19; *see also* Dole Decl. at ¶ 4.) The City of Palm Desert's PACE program, which predated Sonoma County's program, was similarly successful. (Declaration of Justin McCarthy ("McCarthy Decl.") ¶ 8).) From August 28, 2008 to July 6, 2010, Palm Desert's program received approximately 337 applications for financing, of which it approved 227. (*Id.* at ¶ 9.) After the Agency issued its July 6, 2010 anti-PACE Directive, 12 applicants withdrew their applications, and, in the period since, Palm Desert has received only 34 additional applications. (*Id.* at ¶ 12.) Based on this experience, Palm Desert believes that its PACE program will continue to decline if the Agency's anti-PACE Directives remain in place and are not modified. (*Id.* at ¶ 16.) Placer County was forced to suspend indefinitely its residential PACE program in July 2010, following the Agency's July 2010 Directive. (Windeshausen Decl. ¶¶ 14-15, Ex. A.) Before suspension, Placer County had committed to 11 PACE assessments. (*Id.* ¶ 16) Members of Plaintiff Sierra Club who are concerned about energy and water efficiency and climate change and who wish to participate in PACE have been prevented from doing so by the Agency's anti-PACE actions, and current PACE participants are also being adversely affected. (Declaration of Dan Fogarty at ¶¶ 4-6; Declaration of Carroll Nast at ¶¶ 3, 5.)

The State of California has an interest in ensuring that its PACE law operates without interference. Pursuant to the Global Warming Solutions Act of 2006 (AB 32) (Cal. Health & Saf. Code § 38550), and Executive Order S-03-05 (2005), California is committed to reducing statewide greenhouse gas emissions to 1990 levels by 2020, and 80% below 1990 levels by 2050. (RJN, ¶¶ 1 and 2, Exs. 1 and 2.) "The 2020 goal was established to be an aggressive, but achievable, mid-term target, and the 2050 greenhouse gas emissions reduction goal represents the

level scientists believe is necessary to reach levels that will stabilize climate." (RJN, Ex. 3 (AB 32 Scoping Plan) at p. 4).) California's commitment to reducing GHG emissions is due in large part to the State's unique vulnerability to climate change. California is, for example: a coastal state that is and will be particularly affected by rising sea levels (*e.g.*, suffering damage to state infrastructure and state beaches); heavily dependent on the Sierra Nevada snowpack for water supply,[2] which is already being adversely affected by climate change; and a forested state that will face longer and more intense wildfire seasons and increased firefighting costs protecting state and private lands. (RJN, Ex. 5 (Adaptation Plan) at pp. 15, 65, 69, 70, 79, 107, 111.) PACE programs reduce GHG emissions through efficiency upgrades, which reduce a homeowner's total use of energy, and renewable energy projects, which reduce or eliminate a homeowner's reliance of carbon-based energy sources. Similar interests are shared by local governments including Sonoma County, Placer County, and the City of Palm Desert, and by environmental organizations with California members who wish to participate in PACE, including the Sierra Club.

ARGUMENT

I. LEGAL STANDARD

Summary judgment is appropriate when there is no genuine issue as to any material fact and when, viewing the evidence most favorably to the non-moving party, the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a); *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986); *Cline v. Indus. Maint. Eng'g & Contr. Co.*, 200 F.3d 1223, 1228-29 (9th Cir. 2000). "The party moving for summary judgment must offer evidence sufficient to support a finding upon every element of his claim for relief, except those elements admitted by his adversary." *Lockwood v. Wolf Corp.*, 629 F.2d 603, 611 (9th Cir. 1970). A defendants' failure to deny an allegation in its answer to a complaint constitutes an admission that can support summary judgment. *Id.* at 611. As set forth below, Plaintiffs have established every element of each of their claims, brought under the APA and NEPA, through the Agency's Answers and through

[2] All water within the State of California is property of the People of the State. Cal. Water Code § 102; *see also* Cal. Water Code § 12922; *Selma Pressure Treating Co., Inc. v. Osmose Wood Preserving Co.*, 221 Cal. App. 3d 1601, 1616 (1990).

documents produced by the Agency in this litigation. In addition, Plaintiffs have established Article III and prudential standing through declarations and matters that may be judicially noticed.

Where the moving party does not bear the burden of proof on an issue at trial, for example, as to a defense, the moving party may discharge its burden of production by negating an essential element of that defense. *Nissan Fire & Marine Ins. Co., Ltd., v. Fritz Cos., Inc.*, 210 F.3d 1099, 1102 (9th Cir. 2000). The burden then shifts to the non-moving party to show that a dispute exists. *Bhan v. NME Hosps., Inc.*, 929 F.2d 1404, 1409 (9th Cir. 1991). The Agency contends that its anti-PACE actions cannot be "restrain[ed] or affect[ed]" by operation of 12 U.S.C. section 4617(f). An essential element of this defense is that the Agency must have taken the challenged action "as a conservator" of the Enterprises. As this Court already has determined, however, "[s]ubstantive rule-making is not appropriately deemed action pursuant to the FHFA's conservatorship authority." (Order at 19:18-19.) As set forth below, the Agency's anti-PACE directives are substantive rules, not actions of a conservator, which negates an essential element of the Agency's section 4617(f) defense. Plaintiffs thus are entitled to summary judgment.

II. PLAINTIFFS HAVE STANDING TO INVOKE THIS COURT'S JURISDICTION

A. Article III Standing

To have constitutional standing to challenge the Agency's action, Plaintiffs must show: (1) injury in fact, (2) causation, and (3) redressability. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992); *Nw. Envtl. Def. Ctr. v. Bonneville Power Admin.*, 477 F.3d 668, 679 (9th Cir. 2007). Plaintiffs in their remaining claims assert in the main violation of their procedural rights. In these now-consolidated cases, the Court need determine only that a least one Plaintiff has standing to pursue each of the claims. *Horne v. Florez*, __ U.S. __, 129 S.Ct. 2579, 2592-93 (2009); *Laub v. U.S. Dep't of Interior*, 342 F.3d 1080, 1086 (9th Cir. 2003).

Plaintiffs' injuries in fact include interference with state PACE law and local assessment authority, interference with operating and planned local PACE programs and funding for such programs, reduced and lost opportunities for homeowners to participate in PACE programs in California, and lost opportunities to reduce energy use and greenhouse gas emissions that contribute to climate change. This Court previously held, based on the allegations of the

complaints, that Plaintiffs had satisfied the "injury in fact" prong. (Order at 9:13-14); *see also Massachusetts v. EPA*, 549 U.S. 497, 521-523 (2007); *City of Sausalito v. O'Neill*, 386 F.3d 1186, 1198 (9th Cir. 2004). Plaintiffs have now established these same injuries through undisputed evidence.

Turning to causation and redressibility, as the Supreme Court has explained, "[t]he person who has been accorded a procedural right to protect his concrete interests can assert that right without meeting all the normal standards for redressability and immediacy." *Lujan*, 504 U.S. at 572, fn. 7. "When a litigant is vested with a procedural right, that litigant has standing if there is some possibility that the requested relief will prompt the injury-causing party to reconsider the decision that allegedly harmed the litigant." *Massachusetts v. EPA*, 549 U.S. at 518. "'A [litigant] who alleges a deprivation of a procedural protection to which he is entitled never has to prove that if he had received the procedure the substantive result would have been altered. All that is necessary is to show that the procedural step was connected to the substantive result.'" *Id.* (quoting *Sugar Cane Growers Coop. of Fla. v. Veneman*, 289 F.3d 89, 94–95 (C.A.D.C. 2002)). It is sufficient that the agency's decision "could be influenced" by the environmental considerations that the relevant statute requires the agency to study. *Citizens for Better Forestry v. USDA*, 341 F.3d 961, 976 (9th Cir. 2003).

Plaintiffs previously alleged, and now have established, "a sufficient connection between [the Agency's] actions and the thwarting of PACE programs and their anticipated benefits." (*See* Order at 11:8-10.) As this Court noted previously:

> Although the FHFA's July 2010 statement was issued after Fannie Mae and Freddie Mac's May 2010 announcements to their sellers and servicers, the FHFA had publicized its concerns in the prior, June 2009, letter. Fannie Mae, in turn, cited that letter as it raised caution about PACE programs in its September 2009 Lender Letter. In addition, Fannie Mae's and Freddie Mac's August 31, 2010 announcements that they would not purchase PACE encumbered mortgages originated on or after July 6, 2010, were issued in response to the FHFA's statement.

(Order at 11:14-23; EAR, Exs. A, F, G, P, S, R (FHFA 00665-00668, 01268, 01269, 00374-00375, 01236-01238, 01249-01250).) Prior to FHFA's challenged actions, operating PACE programs were thriving and increasing in participation, and additional programs were set to

receive federal funding; after the Agency's actions, PACE participation declined and federal funding was reallocated. In the Court's words: "[t]he financing and benefits previously afforded by PACE programs could be renewed as a result of new information gleaned through the notice and comment and environmental review processes and a resulting change in Defendants' position and related marketplace practices." (Order at 21:9-13.)

As to Plaintiffs' claim that the Agency's actions are arbitrary and capricious, the undisputed facts and reasonable inferences that may be drawn are sufficient to meet the causation and redressibility requirements. Undisputed facts show a "reaction of the marketplace to Defendants' actions and the rapid demise of PACE programs" thereby establishing "a sufficient causal connection between Defendants' actions and Plaintiffs' … injury." (*See* Order at 12:18-21.) Plaintiffs have established redressibility because, if FHFA's policy were set aside, the status quo ante would be reinstated and "it is likely that financing streams would be renewed." (*See id.*)

B. Prudential Standing

Prudential standing under the APA requires that plaintiff's interests must be "'arguably within the zone of interests to be protected or regulated by the statute ... in question.'" *Nat'l Credit Union Admin. v. First Nat. Bank & Trust Co.*, 522 U.S. 479, 488 (1998) (*NCUA*) (quoting *Ass'n of Data Processing Serv. Org. v. Camp*, 397 U.S. 150, 153 (1970)). Plaintiffs proceeding under the APA "need only show that their interests fall within the 'general policy' of the underlying statute, such that interpretations of the statute's provisions or scope could directly affect them." *Graham v. Fed. Emergency Mgmt. Agency*, 149 F.3d 997, 1004 (9th Cir. 1998) (quoting *NCUA*, 522 U.S. at 489). Here, the relevant underlying statutes are the Safety and Soundness Act and NEPA.

As the Court already has determined, "because the housing mortgage market operates alongside a system of laws and assessments that California and the municipalities have erected[,]" the government entities "are arguably within the Safety and Soundness Act's zone of interests." (Order at 24:19-22.) In Plaintiffs' view, because the Safety and Soundness Act requires the Agency to ensure that the regulated entities are operated "consistent with the public interest" (12 U.S.C. § 4513(a)(1)(B)(v)), its zone of interests is wide enough to encompass Sierra Club and its

members. (But see Order at 25:15-21.) The Court, however, need not reach the issue of the Sierra Club's prudential standing to pursue its non-NEPA claims, as the other Plaintiffs possess sufficient interests. *See Horne v. Florez*, 129 S.Ct. at 2592-93.

All Plaintiffs have established environmental interests related to increasing energy efficiency and reducing greenhouse gas emissions and the risk of dangerous climate change that are squarely within the zone of interests of NEPA. *See W. Watersheds Project v. Kraayenbrink*, 632 F.3d 472, 485-486 (9th Cir. 2011) (holding that plaintiff's interest in preventing adverse environmental effects resulting from agency action fell within zone of interests of NEPA).

III. THE AGENCY'S ANTI-PACE DIRECTIVES VIOLATE THE APA'S NOTICE AND COMMENT REQUIREMENTS

It is undisputed that the Agency, in issuing its July 2010 and February 2011 Directives, did not comply with the APA's notice-and-comment requirements, 5 U.S.C. section 553.[3] As set forth below, the Agency was required to do so. The Directives are the Agency's final word on PACE, and constitute substantive rules, not mere interpretations of existing law. The Agency did not give notice of the anti-PACE Directives or provide a formal public comment period before making its final decision. The Agency contends that pursuant to 12 U.S.C. § 4617(f), the Court has no power to "restrain or affect" the challenged anti-PACE actions. An essential element of this defense is that the Agency action at issue be taken "as a conservator[.]" As this Court already has noted, however, the FHFA's conservator powers do not extend to substantive rule-making and, accordingly, 12 U.S.C. section 4617(f) does not bar this Court from fashioning an appropriate remedy for the Agency's violation of the APA's notice-and-comment requirements.[4]

[3] The APA requires agencies to (1) publish notice of the proposed rule-making in the Federal Register (5 U.S.C. § 553(b)); (2) provide a period for interested persons to comment on the proposed rule, which must be considered by the agency prior to adopting the rule (*id.* at § 553(c)); and (3) publish the adopted rule not less than thirty days before its effective date, with certain exceptions that are not applicable here (*id.* at § 553(d)).

[4] The Agency in its Motion to Dismiss asserted two additional defenses under 12 U.S.C. sections 4623(d) (supervisory actions with respect to "significantly undercapitalized entities) and 4635(b) (enforcement orders). The Court rejected each as missing essential elements. (Order at pp. 20-23.) In its currently pending appeal of the Court's preliminary injunction, the Agency did not allege that the Court erred in ruling that these defenses were inapplicable.

A. The Agency's Directives are Final Agency Actions

Under the APA, only a "final agency action" is subject to judicial review. 5 U.S.C. § 704. To determine finality, courts "look to whether the action 'amounts to a definitive statement of the agency's position' or 'has a direct and immediate effect on the day-to-day operations' of the subject party, or if 'immediate compliance [with the terms] is expected.'" *Oregon Natural Desert Ass'n v. U.S. Forest Service*, 465 F.3d 977, 982, (9th Cir. 2006) (citations omitted; alteration in original). Courts focus on the practical and legal effects of the agency action. *Id.* As the Court already has determined, the July 2010 Directive "indicated the FHFA's final stance on PACE obligations, and the February 2011 letter reiterated that policy, thus demonstrating a final agency action subject to review under the APA." (Order at 27:5-9.)

B. The Agency's Directives Constitute Substantive Rules

The notice and comment requirements of the APA apply only to substantive rules, not to "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice." 5 U.S.C. § 553(b)(3)(A). The exemption for interpretive rules is narrowly construed. *Flagstaff Medical Ctr., Inc. v. Sullivan*, 962 F.2d 879, 885 (9th Cir. 1992). "The label an agency gives to a particular statement of policy is not dispositive." *Mt. Diablo Hosp. Dist. v. Bowen*, 860 F.2d 951, 956 (9th Cir. 1988). Thus, a court must determine independently whether a rule is substantive based on its attributes. *Id.*

All of the relevant indicia establish that the July 2010 and February 2011 Directives are substantive, not interpretive rules. The Directives are broad and of prospective application. *See Yesler Terrace Cmty. Council v. Cisneros*, 37 F.3d 442, 448 (9th Cir. 1994). In addition, the Directives do not constitute mere discretionary "fine tuning"; rather, they were issued pursuant to statutory direction; reflected a change from previous policy; created a basis for enforcement; and reserved little discretion to the regulated entities. *See Hemp Indus. Ass'n v. Drug Enforcement Admin.*, 333 F.3d 1082, 1087-88 (9th Cir. 2003); *Erringer v. Thompson*, 371 F.3d 625, 630 (9th Cir. 2004); *cf. Flagstaff*, 962 F.2d at 886. Thus, the Court's prior determination still holds: "the FHFA's policy on PACE obligations amounts to substantive-rule-making, not interpretive rule-making that would be exempt from the notice and comment requirement." (Order at 29:1-3.)

C. Rule-making is Not a Power of the Agency "as a Conservator"; the Anti-Injunction Provision of the Safety and Soundness Act Thus Does Not Bar Relief

The Agency contends that 12 U.S.C. section 4617(f) bars this Court from issuing any relief for a violation of the notice-and-comment requirements of the APA. A necessary element of this statutory defense, however, is that the Agency's challenged action be taken "as a conservator[.]" 12 U.S.C. § 4617(f). As this Court already has determined, "[s]ubstantive rule-making is not appropriately deemed action pursuant to the FHFA's conservatorship authority." (Order 19:18-19.) This legal conclusion is supported by the general principle favoring judicial review; the language and structure of the Safety and Soundness Act, which distinguishes between regulatory and conservatorship powers; and the Agency's own post-conservatorship rule-making actions.

1. The Safety and Soundness Act Supports the Presumption Favoring Judicial Review of Agency Regulations.

As this Court previously observed, "[t]he courts have long recognized a presumption in favor of judicial review of administrative actions." (Order 14:4-7 (citing *Love v. Thomas*, 858 F.2d 1347, 1356 (9th Cir. 1988)). Courts should restrict access to judicial review only where there is "clear and convincing evidence" of a contrary legislative intent. *Bowen v. Michigan Acad. of Family Physicians*, 476 U.S. 667, 671 (1986).

Nothing in the general provisions of the Safety and Soundness Act suggests that Congress intended to insulate the FHFA from judicial review for violations of the APA. Rather, 12 U.S.C. section 4526(a)-(b) expressly provides that "[a]ny regulations issued by the Director" that are "necessary to carry out the duties of the Director under this chapter [Chapter 46, Government Sponsored Enterprises] or the authorizing statutes, and to ensure that the purposes of this chapter and authorizing statutes are accomplished" must be "issued after notice and the opportunity for public comment pursuant to the provisions of section 553 of Title 5." The courts, therefore, are presumptively empowered to determine whether the Agency has violated section 553 and, if so, to fashion an appropriate remedy. 5 U.S.C. § 702; *id*. at § 706(2)(D) (court empowered to hold unlawful and set aside agency decisions made without observance of procedure required by law).

2. Under the Safety and Soundness Act, Rule-making is Reserved to the Agency as Regulator, Not Conservator.

As noted, section 4617(f) insulates from judicial review only the actions of the Agency "as a conservator." Cases examining analogous conservatorship provisions in other statutes (*e.g.*, those governing the Federal Deposit Insurance Corporation (FDIC)) note that an agency as conservator acts by "stepping into the shoes" of the regulated entity. *Ameristar Fin. Servicing, Co., LLC v. United States*, 75 Fed. Cl. 807 810-812 (2007) (citing *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 86 (1994)). "'A conservator is a person or entity, including a government agency, appointed by a regulatory authority to operate a troubled financial institution in an effort to conserve, manage, and protect the troubled institution's assets until the institution has stabilized or has been closed ….'" *Id.* at 808, n.3 (quoting *Marketing and Resolution of Superior Federal*, FSB ¶ 1 (FDIC OIG Audit Report No. 02-024, July 24, 2002)). As conservator, the FHFA immediately succeeds to "all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity" with respect to the entity and its assets. 12 U.S.C. § 4617(b)(2)(A)(i). Specific actions and powers that FHFA may take as conservator are set out in the Safety and Soundness Act in 12 U.S.C. § 4617(b)(2). Among other things, FHFA "as conservator or receiver" may take over the assets and operate the entity, collect obligations and money due the regulated entity, perform all functions of the regulated entity in the name of the regulated entity, preserve the assets and property of the regulated entity, and enter into contracts for assistance in fulfilling FHFA's duties as conservator. 12 U.S.C. § 4617(b)(2)(B)(i)-(v). The Agency "as conservator or receiver" may also, for example, "transfer or sell any asset or liability of the regulated entity in default" and must "pay all valid obligations of the regulated entity that are due and payable …." 12 U.S.C. § 4617(b)(2)(G), (H).

There is, however, no statutory provision granting the FHFA substantive rule-making power in its role as conservator. As this Court previously noted (*see* Order 17:14-18), the Safety and Soundness Act itself draws a distinction between rule-making and conservatorship actions. All of the relevant conservatorship subsections begin with the introductory phrase, "[t]he Agency may, as conservator …." (Order at pp. 17-18.) In the part of the Act addressing conservatorship

duties, 12 U.S.C. § 4617(b), Congress conspicuously omitted the phrase "as conservator" from provisions that authorize regulations related to conservatorships. *See, e.g.*, 12 U.S.C. § 4617(b)(1) ("[t]he Agency may prescribe such regulations as the Agency determines to be appropriate regarding the conduct of conservatorships or receiverships"); 12 U.S.C. § 4617(b)(2)(C) ("[t]he Agency may, by regulation or order, provide for the exercise of any function by any stockholder, director, or officer of any regulated entity for which the Agency has been named conservator or receiver"); 12 U.S.C. § 4517(b)(4) ("the Director may prescribe regulations regarding the allowance or disallowance of claims by the receiver and providing for administrative determination of claims and review of such determination").

FHFA's argument, at bottom, is that after it has been appointed conservator, any action that it unilaterally deems "necessary to put the regulated entity in a sound and solvent condition" or "appropriate to … preserve and conserve the assets" (*see* 12 U.S.C. § 4617(b)(2)(D)(i), (ii)) is insulated from judicial remedy.[5] The Court should reject this unreasonable reading of the statute for at least two reasons. First, the Agency's overarching supervisory and regulatory mission is to ensure that Fannie Mae and Freddie Mac always operate in a "safe and sound manner" (12 U.S.C. § 4513(a)(1)(B)(i)) – this is not an obligation that is specific to the Agency wearing its conservator hat. FHFA's interpretation thus would rewrite section 4617(f) from its current language:

> …no court may take any action to restrain or affect the exercise of powers or functions of the Agency as conservator or receiver.
>
> to
>
> …once the Agency is appointed conservator or receiver, no court may take any action to restrain or affect the exercise of powers or functions of the Agency.

[5] Indeed, in another case, the Agency contended that once it has been appointed conservator, a court cannot even hold it to the requirements of the Federal Rules of Civil Procedure. As the District Court, District of Columbia held, however, the Agency construes the operation of section 4617(f) "much too broadly"; nothing in that section "purports to suspend the operation of the Federal Rules as applied to FHFA." *In re Fed. Nat'l Mortgage Ass'n Sec., Derivative and "ERISA" Litigation v. Raines*, 725 F. Supp. 2d 169, 177, 178 (D.D.C. 2010).

FHFA would prefer the latter statute. Courts are not, however, "at liberty to rewrite the statute to reflect a meaning [deemed] more desirable" but rather "must give effect to the text congress enacted." *Ali v. Fed. Bureau of Prisons*, 552 U.S. 214, 228 (2008).

Second, FHFA's interpretation is not in harmony with the savings provision of section 4511(c), which preserves the regulatory authority of the FHFA even when it is the conservator. That section provides that the authority of the FHFA Director to take actions under subchapter II (containing the conservator and receivers provisions and addressing the regulated entities' capital levels) and subchapter III (governing FHFA enforcement actions against the regulated entities) "shall not in any way limit the general supervisory and regulatory authority granted to the Director …." Under FHFA's reading, conservatorship would subsume the Agency's supervisory and regulatory authority, rendering section 4511(c) meaningless. A court must, however, "interpret the statute to give effect to [all relevant] provisions where possible." *Ricci v. DeStefano*, __ U.S. __, 129 S.Ct. 2658, 2674 (2009). Thus, the only reasonable reading of the Act is that even after FHFA is appointed conservator, the Agency retains power to exercise general supervisory and regulatory authority and, where that authority extends to issuing substantive rules, section 4526(b) applies and requires compliance with the APA.

3. The Agency's Own Post-Conservatorship Actions Establish that the APA Applies to Rule-making.

The Agency's own post-conservatorship actions establish that the Agency itself understands that the APA's notice-and-comment requirements apply to its substantive rule-making. As the Court noted previously, (Order 28:12-26), FHFA recently engaged in a rule-making on a very similar matter. On August 16, 2010, the Agency published a notice and request for comments in the Federal Register concerning the proposed guidance that the regulated entities "should not deal in mortgages on properties encumbered by private transfer fee covenants" because "[s]uch covenants appear adverse to liquidity, affordability and stability in the housing finance market and to financially safe and sound investments." 75 Fed. Reg. 49932 (Aug. 16, 2010).

Numerous other examples of recent FHFA regulatory actions establish that even after assuming conservatorship, the Agency retains rule-making authority, the exercise of which is

subject to the requirements of section 4526(b) and the APA. *See, e.g.*, 76 Fed. Reg. 5292 (Jan. 31, 2011) (advance notice of proposed rule-making re "Alternatives to Use of Credit Ratings in Regulations Governing the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Federal Home Loan Banks"); 75 Fed. Reg. 32099 (June 7, 2010) (notice of proposed rule-making re "Enterprise Duty to Serve Underserved Markets); 75 Fed. Reg. 4255 (Jan. 27, 2011) (final regulation re "Reporting of Fraudulent Financial Instruments").[6] The Agency similarly should have, but did not, comply with the APA's notice-and-comment requirements before issued the July 2010 and February 2011 Directives.

D. The Court Is Empowered to Vacate the Anti-PACE Directives or Require the Agency to Conduct a PACE Rule-making

Because the Agency failed to comply with the APA, the PACE regulations it issued are invalid, and the Court has the power simply to vacate them. 5 U.S.C. § 706(2); *Paulsen v. Daniels*, 413 F.3d 999, 1008 (9th Cir. 2005); *Ctr. for Food Safety v. Vilsack*, 734 F. Supp. 2d 948, 955 (N.D. Cal. 2010); *Citizens for Better Forestry v. U.S. Dept. of Agric.*, 481 F. Supp. 2d 1059, 1100 (N.D. Cal. 2007). This remedy would be appropriate and serve the Plaintiffs' and the public interest.

In limited circumstances, courts have determined that equity requires an invalid rule to remain in place pending remand to the Agency. *See, e.g., Idaho Farm Bureau Fed'n v. Babbitt*, 58 F.3d 1392, 1405 (9th Cir. 1995) (maintaining invalid rule pending remand where concern existed regarding the potential extinction of an animal species); *Western Oil & Gas Ass'n v. E.P.A.*, 633 F.2d 803, 813 (9th Cir. 1980) (leaving an invalid rule in place to "avoid thwarting in an unnecessary way the operation of the Clean Air Act in the State of California during the time the deliberative process is reenacted"). Plaintiffs do not believe that the FHFA can establish that such circumstances exist here. Nonetheless, pursuant to the Court's preliminary injunction, the Agency already has commenced rule-making. Under these circumstances, Plaintiffs would not

[6] As plaintiffs submitted to the district court on March 25, 2011, according to FHFA's website, after September 7, 2008, the Agency had issued three advanced notices of proposed rule-making; 38 notices of proposed rule-making; 11 interim final rules; two proposed rules; and promulgated 27 final rules pursuant to notice and comment procedures. *See* http://www.fhfa.gov/Default.aspx?Page=89 (Agency administrative activity by year).

object to an order that would leave the Directives in place, pending completion of a rule-making on a court-ordered schedule.

IV. THE AGENCY'S ANTI-PACE DIRECTIVES ARE ARBITRARY AND CAPRICIOUS IN VIOLATION OF THE APA

If the Court rules that the Agency violated the notice-and-comment requirements of the APA in issuing its anti-PACE Directives and orders a remedy on that basis, it need not reach Plaintiffs' claim that the Agency's same actions are arbitrary and capricious in violation of section 706(2)(A) of the APA. *See Sprint Corp. v. FCC*, 315 F.3d 369, 377 (D.C. Cir. 2003) ("In light of the remand [for failure to afford notice and comment], we do not reach Sprint's contention that the rule is arbitrary and capricious"). If, however, the Court were to rule against Plaintiffs on their notice and comment claim, the Court would still be required to rule that the anti-PACE Directives are arbitrary and capricious, based on the Agency's failure to support its summary assertions of risk; its failure to consider available data from existing PACE programs in order to determine whether the asserted risk is borne out in practice; and its failure to consider any alternative other than a flat ban on PACE.

A. Standard of Review

Section 706(2)(A) of the APA requires a reviewing court to, "hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). An agency rule is arbitrary and capricious, "if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co. (State Farm)*, 463 U.S. 29, 43 (1983). While the scope of review under the arbitrary and capricious standard is narrow, a reviewing court still must consider whether the agency examined the relevant data and articulated a satisfactory explanation for its action, "including a 'rational connection between the facts found and the choice made.'" *Id.* (quoting *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962).)

An agency's action must be upheld, if at all, on the basis articulated by the agency itself at the time it acted; "the courts may not accept … counsel's *post hoc* rationalizations for agency action." *State Farm*, 463 U.S. at 50; *see also Northwest Environmental Defense Center v. Bonneville Power Admin.*, 477 F.3d 668, 688 (9th Cir. 2007).

B. The Agency Did Not Support Its Cursory Justifications with Evidence

In the Agency's two-page, July 2010 Directive, which the General Counsel reaffirmed on February 2011, its justifications for its anti-PACE action are set forth, in full, as follows:

- "[C]ertain energy retrofit lending programs present significant safety and soundness concerns …."
- "First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors."
- "The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives."
- "First liens for such loans represent a key alteration of traditional mortgage lending practice. They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation."
- "While the first lien position offered in most PACE programs minimizes credit risk for investors funding the programs, it alters traditional lending priorities.
- "Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption."
- "[F]irst liens that disrupt a fragile housing finance market and long-standing lending priorities, the absence of robust underwriting standards to protect homeowners and the lack of energy retrofit standards to assist homeowners, appraisers, inspectors and lenders determine the value of retrofit products combine to raise safety and soundness concerns."

(EAR, Ex. O (FHFA 00374).)

It is fundamental administrative law that "[t]he agency must make findings that support its decision, and those findings *must be supported by substantial evidence*." *Burlington Truck Lines*, 371 U.S. at 168 (emphasis added). The Agency cites no evidence to support its cursory assertions

of risk, and Plaintiffs could locate no such evidence in the administrative record. The cursory and unsupported conclusions in the July 2010 Statement establish that the Agency's anti-PACE actions are arbitrary and capricious. *See Crickon v. Thomas*, 579 F.3d 978, 985 (9th Cir. 2009) (holding Board of Prison's regulation categorically excluding prisoners with certain prior convictions from early release eligibility invalid where "BOP gave no indication of the basis for its decision"; "did not reference pertinent research studies, or case reviews"; "did not describe the process employed to craft the exclusion"; "did not articulate any precursor findings upon which it relied"; and "did not reveal the analysis used to reach the conclusion that the categorical exclusion was appropriate").

C. The Agency Did Not Consider Data from Existing PACE Programs

In order to satisfy the APA, an "agency must explain the evidence which is available, and must offer a 'rational connection between the facts found and the choice made.'" *State Farm*, 463 U.S. at 52 (quoting *Burlington*, 371 U.S. at 168). As the Supreme Court noted, "[g]enerally, one aspect of that explanation would be a justification for [taking action] before engaging in a search for further evidence." *Id.* at 52. In this case, FHFA did not explain what evidence was available from existing PACE programs or what steps it took to obtain such information. At the time of the Agency's July 2010 Directive, there were data available from existing and operating PACE programs, including the Sonoma County and City of Palm Desert programs, that would have shed light on whether, in practice, PACE presents "unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors." Plaintiffs have reviewed all documents provided by the Agency in its administrative record, and there is no suggestion that the Agency sought out or considered evidence from existing PACE programs. Its failure to do so before issuing its anti-PACE directives was arbitrary and capricious.

D. The Agency Did Not Consider Alternatives to a Blanket Prohibition of PACE

While an agency has considerable discretion to exercise its expert judgment, an agency does not have discretion to ignore apparently reasonable courses of action without offering an explanation and engaging in analysis. The *State Farm* case is illustrative. In that case, the

National Highway Transportation Safety Administration (NHTSA) rescinded a standard that required that vehicles manufactured after a certain date be equipped with "passive restraints" – either airbags or automatic safety belts installed at the choice of the manufacturer. *State Farm*, 463 U.S. at 34, 37-38. NHTSA explained that the manufacturers had overwhelmingly chosen to install automatic safety belts, which could be easily detached, and, therefore, the standard would have only minimal safety benefits. *Id.* at 38-39. The Supreme Court held that NHTSA's action was arbitrary and capricious in part because the agency "apparently gave no consideration whatever to modifying the Standard to require that airbag technology be utilized." *Id.* at 46. Observing that "the logical response to the faults of detachable seatbelts would be to require the installation of airbags[,]" the Court held that this less drastic option "should have been addressed and adequate reasons given for its abandonment." *Id.* at 48.

Similarly, in this case, FHFA took its anti-PACE actions without considering whether the asserted risks could be addressed by actions short of a complete prohibition on Fannie Mae and Freddie Mac purchasing mortgages for properties participating in PACE. The July 2010 Directive itself indicates that asserted risk could be reduced by imposition of "robust underwriting standards to protect homeowners" and "energy retrofit standards to assist homeowners, appraisers, inspectors and lenders determine the value of retrofit products[,]" yet the Agency did not analyze or discuss these options. Moreover, the Agency failed to consider whether DOE's Guidelines for Pilot PACE Financing Programs (FHFA 00979-00985) would address all or some of the Agency's concerns or, if they fell short in the Agency's view, whether or how they might be improved. Further, the Agency did not analyze whether certain established or federally funded PACE programs should be allowed to proceed as "pilot" programs for the purposes of gathering additional information about the real-world risks of PACE. FHFA's failure to devote even "one sentence" to consideration of other, logical options to a complete ban on PACE constitutes a violation of the APA. *State Farm*, 463 U.S. at 48.

For the foregoing reasons, FHFA's July 2010 Directive was arbitrary and capricious in violation of the APA, and this violation provides an alternative basis for granting the remedy discussed in Section III.D., above.

V. THE AGENCY WAS REQUIRED TO, BUT DID NOT, COMPLY WITH THE NATIONAL ENVIRONMENTAL POLICY ACT

If the Court determines that the Agency violated the APA in issuing its anti-PACE Directives, there is no need for the Court to determine, in addition, whether the Agency violated NEPA. The Agency will be required to make a new decision consistent with the APA and will at that time have the opportunity to consider NEPA's application. For the sake of completeness, however, Plaintiffs address their NEPA claim. As set forth below, NEPA applies to the Agency's attempt to "pause" a program that the California Legislature expressly found was essential to addressing climate change and would have environmental benefits. The Agency's clear violation of NEPA provides yet another independent basis for vacating the Agency's anti-PACE Directives and remanding to the Agency for compliance with the law.

A. Summary of NEPA and Standard of Review

NEPA is "our basic national charter for protection of the environment," *Blue Mountains Biodiversity Project v. Blackwood*, 161 F.3d 1208, 1215-16 (9th Cir. 1998), ensuring that federal agencies take a "hard look" at the environmental impacts of their actions before a decision is made. *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 350 (1989). NEPA requires the preparation of an Environmental Impact Statement (EIS) for "major federal actions significantly affecting the quality of the human environment." *Ctr. for Biological Diversity v. Kempthorne*, 588 F.3d 701, 711 (9th Cir. 2009); 42 U.S.C. § 4332(C). An agency may choose to prepare an environmental assessment (EA), which is a concise public document that provides sufficient evidence and analysis for determining whether to prepare an EIS or a finding of no significant impact (FONSI), and also considers alternatives to the proposed action, as required by §102(2)(E) of NEPA. 42 U.S.C. § 4332(E); 40 C.F.R. § 1508.9(a); *see also Ctr. for Biological Diversity*, 588 F.3d at 711.

Judicial review of agency decisions under NEPA is governed by the APA. 5 U.S.C. § 706(2)(A); *Native Ecosystems Council v. Dombeck*, 304 F.3d 886, 891 (9th Cir. 2002). As the Ninth Circuit repeatedly has held, "agency action taken without observance of the procedure

required by law will be set aside." *Idaho Sporting Congress v. Alexander*, 222 F.3d 562, 567 (9th Cir. 2000) (and cases cited therein).

B. The Agency's Anti-PACE Directives Constitute Major Federal Action.

FHFA's July 2010 Statement was a major federal action that triggered NEPA, whether it constitutes a substantive rule on PACE or is simply a change in PACE policy. Adoption of agency rules, regulations or policies constitutes "major federal action" under NEPA. *See* 40 C.F.R. § 1508.18(a) ("[m]ajor Federal action" includes "new or revised agency rules, regulations, plans, policies, or procedures").

C. The Agency's Anti-PACE Directives, Which Interfere with State Law and Local Programs Designed to Achieve Environmental Benefits, May Have a Significant Effect on the Environment.

FHFA took action intended to "pause" state law based programs that were expressly designed to address one of the most important environmental problems currently facing California and the nation – greenhouse gas pollution and climate change – by encouraging energy efficiency and renewable energy projects. As discussed in the Statement of Undisputed Facts, above, the Agency's actions impaired the continuation of existing residential PACE programs, including those of Sonoma County and the City of Palm Desert, and prevented the operation of new residential PACE programs, including Placer County's program. FHFA was aware of the potential environmental impacts of its decision, and its July 2010 Directive conceded as much: "FHFA recognizes that PACE and PACE-like programs … also represent serious efforts to reduce energy consumption." Accordingly, NEPA required, at the very least, that FHFA prepare an EA showing that it took a hard look at the consequences of its anti-PACE actions and explaining whether shutting down or impairing PACE programs would impact the environment. 40 C.F.R. § 1508.9(a); *see also Ctr. for Biological Diversity*, 588 F.3d at 711. The Agency did not, however, provide any consideration or analysis whatsoever as to the potential environmental consequences of its actions. This violation of NEPA provides yet another basis for the Court to set aside the July 2010 and February 2011 Directives. *See Metcalf v. Daley*, 214 F.3d 1135, 1141 (9th Cir. 2000); *Save the Yaak Committee v. Block*, 840 F.2d 714, 717 (9th Cir. 1988).

CONCLUSION

For the foregoing reasons, the Court should grant summary judgment on Plaintiffs' claims that the FHFA violated the notice-and-comment requirements of the APA in issuing its anti-PACE Directives. While the normal remedy for this type of violation would be to vacate the illegal agency action, in this case, the FHFA already has commenced the rule-making process concerning PACE, and the Agency will be even closer to issuing a final rule at the date of the hearing on this matter. In these circumstances, Plaintiffs would not object to an order leaving the previous Directives in place pending completion of the rule-making and directing the Agency to complete its PACE rule-making by a date certain (*e.g.*, by June 1, 2012.)

Alternatively, if the Court holds that the anti-PACE Directives do not constitute substantive rules, the Court should still vacate the Agency's anti-PACE actions as arbitrary and capricious and in violation of NEPA and remand to the agency for proceedings consistent with the Court's opinion.

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