

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA**

DOREEN EDWARDS, OLUBUKOLA)
KESHNIRO, GARRY BREWSTER,)
MARIA AND THOMAS VELLUCCI,)
individually and on behalf of all other)
persons similarly situated,)

Plaintiffs,)

v.)

AURORA LOAN SERVICES, LLC,)
TIMOTHY F. GEITHNER, HENRY)
ALLISON, JR., EDWARD DeMARCO,)
FEDERAL NATIONAL MORTGAGE)
ASSOCIATION, MICHAEL J.)
WILLIAMS, ERIC SCHUPPENHAUER,)

Defendants.)

No. 09-cv-02100-HHK

**MOTION TO DISMISS BY DEFENDANTS FEDERAL NATIONAL MORTGAGE
ASSOCIATION, MICHAEL J. WILLIAMS, AND ERIC SCHUPPENHAUER**

Pursuant to Federal Rules of Civil Procedure 12(b)(1) and 12(b)(6), and Local Civil Rule 7, Defendants Federal National Mortgage Association, Michael J. Williams, and Eric Schuppenhauer move the Court for an Order dismissing Plaintiffs' Complaint. In support of the Motion, the Court is respectfully referred to the accompanying Memorandum of Law as well as the Declaration of Noah A. Levine and accompanying Exhibits. A proposed order is attached.

Dated: January 25, 2010

Respectfully submitted,

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**MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS
BY DEFENDANTS FEDERAL NATIONAL MORTGAGE ASSOCIATION,
MICHAEL J. WILLIAMS, AND ERIC SCHUPPENHAUER**

TABLE OF CONTENTS

	Page(s)
TABLE OF AUTHORITIES	iii
INTRODUCTION	1
STATEMENT.....	3
I. The Home Affordable Modification Program	3
A. The Emergency Economic Stabilization Act.....	3
B. The Home Affordable Modification Program	4
C. HAMP’s Operation	6
D. HAMP’s Continued Evolution.....	8
ARGUMENT	9
I. Motion To Dismiss Standard	9
II. Plaintiffs’ Claim Against The Fannie Mae Defendants Should Be Dismissed For Lack Of Standing: The Alleged Harm To Plaintiffs Is Not Fairly Traceable To Any Action of Fannie Mae.....	10
III. Plaintiffs Fail To State A Claim Because Their Complaint Does Not Adequately Allege A Deprivation Of A Protected Property Interest	12
A. Neither EESA Nor HAMP Confer Any Legally Enforceable Entitlement To A HAMP Modification	13
B. Plaintiffs Have No Protected Property Interest As Third-Party Beneficiaries Of Aurora’s Contract With The Government	15
C. HAMP Is Too Uncertain And Allows Too Much Discretion To Create A Property Interest Protected By The Due Process Clause.....	18
D. Plaintiffs, As Prospective Applicants For HAMP Modifications, Have No Property Interest	20
IV. HAMP Provides Plaintiffs All The Process That the Constitution Requires.....	21
A. If Plaintiffs Have An Enforceable Third-Party-Beneficiary Entitlement To A HAMP Modification, Their Third-Party Contract Claim Would Provide All The Process That Is Due	22

B. HAMP In Any Event Provides Potentially Eligible Borrowers With
Sufficient Due Process23

CONCLUSION.....25

TABLE OF AUTHORITIES

CASES

	Page(s)
<i>Abney v. United States</i> , 431 U.S. 651 (1977).....	25
<i>Allen v. Wright</i> , 468 U.S. 737 (1984)	10
<i>American Manufacturers Insurance Co. v. Sullivan</i> , 526 U.S. 40 (1999).....	20, 21
<i>Ashcroft v. Iqbal</i> , 129 S. Ct. 1937 (2009).....	9
<i>Beckett v. Air Line Pilots Ass’n</i> , 995 F.2d 280 (D.C. Cir. 1993).....	15
<i>Bell Atlantic Corp. v. Twombly</i> , 550 U.S. 544 (2007).....	9
<i>Bishop v. Wood</i> , 426 U.S. 341 (1976).....	14
<i>Board of Regents v. Roth</i> , 408 U.S. 564 (1972).....	12, 13, 18, 21
<i>Cafeteria & Restaurant Workers v. McElroy</i> , 367 U.S. 886 (1961).....	23
<i>Coastland Corp. v. Currituck County</i> , 734 F.2d 175 (4th Cir. 1984).....	22
<i>Connecticut Board of Pardons v. Dumschat</i> , 452 U.S. 458 (1981).....	14
<i>Crow Creek Sioux Tribe v. Brownlee</i> , 331 F.3d 912 (D.C. Cir. 2003).....	10
<i>Easter v. American West Financial</i> , 381 F.3d 948 (9th Cir. 2004)	10
<i>Escobedo v. Countrywide Home Loans, Inc.</i> , No. 09-cv-1557, 2009 WL 4981618 (S.D. Cal. Dec. 15, 2009).....	16
<i>German Alliance Insurance Co. v. Home Water Supply Co.</i> , 226 U.S. 220 (1912).....	15
<i>Goldberg v. Kelly</i> , 397 U.S. 254 (1970)	13, 20
<i>Greenbriar Village, LLC v. Mountain Brook, City</i> , 345 F.3d 1258 (11th Cir. 2003).....	20
<i>Herbert v. National Academy of Sciences</i> , 974 F.2d 192 (D.C. Cir. 1992).....	9
<i>Hinton v. Corrections Corp. of America</i> , 624 F. Supp. 2d 45 (D.D.C. 2009)	5
<i>Jones v. Barnes</i> , 463 U.S. 745 (1983).....	25
<i>Kentucky Department of Corrections v. Thompson</i> , 490 U.S. 454 (1989).....	14
<i>Kowal v. MCI Communications Corp.</i> , 16 F.3d 1271 (D.C. Cir. 1994).....	9

Loulou v. Ashcroft, 354 F.3d 706 (8th Cir. 2003).....25

Lujan v. Defenders of Wildlife, 504 U.S. 555 (1992)10

Lujan v. G&G Fire Sprinklers, Inc., 532 U.S. 189 (2001)22

Lyng v. Payne, 476 U.S. 926 (1986).....21

M.L.B. v. S.L.J., 519 U.S. 102 (1996).....25

Macharia v. United States, 334 F.3d 61 (D.C. Cir. 2003)9

Mathews v. Eldridge, 424 U.S. 319 (1976).....20, 21, 23

Memphis Light, Gas & Water Division v. Craft, 436 U.S. 1 (1978).....14

Natale v. Ridgefield, 170 F.3d 258 (2d Cir. 1999).....20

O’Bannon v. Town Court Nursing Center, 447 U.S. 773 (1980)13, 14, 17

Ortwein v. Schwab, 410 U.S. 656 (1973)25

PDK Labs Inc. v. Reno, 134 F. Supp. 2d 24 (D.D.C. 2001)29

Platt v. Brockenborough, 476 F. Supp. 2d 467 (E.D. Pa. 2007).....25

Rasul v. Bush, 215 F. Supp. 2d 55 (D.D.C. 2002)9

Redondo-Borges v. HUD, 421 F.3d 1 (1st Cir. 2005).....17

Reed v. Village of Shorewood, 704 F.2d 943 (7th Cir. 1983).....18

Roberts v. Cameron-Brown Co., 556 F.2d 356 (5th Cir. 1977).....17

S&D Maintenance Co. v. Goldin, 844 F.2d 962 (2d Cir. 1988).....17

San Bernardino Physicians’ Services Medical Group v. San Bernardino County,
825 F.2d 1404 (9th Cir. 1987)17

SEC v. Prudential Securities, Inc., 136 F.3d 153 (D.C. Cir. 1998)15, 16

Sharp v. Lindsey, 285 F.3d 479 (6th Cir. 2002).....22

Sierra Club v. EPA, 292 F.3d 895 (D.C. Cir. 2002)10

Suburban Mortgage Associates, Inc. v. HUD, 480 F.3d 1116 (Fed Cir. 2007).....22

Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007)5

Town of Castle Rock v. Gonzales, 545 U.S. 748 (2005).....12, 13, 14, 17, 19, 20

United States v. Posner, 424 F.2d 181 (9th Cir. 1970).....25

Veitch v. England, 471 F.3d 124 (D.C. Cir. 2006)10

Williams v. Geithner, No. 09-1959, 2009 WL 3757380 (D. Minn. Nov. 9, 2009).....2, 3, 18, 19

OTHER AUTHORITIES

42 U.S.C. § 1983.....22

Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat.
3765.....3, 4, 13

Restatement (Second) of Contracts (1981)15

INTRODUCTION

Defendant Federal National Mortgage Association (“Fannie Mae”) has a public mission to support liquidity and stability in the secondary mortgage market, ensuring that individuals can access credit to purchase homes they can afford. Pursuant to that mission, Fannie Mae has made significant efforts to prevent foreclosures and keep people in their homes. One way Fannie Mae has pursued these efforts is through participation in the United States Treasury Department’s (“Treasury”) Home Affordable Modification Program (“HAMP”). In HAMP, private mortgage servicers voluntarily enter into participation contracts with the government, agreeing to modify the terms of qualifying mortgage loans according to Treasury guidelines. Fannie Mae has contracted with Treasury to serve as its financial agent for HAMP and, in that role and on Treasury’s behalf, Fannie Mae enters into participation contracts with the private servicers.

It is not clear why Plaintiffs have sued Fannie Mae or two of its officers. Fannie Mae does not own Plaintiffs’ loans, it did not make any determinations regarding Plaintiffs’ eligibility for HAMP modifications, nor did it deny Plaintiffs any procedures in connection with such determinations. Plaintiffs are New York homeowners who allege that one participating servicer—Defendant Aurora Loan Services, LLC (“Aurora”)—did not fulfill its contractual obligations when Plaintiffs asked that servicer to consider their loans for HAMP modifications. Plaintiffs’ primary claims are third-party-beneficiary contract claims against Aurora, while they assert only constitutional claims against the Fannie Mae Defendants, naming certain Treasury and Federal Housing Finance Agency officials as defendants on the latter claims too. Plaintiffs claim that HAMP modifications constitute “property” for purposes of the Due Process Clause (Compl. ¶ 178) but, given that Fannie Mae neither owns the loans to be modified nor made any HAMP determinations about those loans, Plaintiffs do not allege that Fannie Mae ever deprived them of that putative property. The only basis that Plaintiffs assert for their constitutional claim

is the allegation that Fannie Mae failed “to implement policies and procedures” that, in turn, would “protect the procedural due process rights of Plaintiffs and other similarly situated borrowers.” Compl. ¶ 1. Plaintiffs make this claim despite the fact that Fannie Mae acts only as Treasury’s agent, and Treasury retains sole responsibility for the Program Guidelines that govern servicers’ HAMP determinations. As for Defendants Williams and Schuppenhauer, Plaintiffs make no allegations whatsoever that either did anything in violation of the Constitution. All Plaintiffs say about the two defendants is that they respectively are Chief Executive Officer and Senior Vice President of Fannie Mae. Compl. ¶¶ 23-24.

Plaintiffs’ claims against the Fannie Mae Defendants should be dismissed. *First*, Plaintiffs lack standing to assert their claims because the Fannie Mae Defendants cannot fairly be deemed responsible for any injury that Plaintiffs allege they have suffered. Fannie Mae does not own Plaintiffs’ loans, Fannie Mae did not make any determinations about whether those loans should be modified pursuant to HAMP, and Fannie Mae has no authority to amend the Treasury Program Guidelines governing such determinations. (*Infra*, Argument Part II.)

Second, Plaintiffs’ constitutional claim lacks merit. One court already has rejected the same constitutional claim that Plaintiffs assert here, holding that “HAMP does not provide Plaintiffs with a ‘protected property interest,’ the denial of which must comport with due process protections.” *Williams v. Geithner*, No. 09-1959, 2009 WL 3757380, at *7 (D. Minn. Nov. 9, 2009). As that court recognized, borrowers have no enforceable legal entitlement to HAMP modifications. HAMP not only “ma[kes] servicer participation voluntary, but also afford[s] to program participants discretion on several variables that” affect eligibility for a HAMP modification, precluding the recognition of any constitutionally protected property interest. *Id.*

The *Williams* decision is correct. If credited, Plaintiffs' theory would revolutionize constitutional law. HAMP is not like any program that courts have found to implicate a property interest protected by the Due Process Clause. HAMP is neither a government entitlement program nor even a contract by which the government has assumed legal obligations to borrowers. The alleged government benefit at issue is not a direct payment or employment, but rather the reformation of a private contract. The benefit is also highly uncertain, and receipt of the benefit in any one case is subject to the discretion of a number of parties. In short, receipt of a HAMP modification is far from an enforceable legal entitlement. It is not a property interest protected by the Constitution. (*Infra*, Argument Part III.)

Finally, even if HAMP modifications could be considered property interests protected by the Fifth Amendment, adequate process already exists to protect any such interests. (*Infra*, Argument Part IV.)

STATEMENT

I. The Home Affordable Modification Program

A. The Emergency Economic Stabilization Act

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act ("EESA"), Pub. L. No. 110-343, 122 Stat. 3765, authorizing the Secretary of the Treasury to purchase up to \$700 billion in "troubled assets" to stabilize credit markets. Section 109 requires the Secretary to promote foreclosure mitigation initiatives by "implement[ing] a plan that seeks to maximize assistance for homeowners and us[ing] the authority of the Secretary to encourage the servicers of the underlying mortgages, considering net present value to the taxpayer, to take advantage of the HOPE for Homeowners Program ... or other available programs to minimize foreclosures." *Id.* § 109(a).

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

B. The Home Affordable Modification Program

In early 2009, Treasury unveiled HAMP, the Obama Administration’s primary foreclosure prevention program. *See* Compl. ¶¶ 26-27. HAMP does not involve direct government loans or payments to mortgage borrowers. Instead, HAMP provides financial incentives to mortgage servicers and investors to encourage them to modify the terms of private mortgages where foreclosure may be avoidable and modification is in the financial interests of the involved parties. *Id.* ¶ 33. As Treasury’s agent, Fannie Mae contracts with the private servicers, requiring the servicers to modify loans according to a separate set of Treasury Program Guidelines incorporated into the servicer participation contracts. Treasury then uses EESA funds to pay the incentives to the servicers who complete the modifications and to the investors whose mortgages are modified. *See id.*

To help administer HAMP, Treasury retained Fannie Mae as its financial agent. *See* Compl. ¶¶ 3, 22.¹ Fannie Mae acts as program administrator, record-keeper, and paying agent,

¹ Section 101 of EESA authorizes Treasury to designate financial agents. The Financial Agency Agreement (“FAA”) between Treasury and Fannie Mae is appended as Exhibit 1 to the Declaration of Noah A. Levine (“Levine Declaration”) and is available at <http://www.financialstability.gov/docs/ContractsAgreements/Fannie%20Mae%20FAA%20021809%20.pdf>. This contract, like other documents cited below, is properly considered on a motion to dismiss. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007); *see also Hinton v. Corrections Corp. of Am.*, 624 F. Supp. 2d 45, 46 (D.D.C. 2009).

and is the party that formally enters into the HAMP participation agreements with private servicers on Treasury's behalf. *See* Compl. ¶ 3. Fannie Mae is required by its agency agreement to "comply with all lawful instructions or directions received from the Treasury." FAA, at 4. It is therefore Treasury—and not Fannie Mae—that retains full responsibility and discretion over the Program Guidelines that govern servicers' HAMP determinations. Fannie Mae's contract with Treasury is explicit on this point, stating that "Treasury is solely responsible for developing the Program Guidelines and ... [Fannie Mae] must follow the Program Guidelines." *Id.* at F-2.

Servicer participation in HAMP is voluntary. Servicers who do elect to participate enter into contracts—known as Servicer Participation Agreements ("SPAs")—with Fannie Mae as the financial agent for Treasury, under which the servicers commit to perform loan modifications pursuant to the Program Guidelines (hereinafter "Guidelines" or "Treasury Guidelines"). *See* Compl. ¶ 3.² The Guidelines contain initial HAMP eligibility criteria, prescribe factors that servicers must consider to determine whether a modification is available, and set forth steps the servicers must take to set the terms of any modification.³

The SPA and the Treasury Guidelines incorporated therein govern the obligations of the servicer to Treasury. Nothing in the SPA extends the servicer's obligations to a potentially eligible borrower, or indicates that a borrower is considered an intended beneficiary of the contract with a right to enforce it or the incorporated Guidelines against the servicer. To the

² Aurora's SPA is appended as Exhibit 2 to the Levine Declaration and is available at <http://www.financialstability.gov/docs/HAMP/AuroraLoanServicesLLCServicerParticipationAgreement.pdf>.

³ The current Guidelines are found in Supplemental Directive 09-01 ("SD09-01") (Apr. 6, 2009), which is appended as Exhibit 3 to the Levine Declaration and available at https://www.hmpadmin.com/portal/docs/hamp_servicer/sd0901.pdf.

contrary, the SPA identifies the beneficiaries of the SPA as “the parties to the Agreement and their permitted successors-in-interest.” Aurora SPA § 11.E.

C. HAMP’s Operation

The Treasury Guidelines establish a number of initial eligibility criteria for receipt of a HAMP modification, including:

- the loan is a first-lien mortgage loan originated on or before January 1, 2009;
- the loan is secured by a property that is the borrower’s principal residence;
- the property has not been abandoned or condemned;
- the current unpaid principal balance is within specified limits;
- the loan has not previously been modified under HAMP;
- the borrower has a monthly mortgage payment greater than 31 percent of monthly income, but has insufficient assets to make the payment; and
- the loan is delinquent or an imminent default is reasonably foreseeable.

See Compl. ¶ 35; SD09-01, at 2-3. Servicers are afforded discretion to make the “imminent default” determination using their own internal standards. SD09-01, at 3-4.

Initial eligibility for participation does not automatically qualify a borrower for a HAMP modification. After the servicer verifies initial eligibility, the Guidelines require the servicer then to perform a full evaluation of the loan to determine whether a HAMP modification is available. Modification is not required in several circumstances:

- Where the modification is prohibited by an investor servicing agreement, and the servicer’s reasonable efforts to lift the prohibition are unsuccessful. Likewise, modification is not required where the servicer cannot obtain any other third-party consents, waivers, or delegations required by contract or law. *See* SD09-01, at 1; Aurora SPA § 2.B.
- Where the projected net present value (“NPV”) of the borrower’s modified loan payments would be less than the projected NPV if the loan were not modified (an “NPV-negative” result). Servicers with sufficiently large books of business are

permitted discretion to modify their NPV models using statistics from their own portfolios. *See* SD09-01, at 4-5.

- Where application of a required modification “waterfall” (specified reductions of the interest rate, extensions of the loan term, and forbearance of a portion of principal) will not achieve the targeted monthly mortgage payment of 31 percent of the borrower’s gross monthly income. *See* SD09-01, at 8-10.

If the loan qualifies for HAMP modification, the servicer must first offer a trial modification, in which the borrower must make several payments (generally for three months) under the modified terms to demonstrate the sustainability of the modified mortgage. *See* SD09-01, at 15. If the borrower completes the trial period and provides required documentation, and the servicer verifies the borrower’s eligibility, then the servicer must offer a permanent modification. *See id.* at 14-15, 17-18.

If the servicer determines that a loan is not eligible for a HAMP modification, the servicer must report the reason to Fannie Mae as Treasury’s program administrator.⁴ The servicer also must send a letter to the borrower explaining in “clear, non-technical language” the reason or reasons for the modification denial.⁵ That letter must include a toll-free number through which the borrower can reach a representative of the servicer who is “capable of providing specific details” about the notice and the reason for the denial.⁶ The notice also must provide the borrower with the phone number for a hotline through which the borrower can obtain

⁴ *See* Supplemental Directive 09-06, at 2, 14 (Sept. 11, 2009) (“SD09-06”), *attached as Exhibit 4 to the Levine Declaration; Compl. ¶ 148.*

⁵ *See* Supplemental Directive 09-08, at 2 (Nov. 3, 2009) (“SD09-08”), *attached as Exhibit 5 to the Levine Declaration; Compl. ¶ 148.*

⁶ SD09-08, at 4.

assistance from a dedicated team of nonprofit housing counselors to intercede on the borrower's behalf with the servicer.⁷

D. HAMP's Continued Evolution

HAMP was not envisioned as a permanent entitlement program, but rather as a short-term initiative that, due to its quick enactment, was expected to involve a gradual build-out by servicers of the supporting infrastructure necessary to render it fully operational. As that build-out has progressed, the program has showed increasing success. After approximately ten months, nearly 100 servicers have entered into HAMP participation contracts, servicers have offered trial modifications to more than 1.1 million homeowners, and more than 850,000 of those modifications are underway.⁸ Treasury reports that "HAMP is on track to provide a second chance for up to 3 to 4 million borrowers by the end of 2012."⁹

Treasury also continues to undertake efforts to improve HAMP, including:

- Launching an aggressive campaign to convert trial modifications to permanent modifications;
- Increasing the transparency of the NPV model through new tools that counselors can use to assist borrowers applying for modifications;
- Improving the escalation process so that borrowers may report suspected misapplication of HAMP program rules to trained staff who can intercede with the servicer to reevaluate HAMP applications;
- Directing Freddie Mac to undertake a "second look" process—now underway—to review delinquent loans to ensure that borrowers have been solicited and properly evaluated for HAMP; and

⁷ *Id.*

⁸ See Making Home Affordable Program Servicer Performance Report Through December 2009 (Jan. 19, 2010), *attached as Exhibit 6 to the Levine Declaration.*

⁹ Testimony of Assistant Treasury Secretary Herbert Allison, House Financial Services Committee, Hearing on the Private Sector and Government Response to the Mortgage Foreclosure Crisis (Dec. 8, 2009) ("Allison Testimony"), *attached as Exhibit 7 to the Levine Declaration.*

- Establishing a compliance committee within Treasury to review servicers' compliance and determine appropriate remedies, from reconsideration of individual loans to additional servicer oversight and monetary penalties.

Allison Testimony, *supra* n.9.

ARGUMENT

I. Motion To Dismiss Standard

A Rule 12(b)(1) motion to dismiss for lack of standing implicates subject matter jurisdiction, and the plaintiff bears the burden of establishing that the Court has subject matter jurisdiction. *See Rasul v. Bush*, 215 F. Supp. 2d 55, 61 (D.D.C. 2002). On a Rule 12(b)(1) motion, the court must scrutinize the plaintiffs' factual allegations more closely than on a Rule 12(b)(6) motion for failure to state a claim. *See Macharia v. United States*, 334 F.3d 61, 64, 69 (D.C. Cir. 2003). The Court is not limited to the allegations contained in the complaint, but may consider materials outside the pleadings. *See Herbert v. National Acad. of Scis.*, 974 F.2d 192, 197 (D.C. Cir. 1992).

When ruling on a Rule 12(b)(6) motion to dismiss, a court must assume the veracity of all "well-pleaded factual allegations" in the complaint, but need not accept as true "naked assertion[s]' devoid of 'further factual enhancement.'" *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949-1950 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 557 (2007)). Nor should the court accept "legal conclusions cast in the form of factual allegations." *Kowal v. MCI Commc'ns Corp.*, 16 F.3d 1271, 1276 (D.C. Cir. 1994). A pleading must offer more than "'labels and conclusions' or 'a formulaic recitation of the elements of a cause of action'...." *Iqbal*, 129 S. Ct. at 1949 (quoting *Twombly*, 550 U.S. at 555). Rather, the plaintiff must plead factual allegations sufficient to raise the right to relief beyond the speculative level. *See Twombly*, 550 U.S. at 555.

II. Plaintiffs' Claim Against The Fannie Mae Defendants Should Be Dismissed For Lack Of Standing: The Alleged Harm To Plaintiffs Is Not Fairly Traceable To Any Action of Fannie Mae

“Standing is one of the essential prerequisites to jurisdiction under Article III.” *Crow Creek Sioux Tribe v. Brownlee*, 331 F.3d 912, 915 (D.C. Cir. 2003). A plaintiff bears the burden of establishing proper standing “at the outset of its case.” *Sierra Club v. EPA*, 292 F.3d 895, 901 (D.C. Cir. 2002). Among other things, “Article III standing requires the plaintiff to show that his injury is ‘fairly traceable to the defendant’s allegedly unlawful conduct.’” *Veitch v. England*, 471 F.3d 124, 135 (D.C. Cir. 2006) (quoting *Allen v. Wright*, 468 U.S. 737, 751 (1984)). When a plaintiff’s injuries cannot fairly be traced to a particular defendant, the plaintiff has no standing to sue that defendant, and the claims against that defendant must be dismissed. *See, e.g., Easter v. American W. Fin.*, 381 F.3d 948, 961-962 (9th Cir. 2004) (dismissing defendants who did not own named plaintiffs’ loans because imposition of usurious interest rates could only be traced to lenders that owned named plaintiffs’ loans).

Plaintiffs’ core allegation is that they were harmed when their private loan servicer—Aurora—did not properly consider their loans for HAMP modifications. Plaintiffs’ asserted injury is that they face “a substantially greater risk of losing their homes to foreclosure.” Compl. ¶ 1. To establish standing to sue the Fannie Mae Defendants, Plaintiffs accordingly must establish some causal connection between this alleged injury and some conduct of the Fannie Mae Defendants. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-561 (1992). Plaintiffs, however, never allege that Fannie Mae or the two named company officers did anything that would render them responsible for this injury. Throughout the complaint, Plaintiffs’ allegation is that Aurora, which is charged with reviewing the borrowers’ loans for HAMP eligibility, caused Plaintiffs’ injuries. According to the complaint (and the basic manner in which HAMP works), it is Aurora that allegedly refused to consider Plaintiffs for HAMP modifications, Aurora that

allegedly failed to provide sufficient notice of the reasons for denial, and Aurora that allegedly failed to provide for an appeal of any such denial to a neutral decisionmaker. *See, e.g.*, Compl. ¶¶ 6, 8, 52-54, 170-172.

As the complaint's allegations make clear, the injuries allegedly flowing from the denial of a HAMP modification cannot fairly be traced to any action taken by the Fannie Mae Defendants. Fannie Mae does not own or service Plaintiffs' loans. Fannie Mae did not participate in or direct Aurora's alleged inaction on Plaintiffs' modification requests. As a result, Fannie Mae cannot be charged with any allegedly improper denial of HAMP modifications to Plaintiffs.

Fannie Mae also cannot be charged with any improper denial of procedural protections to Plaintiffs. As the complaint makes clear, again, Plaintiffs' allegation is that Aurora did not afford such protections as part of its HAMP determination process. *See, e.g.*, Compl. ¶¶ 170-172. Plaintiffs do allege that Fannie Mae (and other defendants) failed to require procedures that, in turn, would have required servicers like Aurora to afford notice and a right to appeal (*see, e.g.*, Compl. ¶¶ 1, 7, 179-180), but that allegation cannot suffice to establish Article III standing for at least two reasons. First, the Due Process Clause prohibits the government¹⁰ from depriving persons of property without due process of law; it does not require that the government "protect the procedural due process rights" (Compl. ¶ 1) of persons when *other parties* allegedly deprive those persons of property. Second, Fannie Mae does not bear legal responsibility for the Treasury Program Guidelines that govern servicers' HAMP decisions, so the Fannie Mae Defendants cannot in any event properly be charged with any improper failure to require certain

¹⁰ Fannie Mae does not concede that it can properly be treated as the government for purposes of the Due Process Clause but, even if it could, as the argument in the accompanying text demonstrates, it cannot be charged with responsibility for any alleged due process injury.

procedural protections as part of those Guidelines. Fannie Mae's contract with Treasury is clear, stating that "Treasury is solely responsible for developing the Program Guidelines and ... [Fannie Mae] must follow the Program Guidelines." FAA, at F-2.

The complaint does even less to establish Plaintiffs' standing to assert claims against the two Fannie Mae officers. There is no allegation whatsoever of any causal connection between the officers' conduct and any injury to Plaintiffs. Indeed, there is no allegation that either defendant did anything other than serve as Fannie Mae's CEO (Mr. Williams) or Senior Vice President responsible for HAMP (Mr. Schuppenhauer). Compl. ¶¶ 23-24.

III. Plaintiffs Fail To State A Claim Because Their Complaint Does Not Adequately Allege A Deprivation Of A Protected Property Interest

The Due Process Clause safeguards "the security of interests that a person has already acquired in specific [government] benefits," but it does not apply to every prospective advantage potentially afforded by government actions. *Board of Regents v. Roth*, 408 U.S. 564, 576 (1972). To constitute a property interest for purposes of the Clause, "a person clearly must have more than an abstract need or desire ... [or] a unilateral expectation" of receiving a particular government benefit; "[h]e must, instead, have a legitimate claim of entitlement to it." *Id.* at 577. Property interests are not created by the Constitution itself but, "[r]ather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law." *Town of Castle Rock v. Gonzales*, 545 U.S. 748, 756 (2005). The question is not simply whether there is an expectation of certain government treatment, but whether the individual has an enforceable right to that treatment. *E.g., id.* at 757; *O'Bannon v. Town Court Nursing Ctr.*, 447 U.S. 773, 788 n.21 (1980).

For several reasons, HAMP is quite different from any program courts have found to support a protected property interest. In contrast to cases that have considered federal

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

A. Neither EESA Nor HAMP Confer Any Legally Enforceable Entitlement To A HAMP Modification

EESA’s text precludes any assertion that the statute establishes any entitlement to HAMP modifications. Section 109 uses the term “shall,” but only to require that the Secretary “implement a plan *that seeks to* maximize assistance for homeowners” and use his authority “*to encourage* the servicers of the underlying mortgages, considering net present value to the taxpayer, to take advantage of ... available programs to minimize foreclosures.” EESA § 109(a) (emphases added). EESA neither compels assistance to any identifiable category of borrowers or loans, nor mandates the form or scope of any mitigation measures to be provided. All such issues are left to the discretion of the Secretary. That discretion, standing alone, bars any assertion that EESA creates an enforceable legal entitlement in borrowers to HAMP loan modifications. *See, e.g.*, *Castle Rock*, 545 U.S. at 756 (“Our cases recognize that a benefit is not a protected entitlement if government officials may grant or deny it in their discretion.”). In short, EESA is “not worded in such a way that a [borrower] could reasonably expect to enforce

[it] against [government] officials.” *Kentucky Dep’t of Corrs. v. Thompson*, 490 U.S. 454, 464 (1989).

Nor is HAMP itself structured such that borrowers could reasonably expect to be entitled to HAMP modifications. No regulation or contract requires the government to provide HAMP modifications. HAMP is not built upon any mandatory regulations at all, but rather was developed and has been implemented by contract. Those contracts, the SPAs, preserve to Treasury the discretion to terminate the program altogether or amend the program terms going forward, without legislation, rulemaking, or similar process.¹¹

When it comes to the specific property interest to which Plaintiffs assert an entitlement—the receipt of a loan modification (Compl. ¶ 169)—no statute, regulation, or contract “purport[s] to limit the Government’s right[s],” “define the Government’s obligations[,] or limit its powers in any way.” *O’Bannon*, 447 U.S. at 785 & n.18. This absence of any restriction on the government, requiring it to provide loan modifications according to established criteria, is fatal to Plaintiffs’ Due Process Clause theory because ultimately “[t]he ground for a constitutional claim, if any, must be found in statutes or other rules defining the *obligations* of the [relevant government] authority.” *Connecticut Bd. of Pardons v. Dumschat*, 452 U.S. 458, 465 (1981) (emphasis added); *see also Memphis Light, Gas & Water Div. v. Craft*, 436 U.S. 1, 11 (1978) (no property interest in government services that can be terminated at will); *Bishop v. Wood*, 426 U.S. 341, 347-348 (1976) (same regarding at-will government employment). Here, there is no such ground.

¹¹ See Aurora SPA §§ 6(D), (E) (authorizing termination of SPA upon Treasury’s direction or HAMP’s termination); *id.* § 10 (authorizing amendments that materially impact eligibility requirements, incentives, and servicers’ obligations on prospective basis).

B. Plaintiffs Have No Protected Property Interest As Third-Party Beneficiaries Of Aurora's Contract With The Government

Plaintiffs seek to establish an enforceable legal entitlement to HAMP modifications under a third-party-beneficiary contract theory. That theory is not applicable here and, regardless, would not transform HAMP modifications into protected property interests for the purposes of the Due Process Clause.

Government contracts by their nature benefit the public, but only in rare circumstances will courts deem individual members of the public to be intended beneficiaries empowered to enforce those contracts in court. *See Restatement (Second) of Contracts* § 313(2) cmt. a (1981) (“Government contracts often benefit the public, but individual members of the public are treated as incidental beneficiaries unless a different intention is manifested.”). This “exceptional privilege” is granted so rarely because of the complications that would ensue from private enforcement of government contracts by members of the general public. *See, e.g., German Alliance Ins. Co. v. Home Water Supply Co.*, 226 U.S. 220 (1912). To overcome the “basic contract principle that third party beneficiaries of a government contract are generally assumed to be merely incidental beneficiaries, and may not enforce the contract,” a third party therefore must show that the parties “clear[ly] inten[ded]” that the third party be permitted to sue to enforce the contract. *Beckett v. Air Line Pilots Ass’n*, 995 F.2d 280, 288 (D.C. Cir. 1993).

Plaintiffs have not established, and cannot establish, that “clear intent” here. Plaintiffs’ primary ground for treatment as third-party beneficiaries of the SPAs (*see* Compl. ¶¶ 42-50) appears to be the “mistaken belief” that if the contracting parties had any intent to benefit them (the borrowers), then they are intended beneficiaries with enforcement rights. *SEC v. Prudential Secs., Inc.*, 136 F.3d 153, 159 (D.C. Cir. 1998). But the D.C. Circuit has rejected that theory, making clear that “[t]he test is not ... only whether the contracting parties intended to confer a

benefit directly on the third parties, but also whether the parties intended the third party to be able to sue to protect that benefit.” *Id.* A third party is “not an ‘intended beneficiary’ unless the parties ‘intended that [the] third party should receive a benefit *which might be enforced in the courts.*’” *Id.* Plaintiffs do not point to anything in the SPAs—or even beyond them—that would suggest that Treasury, Fannie Mae, and servicers intended that borrowers be empowered to enforce the contract’s provisions.

Indeed, the text of Aurora’s SPA demonstrates the contrary: only the parties and their successors in interest are empowered to enforce it. *See Escobedo v. Countrywide Home Loans, Inc.*, No. 09-cv-1557, 2009 WL 4981618, at *3 (S.D. Cal. Dec. 15, 2009) (holding that borrowers are merely incidental beneficiaries of HAMP SPA, not intended beneficiaries with enforceable rights). The SPA specifically addresses the issue of intended beneficiaries and states that the contract “shall inure to the benefit of and be binding upon *the parties to the Agreement and their permitted successors in interest.*” Aurora SPA § 11.E (emphasis added); *see also Escobedo*, 2009 WL 4981618, at *2 (relying in part on Section 11.E of HAMP SPA in rejecting intended beneficiary claim). The SPA gives Fannie Mae (as Treasury’s agent) discretion to determine how to respond to any default by Aurora, permitting it to “take any, all, or none” of a variety of actions ranging from monetary penalties, to additional oversight, to termination. Aurora SPA § 6.B; *see also* Compl. ¶ 139. Nothing in the SPA suggests that third parties can interfere with this discretion by seeking specific enforcement of the agreement in court.¹²

¹² Even beyond the specific context of the SPAs used in HAMP, and the Guidelines incorporated therein for servicing of eligible loans, courts generally have rejected assertions that mortgage servicing guidelines bestow enforceable rights upon affected borrowers absent some express indication of intent to vest borrowers with such a right. *See, e.g., Roberts v. Cameron-Brown Co.*, 556 F.2d 356, 360-361 (5th Cir. 1977) (HUD servicing handbook for low-income housing assistance program).

Finally, even were third-party enforcement of the SPA by interested borrowers legally supported, that would not make the receipt of a HAMP modification a constitutionally protected property interest. Even as to parties in direct contractual privity, courts have been reluctant to hold that a government contract gives rise to a protected property interest. Courts repeatedly have held that “a simple breach of contract does not amount to an unconstitutional deprivation of property” because “[t]o hold otherwise would run the risk of transmogrifying virtually every dispute involving an alleged breach of contract by a [government] into a constitutional case.” *Redondo-Borges v. HUD*, 421 F.3d 1, 10 (1st Cir. 2005); *see also S&D Maint. Co. v. Goldin*, 844 F.2d 962, 966 (2d Cir. 1988); *San Bernardino Physicians’ Servs. Med. Group, Inc. v. San Bernardino County*, 825 F.2d 1404, 1410 (9th Cir. 1987).

Recognizing a third-party-beneficiary theory as sufficient to establish a protected property interest would stretch the Constitution even further, locating Plaintiffs’ alleged property interest in contracts that the government has entered into with *private parties other than Plaintiffs*. In this respect, Plaintiffs’ theory requires a leap that courts have been reluctant to take—recognition of a protected property interest based on an indirect advantage that one would receive by virtue of limitations on the government’s discretion to act towards another. *See, e.g., Castle Rock*, 545 U.S. at 766-767 (domestic violence victim’s interest in enforcement of protective order too indirect to warrant due process protection); *O’Bannon*, 447 U.S. at 788 & n.21 (distinguishing between individual’s assertion of property interest based on “direct relationship” with government, and improper assertion of property interest based on government’s relation with another). Plaintiffs’ theory would wrongly and exponentially expand the scope of the Due Process Clause, requiring procedural protections to be afforded for the

interests of all sorts of asserted third-party beneficiaries of government contracts. The Court should reject this theory.

C. HAMP Is Too Uncertain And Allows Too Much Discretion To Create A Property Interest Protected By The Due Process Clause

Plaintiffs insist that Aurora's discretion to grant or deny a HAMP modification is "strictly limited" by HAMP's rules, and that these "substantive constraints" create a protected property interest in the receipt of a HAMP modification. Compl. ¶¶ 168-169. Another federal court, considering virtually identical claims, already has considered and rejected that argument, holding that the significant discretion built into HAMP precludes any finding of a protected property interest. In *Williams v. Geithner*, No. 09-1959, 2009 WL 3757380 (D. Minn. Nov. 9, 2009), the court noted the "broad discretion afforded to servicers in the modification process" and held that a putative class of HAMP-eligible borrowers could not demonstrate "a legitimate claim of entitlement to a loan modification" amounting to a protected property interest. *Id.* at *6-7. Both the discretionary features of HAMP described in *Williams* and the fact that the Treasury Guidelines condition the receipt of any HAMP modification on so many complex factors rebut Plaintiffs' assertion of a property interest.

The Due Process Clause protects certain entitlements "upon which people rely in their daily lives," *Roth*, 408 U.S. at 577, but no reliance interest can exist when the alleged "property" at issue is merely a subjective hope of obtaining a prospective advantage that is uncertain, due to its having been conditioned on *either* the satisfaction of numerous complex determinations *or* the discretion of third parties. *See, e.g., Reed v. Village of Shorewood*, 704 F.2d 943, 948 (7th Cir. 1983) (defining property as "what is securely and durably yours under state (or ... federal) law, as distinct from what you hold subject to so many conditions as to make your interest meager, transitory, or uncertain"); *PDK Labs Inc. v. Reno*, 134 F. Supp. 2d 24, 32 (D.D.C. 2001) ("Where

an agency has discretion to determine which individuals qualify for a benefit, ... no constitutionally protected interest exists.”).

Any alleged entitlement to a HAMP modification is too uncertain, and depends on too much discretion vested in third parties, to qualify for protection under the Due Process Clause. As the court in *Williams* described, a borrower’s qualification for a modification depends not only upon the voluntary choice of his or her servicer to participate in HAMP, 2009 WL 3757380, at *7, but also upon the wholly discretionary decisions of the investors in his or her loan to permit the modification, *id.* at *3. That discretion precludes recognition of a property interest. *See, e.g., Castle Rock*, 545 U.S. at 756. The court in *Williams* further emphasized that HAMP permits servicers additional discretion by permitting them to customize their NPV models used to determine HAMP eligibility in a number of ways. Servicers may—at their own discretion—alter the base NPV model using statistics drawn from their own loan portfolios. *See Williams*, 2009 WL 3757380, at *6. They may also, in their own discretion, adjust the discount rate used in the NPV model to reflect how different investors value payments over time. *See id.*

Other features of HAMP not mentioned in the *Williams* decision inject even greater uncertainty into the process. Borrowers may be denied participation in HAMP if their loan is neither delinquent nor subject to “imminent default,” with the servicer permitted to make the latter determination based on its own distinctive internal standards. And even where application of all HAMP’s eligibility factors and the servicer’s customized NPV model yield a qualifying modification, the borrower must still successfully complete a trial period before the servicer must offer a permanent HAMP modification.

In short, there is no sense in which potentially eligible borrowers could assert a legitimate claim of expectation of or entitlement to a HAMP modification. To the contrary, any claim to a

modification is highly indeterminate given the number of actors, their discretion, and the complex conditions involved. “Such indeterminacy is not the hallmark of a duty that is mandatory.” *Castle Rock*, 545 U.S. at 763. Whether borne of discretion or otherwise, such substantial ““uncertainty” ... preclude[s the] existence of a federally protectable property interest.” *Id.* at 764 (citation omitted); *see also Greenbriar Village, LLC v. Mountain Brook, City*, 345 F.3d 1258, 1266 (11th Cir. 2003) (uncertainty as to duration of rights precludes claim of entitlement); *Natale v. Town of Ridgefield*, 170 F.3d 258, 263 (2d Cir. 1999) (uncertainty as to legal rules precludes claim of entitlement).

D. Plaintiffs, As Prospective Applicants For HAMP Modifications, Have No Property Interest

Finally, Supreme Court precedent squarely forecloses Plaintiffs’ assertion that, based on their alleged satisfaction of “minimum HAMP eligibility requirements” (Compl. ¶ 53), they possess a property interest demanding due process. The Supreme Court rejected a similar argument in *American Manufacturers Mutual Insurance Co. v. Sullivan*, 526 U.S. 40 (1999). There, the plaintiffs asserted a property interest in workers’ compensation benefits and contended that, having shown “eligibility” for the benefits, the Due Process Clause barred deprivation of the benefits absent notice and opportunity to be heard. *Id.* at 47-48. The Court disagreed, holding that no property interest had been established. *Id.* at 59-61. The key distinction between the plaintiff’s theory and the Court’s due process precedents, the Court observed, was that the plaintiffs were not yet receiving the benefits and thus had not yet established their entitlement to the payments pending provision of the process they claimed was due. In contrast, in cases like *Goldberg v. Kelly*, 397 U.S. 254 (1970), and *Mathews v. Eldridge*, 424 U.S. 319 (1976), “an individual’s entitlement to benefits had been established, and the question presented was whether predeprivation notice and a hearing were required before the

individual's interest in *continued* payment of benefits could be terminated." *Sullivan*, 526 U.S. at 60 (emphasis in original). The plaintiffs in *Sullivan* had at best "established their initial *eligibility*," but not their ultimate qualification for or entitlement to the benefits. *Id.* at 61 (emphasis in original). "Consequently, they do not have a property interest." *Id.*

Plaintiffs' argument here fails for the same reason. Plaintiffs have not yet been found to qualify for a HAMP modification, so they do not—and cannot—assert any property interest in the "continued" receipt of such a HAMP modification. *Sullivan*, 526 U.S. at 60; *see also Lyng v. Payne*, 476 U.S. 926, 942 (1986) (rejecting due process claims, and explaining: "[w]e have never held that applicants for benefits, as distinct from those already receiving them, have a legitimate claim of entitlement protected by the Due Process Clause"); *Roth*, 408 U.S. at 576 (Clause protects "interests that a person has already acquired in specific benefits"). Plaintiffs allege only initial eligibility and, on that ground, press a constitutional claim. *Compare* Compl. ¶ 53 ("minimum HAMP eligibility requirements") *with Sullivan*, 526 U.S. at 61. *Sullivan* bars that claim.

IV. HAMP Provides Plaintiffs All The Process That the Constitution Requires

Finally, even if Plaintiffs' allegations were sufficient to establish a protected property interest, Plaintiffs fail to state a constitutional claim because they seek protections far beyond what the Constitution would require. "[D]ue process is flexible, and calls for such procedural protections as the particular situation demands." *Mathews*, 424 U.S. at 332, 333-335. Here, Plaintiffs' demands for a highly detailed and burdensome notice and a vague, undefined "appeal" right before a separate decisionmaker find no ground in the Constitution.

A. If Plaintiffs Have An Enforceable Third-Party-Beneficiary Entitlement To A HAMP Modification, Their Third-Party Contract Claim Would Provide All The Process That Is Due

The Fifth Amendment protects against government deprivation of property “without due process of law.” Plaintiffs claim that they are intended beneficiaries of Aurora’s SPA, and are therefore entitled to invoke judicial process to enforce its terms. Fannie Mae disagrees, but if Plaintiffs are correct about their breach-of-contract claim, then their constitutional claim should fail because they can use judicial process (as they have sought to do here) to protect their property interests. Except in special circumstances, when a plaintiff alleges deprivation of a property interest through a breach of contract, “ordinary judicial process ... for resolving [the] contractual dispute” provides sufficient process. *Lujan v. G&G Fire Sprinklers, Inc.*, 532 U.S. 189, 197 (2001); *see, e.g., Suburban Mortgage Assocs., Inc. v. HUD*, 480 F.3d 1116, 1127-1128 (Fed Cir. 2007) (“[A] claim that a government agency has violated a party’s right to due process by refusing performance under a contract is substantively indistinguishable from a breach of contract claim. The process to which plaintiff is due on these facts is a post-deprivation suit for breach of the contract.”).

The adequacy of a contract action to address deprivations of property by government actors is frequently cited in actions brought against state actors under 42 U.S.C. § 1983. Courts addressing such lawsuits refuse to turn an “ordinary breach of contract action into a federal constitutional case” when contract law “provides a perfectly adequate procedure for determining whether a breach has occurred and for granting redress if it did.” *Sharp v. Lindsey*, 285 F.3d 479, 489 (6th Cir. 2002); *see also Coastland Corp. v. Currituck County*, 734 F.2d 175, 178 (4th Cir. 1984) (“Even if [the plaintiff] could be considered a third party beneficiary, there would be no process due since a suit for breach of contract would have provided [the plaintiff] with an adequate remedy in state law.”). If—as Plaintiffs claim—they can invoke contract law to

enforce all obligations due to them under Aurora's SPA with the government, then a hearing by this Court on that claim satisfies the Constitution's due process requirements, obviating the need for any additional administrative procedures.

B. HAMP In Any Event Provides Potentially Eligible Borrowers With Sufficient Due Process

The "very nature of due process negates any concept of inflexible procedures universally applicable to every imaginable situation," so a court must assess the interests at issue in each context when determining what, if any, process is due. *Cafeteria & Restaurant Workers Union v. McElroy*, 367 U.S. 886, 895 (1961). This assessment requires the court to consider the private interest that the official action will affect; the risk of an erroneous deprivation and probable value, if any, of additional safeguards; and the government's interest in avoiding related fiscal and administrative burdens. *Mathews*, 424 U.S. at 332, 333-335. Here, the complaint fails to state a claim because, evaluated on these factors, HAMP as a matter of law provides potentially eligible borrowers with all the process that could be due.

The complaint provides no reason to believe that the risk of erroneous deprivation of a HAMP modification is high, nor that additional procedures would substantially diminish that risk. More likely, the risk of error is low given the multiple, overlapping systems that Treasury has established to encourage and monitor servicer compliance. As Plaintiffs acknowledge, Treasury has retained the Federal Home Loan Mortgage Corporation ("Freddie Mac") to serve as HAMP compliance agent. Compl. ¶ 129. Freddie Mac conducts on-site and remote servicer reviews and audits, and performs announced and unannounced testing of servicer infrastructure. *Id.* Freddie Mac's mandate specifically includes a "second look" process whereby Freddie Mac reviews a sample of delinquent loans to ensure that borrowers have been solicited and properly evaluated for HAMP. *See supra*, *Statement*, Part II.D. Freddie Mac reports its findings to a

compliance committee within Treasury that can then determine appropriate remedies, ranging from reconsideration of individual loans to additional servicer oversight and monetary penalties.

See id.

Beyond these high-level compliance efforts, the risk of error is further diminished by the borrower notices required by Supplemental Directive 09-08. As Plaintiffs acknowledge, Treasury requires servicers to inform borrowers in writing and “in detail” why they have been denied a HAMP modification, and allows borrowers to contact their servicer to correct errors. Compl. ¶ 50. Servicers’ notices must provide the specific reason that the modification was denied and “must be written in clear, non-technical language, with acronyms and industry terms such as ‘NPV’ explained in a manner that is easily understandable.” SD09-08, at 2. Furthermore, the notices must provide a toll-free number through which the borrower can contact the servicer to obtain “specific details about the contents of the Borrower Notice and reasons for a non-approval determination.” *Id.* The notices also alert the borrower to free assistance available from HUD-approved housing counselors, who can further escalate suspected HAMP noncompliance to trained staff who intercede with the servicer to reevaluate HAMP applications. *Id.*

The complaint includes no allegation—or reason to believe—that ratcheting up the level of detail in HAMP denial notices would significantly diminish the risk of error. Plaintiffs allege that the notices are inadequate because they “fail[] to [include] other critical information necessary to enable a borrower to contest a denial,” such as “the nature of any investor restrictions and steps the Participating Servicer took to comply with the requirement that servicers make reasonable efforts to obtain investor waivers.” Compl. ¶ 181. But that additional information is unlikely to assist the borrower. The denial reasons that Treasury’s Supplemental

Directive requires the servicer to explain in detail to the borrower are subjects where the borrower may have additional—or more accurate—information bearing on the application. The subjects raised by the complaint, in contrast, are ones where the borrower is unlikely to have any additional information bearing on the HAMP application—*e.g.*, regarding the servicer’s contractual relationship with the investor.

Plaintiffs’ demand of an appeal also lacks merit because “[t]here is, of course, no constitutional right to an appeal.” *Jones v. Barnes*, 463 U.S. 745, 751 (1983); *see also M.L.B. v. S.L.J.*, 519 U.S. 102, 102-103 (1996) (“the Federal Constitution guarantees no right to appellate review”). The Supreme “Court has long recognized that, even in criminal cases, due process does not require a State to provide an appellate system.” *Ortwein v. Schwab*, 410 U.S. 656, 660 (1973); *see also id.* at 659-660 (no due process right to judicial review of state welfare agency decision); *Abney v. United States*, 431 U.S. 651, 656 (1977) (“[I]t is well settled that there is no constitutional right to an appeal.”). This is true in administrative contexts too. *See, e.g., Loulou v. Ashcroft*, 354 F.3d 706, 708 (8th Cir. 2003) (alien has no due process right to administrative appeal from Board of Immigration Appeals decision); *United States v. Posner*, 424 F.2d 181, 183-184 (9th Cir. 1970) (conscientious objection claimant has no due process right to administrative appeal of adverse classification decision); *Platt v. Brockenborough*, 476 F. Supp. 2d 467, 470 (E.D. Pa. 2007) (prisoner has no due process right to appeal results of disciplinary hearing).

CONCLUSION

For the foregoing reasons, the complaint should be dismissed under Rule 12(b)(1) for lack of subject matter jurisdiction and under Rule 12(b)(6) for failure to state a claim.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on January 25, 2010, I caused a true and correct copy of the foregoing to be electronically filed with the Clerk of the District Court using the CM/ECF system, which sent notification of such filing to all counsel of record.

/s/ Seth P. Waxman