

## Should The Cuomo Settlement Be Treated As An Agency Rulemaking?

By Ted Koshiol

On March 3, 2008, the New York Attorney General's office ("NY AG") announced that an important settlement deal had been reached with the two giants of the secondary mortgage market, the Federal National Mortgage Association ("Fannie Mae" or "Fannie") and the Federal Home Loan Mortgage Corporation ("Freddie Mac" or "Freddie"), and Fannie and Freddie's primary regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO") the Office of Federal Housing Enterprise Oversight ("OFHEO").<sup>1</sup> The NY AG agreed to cease its investigation of whether the two corporations were complicit with other financial institutions in illegally inflating home values.<sup>2</sup> In return, Fannie and Freddie agreed to a new policy of only purchasing mortgages from banks that would abide by a new set of appraisal standards, the Housing Valuation Code of Conduct ("HVCC").<sup>3</sup> Due to Fannie and Freddie's substantial market share<sup>4</sup> in the secondary mortgage industry, observers immediately recognized that the impact of the agreement would be widespread, effectively requiring every mortgage lender in America to abide by the terms of the HVCC.<sup>5</sup>

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<sup>1</sup> Press Release, N.Y. Attorney Gen., New York Attorney General Cuomo announces agreement with Fannie Mae, Freddie Mac, and OFHEO (Mar. 3, 2008), [http://www.oag.state.ny.us/media\\_center/2008/mar/mar3a\\_08.html](http://www.oag.state.ny.us/media_center/2008/mar/mar3a_08.html)

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> Freddie and Fannie's market share reached 80 % of all new mortgages in the US in 2008. Press Release, Fed. Hous. Fin. Agency, Statement of FHFA Director James B. Lockhart (Sept. 7, 2008), <http://www.fhfa.gov/webfiles/23/FHFASStatement9708final.pdf>

<sup>5</sup> See Karen Freifeld and Sharon L. Lynch. *Fannie, Freddie to Overhaul Appraisals in Cuomo Deal*, Bloomberg, Mar. 3, 2008, [http://www.bloomberg.com/apps/news?pid=20601087&sid=aTR0\\_ZkyGHfs&refer=home](http://www.bloomberg.com/apps/news?pid=20601087&sid=aTR0_ZkyGHfs&refer=home); Paul Jackson, *Fannie Mae, Freddie Mac Reach Landmark Agreement on Appraisal Practices*, Mar. 3, 2008, <http://www.housingwire.com/2008/03/03/fannie-mae-new-york-ag-reach-agreement-on-appraisal-practices/>

However, the HVCC soon received hefty criticism from a variety of other interested parties. Very few supporters of the HVCC emerged; appraisers' groups, mortgage bankers' groups, and even other government agencies all began to clamor about the code's insufficiencies.<sup>6</sup> Though the HVCC's goal of creating an appraisal process truly independent from the loan generation process was generally supported, the critics alleged that the HVCC imposed significant changes on the mortgage industry but still would not result in increased appraiser independence.<sup>7</sup> A number of the HVCC critics further expressed frustration that their opinions on the agreement were not sought out before the agreeing parties entered the deal.<sup>8</sup>

These complaints raise a unique and interesting legal issue: Should the settlement entered into by the OFHEO be subject to the rulemaking requirements of the Administrative Procedures Act ("APA")? Or, put more broadly, if an agency enters into a settlement agreement to resolve a pending judicial matter, is the agreement always an adjudicatory action, or are there instances where the settlement should be required to allow for notice and comment pursuant the APA? This note will argue that, at least in this circumstance, the Cuomo settlement agreement should be thought of as an agency rulemaking, and therefore should have been subjected to notice and comment procedures.

This article begins by providing a complete background to the HVCC, including a discussion of how it came about, why the OFHEO was involved, and what the HVCC's

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<sup>6</sup> *See, e.g.*, Comment Letter from the Appraisal Foundation to Freddie Mac Senior Vice President of Credit Risk Oversight, (Apr. 29, 2008)

[http://www.appraisalfoundation.org/s\\_appraisal/bin.asp?CID=5&DID=1165&DOC=FILE.PDF](http://www.appraisalfoundation.org/s_appraisal/bin.asp?CID=5&DID=1165&DOC=FILE.PDF); Comment Letter from the Mortgage Bankers Association to James B. Lockhart, Director of OFHEO (Apr. 30, 2008) [http://www.appraisalinstitute.org/newsadvocacy/downloads/OFHEO\\_FRE\\_FNM\\_Appraisal\\_Letter.pdf](http://www.appraisalinstitute.org/newsadvocacy/downloads/OFHEO_FRE_FNM_Appraisal_Letter.pdf); Comment Letter from the Office of the Comptroller of the Currency to James B. Lockhart, Director of OFHEO (May 27, 2008) <http://www.appraisalinstitute.org/newsadvocacy/downloads/OCCLetter.pdf>

<sup>7</sup> *See, e.g., Id.*

<sup>8</sup> *See, e.g., Id.*

provisions actually entail. Then it discusses the statutory procedures set forth by the APA for each type of agency action—formal adjudication, formal rulemaking, informal adjudication and informal rulemaking, and when those procedures are triggered. Lastly, this article argues that the settlement entered into by the OFHEO is best thought of as a rulemaking, not adjudication, and therefore should be required to abide by notice and comment requirements set forth by the APA.

### I. Background

It's no secret: we are in the midst of a housing crisis. Since late 2006, the frequency of home foreclosures has dramatically risen even as home prices continue to fall.<sup>9</sup> At the same time, it has become more difficult for prospective home owners to obtain mortgages.<sup>10</sup> Home values, which saw outstanding growth in the earlier part of the past decade,<sup>11</sup> have seen significant declines in a variety of communities across the country.<sup>12</sup> And, of course, the effect of the housing market collapse continues to be felt across the broader economy as well; mortgage-backed securities have proven to be risky investments, implicated by many experts as a primary cause of the “credit crunch,” and ongoing economic downturn.<sup>13</sup>

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<sup>9</sup> See Carolyn Said, *Report Finds U.S. Mortgage Problems Increasing*, SAN FRANCISCO CHRONICLE, Apr. 3, 2009, <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2009/04/03/BUU716RR4Q.DTL>; Mark Trumbull, *Record Tumble for Home Prices*, THE CHRISTIAN SCIENCE MONITOR, Mar. 31, 2009, <http://features.csmonitor.com/economyrebuild/2009/03/31/record-tumble-for-home-prices/>

<sup>10</sup> See *Mortgage Rates Again at Record Lows*, Bloomberg, Apr. 3, 2009, Carolyn Said, *Report Finds U.S. Mortgage Problems Increasing*, SAN FRANCISCO CHRONICLE, Apr. 3, 2009 <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2009/04/03/BUU716RR4Q.DTL>

<sup>11</sup> See *Strong Economies Balance Increasing Risk of Home Price Declines, According to PMI Mortgage Insurance Co.'s Spring U.S. Market Risk Index; New PMI Research Demonstrates the Historical Value of Homeownership*, BUSINESS WIRE, Apr. 4, 2006.

<sup>12</sup> See Dan Levy, *Home Prices in U.S. to Decline Through 2010, PMI Says*, BLOOMBERG, Apr. 1, 2009, [http://www.bloomberg.com/apps/news?pid=20601103&sid=a\\_i8BIV5UrnM&refer=news](http://www.bloomberg.com/apps/news?pid=20601103&sid=a_i8BIV5UrnM&refer=news).

<sup>13</sup> See John Dunbar, *Unregulated Swaps Hastened Wall Street Collapse*, USA TODAY, Oct. 7, 2008, [http://www.usatoday.com/news/washington/2008-10-07-3663940600\\_x.htm](http://www.usatoday.com/news/washington/2008-10-07-3663940600_x.htm); Stephen Foley, *Fed Offers Credit Markets Another \$800bn Bailout*, THE INDEPENDENT, Nov. 26, 2008, <http://www.independent.co.uk/news/business/news/fed-offers-credit-markets-another-800bn-bailout->

But what created the housing market bubble in the first place? Observers have identified several causes of the housing market collapse, including the structure of subprime loans, a failure of government oversight of the lending process, ignorant (or overly optimistic) home buyers, and the inflation of home values in the early twentieth century.<sup>14</sup> Addressing the various causes of the housing market fall was a top priority for numerous elected officials in the 2008 legislative session, and a variety of bills were introduced to confront both the sources and ramifications of the housing market collapse.<sup>15</sup> These efforts culminated with the passage of the Housing and Economic Recovery Act of 2008 and the creation of the Federal Housing Finance Agency (“FHFA”).<sup>16</sup> The legislation “strengthens and modernizes the regulation” of Fannie and Freddie and “expands the[ir] housing mission” while also “providing for new . . . loans after lenders take deep discounts.”<sup>17</sup>

#### A. The Cuomo Approach

For his part, New York Attorney General (and former Secretary of Housing and Urban Development under President Clinton, from 1997 to 2001) Andrew Cuomo looked to address one source of the problem from a judicial, rather than legislative, approach. In 2007, he began investigating whether lenders had been asserting influence on real estate

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1035328.html; Daniel Indiviglio, *Another Shot at the Credit Crunch*, FORBES, Apr. 3, 2009, [http://www.forbes.com/2009/03/03/talf-fed-lending-business-washington\\_talf.html](http://www.forbes.com/2009/03/03/talf-fed-lending-business-washington_talf.html);

<sup>14</sup> See, e.g., Daniel Gross, *The Mark-to Market Melee*, NEWSWEEK, Apr. 1, 2008, <http://www.newsweek.com/id/130029>; Jason DeRusha, *Good Question: What Caused the Financial Crisis?*, WCCO, Sept. 18, 2008, <http://wcco.com/business/cause.financial.crisis.2.820905.html>

<sup>15</sup> Dozens of bills were introduced with the purpose of supporting the housing market; see, e.g., Responsible Investment for Home Ownership Act of 2008, H.R.6373.IH, 110th Cong. (2008); FHA Housing Stabilization and Homeownership Retention Act of 2008, H.R.5830.RH, 110th Cong. (2008); Homeownership Protection and Housing Market Stabilization Act of 2008, H.R.5857.IH, 110th Cong. (2008).

<sup>16</sup> Pub. L. No. 110-289, 122 Stat. 2654.

<sup>17</sup> Senate Committee on Housing Finance and Urban Affairs, Summary of the “Housing and Economic Recovery Act of 2008” (June 20, 2008) [http://banking.senate.gov/public/\\_files/HousingandEconomicRecoveryActSummary.pdf](http://banking.senate.gov/public/_files/HousingandEconomicRecoveryActSummary.pdf)

appraisers to encourage the inflation of home values.<sup>18</sup> Cuomo believed that there may have been prosecutable collusion between lenders and appraisers, done in the interest of garnering lenders more debt.<sup>19</sup> In late 2007, Cuomo expanded his investigation to include Fannie Mae and Freddie Mac, questioning whether these mortgage purchasers' due diligence procedures systematically failed to examine whether home values had been inflated.<sup>20</sup>

Fannie and Freddie never admitted to any wrongdoing but nonetheless agreed to a settlement agreement with Cuomo and the New York Attorney General's Office, in early 2008.<sup>21</sup> The agreement is simple: it restricts Freddie and Fannie to purchasing mortgages only from lenders that demonstrably uphold the Home Valuation Code of Conduct.<sup>22</sup> This means that the HVCC is voluntary, at least in principle. A lender is only required to abide by the HVCC if it wishes to sell any of its mortgages to Freddie or Fannie. However, in reality, Freddie and Fannie purchase a majority of the mortgages sold on the secondary market, purchasing some mortgages from every mortgage originator in America.<sup>23</sup> Accordingly, the practical impact of the Cuomo settlement agreement was that every mortgage originator would have to adopt the HVCC or find some way to avoid dealing with Freddie and Fannie.

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<sup>18</sup> Press Release, N.Y. Attorney Gen., New York Attorney General Sues First American and Its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals (Nov. 1, 2007) [http://www.oag.state.ny.us/media\\_center/2007/nov/nov1a\\_07.html](http://www.oag.state.ny.us/media_center/2007/nov/nov1a_07.html)

<sup>19</sup> *See, Id.*

<sup>20</sup> Press Release, N.Y. Attorney Gen., New York Attorney General Cuomo Sends Letters of Notice and Demand to Freddie Mac and Fannie Mae (Nov. 7, 2007) [http://www.oag.state.ny.us/media\\_center/2007/nov/nov7a\\_07.html](http://www.oag.state.ny.us/media_center/2007/nov/nov7a_07.html)

<sup>21</sup> *See* David S. Hilzenrath, *Fannie, Freddie Agree to Tighten Appraisal Rules*, WASHINGTON POST, Mar. 4, 2008, at D01; Press Release, Office of Fed. Hous. Enter. Oversight, OFHEO, NY Attorney General, Fannie Mae and Freddie Mac Sign Agreement to Combat Appraisal Fraud, (Mar. 3, 2008) <http://www.ofheo.gov/NewsRoom.aspx?Q1=0&Q2=0&FormMode=Detail&ID=417>

<sup>22</sup> *Id.*

<sup>23</sup> *See* Press Release, Fed. Hous. Fin. Agency, Statement of FHFA Director James B. Lockhart (Sept. 7, 2008), <http://www.fhfa.gov/webfiles/23/FHFASStatement9708final.pdf>

One intriguing but essential detail about the Cuomo settlement agreement is the parties involved. Obviously, the NY AG's office and Fannie Mae and Freddie Mac were parties to the accord. But, the NY AG also brought the OFHEO in on the discussion process, getting the agency's input when drafting the HVCC and, ultimately, getting the agency's approval on the settlement agreement.<sup>24</sup> The OFHEO, though it was never implicated or investigated for any wrongdoing, was made a party to the final settlement.<sup>25</sup>

### B. The Special Nature of Government Sponsored Enterprises

The reason for bringing the OFHEO on board for the settlement discussion has to do with the unique nature of Government Sponsored Enterprises. Freddie and Fannie are both GSEs. This means that they are private corporations, but that they were originally chartered by the federal government. Fannie Mae was chartered in 1968, primarily in order to purchase mortgages to increase availability of lending funds and to provide assistance those unable to obtain adequate housing.<sup>26</sup> Similarly, Freddie Mac was chartered in 1970, to create a competitive market with Fannie Mae.<sup>27</sup> In this way, both charters entrust the corporations with important public policy goals.

Because of their public policy function, the corporations have historically been tightly regulated, and have been the recipients of certain special privileges. For example, Freddie and Fannie enjoy special tax breaks, exemptions from some Securities and Exchange Commission ("SEC") regulations, and special lines of credit at the U.S. Treasury.<sup>28</sup> However, Fannie and Freddie have always been private corporations.

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<sup>24</sup> See Home Value Protection Program and Cooperation Agreement (Mar. 3, 2008) <http://www.ofheo.gov/media/agreements/3308FannieAgree.pdf>

<sup>25</sup> *Id.* at \*8.

<sup>26</sup> Federal National Mortgage Association Charter Act, 12 U.S.C. § 1716 (2007).

<sup>27</sup> Federal Home Loan Mortgage Corporation Act, 12 U.S.C. § 1451 (2005).

<sup>28</sup> See 12 U.S.C. § 1723(a) (2009).

Though closely regulated by the OFHEO, the GSEs are independently owned and operated.

Accordingly, the GSEs are *not* administrative agencies. The OFHEO, however, is a federal agency. The OFHEO's responsibilities include consistently monitoring the fiscal health of Fannie and Freddie, developing capital standards for the GSEs, simulating the impact of various interest rate and credit scenarios; making quarterly findings of capital adequacy at the GSEs, and enforcing its regulations where appropriate.<sup>29</sup> With respect to the Cuomo settlement, the OFHEO was brought into the settlement discussions, and helped create the HVCC before signing off on the official settlement agreement.<sup>30</sup>

### C. The Home Valuation Code of Conduct

As mentioned above, the settlement agreement itself is rather minimal. Simply put, Freddie and Fannie agreed to only buy mortgages from lenders upholding the new HVCC appraisal standards.<sup>31</sup> The HVCC is a somewhat more substantial document, which would impose significant restrictions on any lenders choosing to adopt it. To understand why so many industry groups were unhappy with the HVCC, it is necessary to understand those restrictions.

It should be noted that the overarching goal of the HVCC is clear: appraisals truly independent from the lending process. Generally speaking, this goal is a worthwhile one. Surveys of appraisers throughout the past decade have consistently indicated that there is

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<sup>29</sup> See 12 U.S.C. § 4511 et. seq. (2007).

<sup>30</sup> Press Release, Office of Fed. Hous. Enter. Oversight, OFHEO, NY Attorney General, Fannie Mae and Freddie Mac Sign Agreement to Combat Appraisal Fraud, (Mar. 3, 2008) <http://www.ofheo.gov/NewsRoom.aspx?Q1=0&Q2=0&FormMode=Detail&ID=417>

<sup>31</sup> HOME VALUE PROTECTION PROGRAM AND COOPERATION AGREEMENT 2-3 (2009), <http://www.ofheo.gov/media/agreements/3308FannieAgree.pdf>

widespread and increasing pressure from lenders to inflate home values.<sup>32</sup> Why would lenders want to inflate the value of the homes? For the individual mortgage broker, a more expensive loan results in a bigger commission.<sup>33</sup> Appraisers are willing to similarly inflate the home value in order to appease brokers and, hopefully, get repeat business.<sup>34</sup> For lending institutions, a high appraisal value means that the collateral backing the loan is worth more, reducing the lender's risk.<sup>35</sup>

To accomplish its goal, the HVCC included several provisions that became controversial. Most importantly, the code stated that “[n]o employee, director, officer, or agent of the lender . . . shall . . . influence the development, reporting, result, or review of an appraisal through coercion . . . or in any other manner.”<sup>36</sup> To that end, the HVCC prohibited mortgage lenders from getting appraisals from in-house appraisers, affiliates of the lenders, or entities owned by or owning the lender.<sup>37</sup> Additionally, the HVCC mandated separation between the lender's staff that is ordering the appraisals and the staff that is producing the mortgage loans.<sup>38</sup> To enforce these restrictions, the HVCC also provided for the creation of the Independent Valuation Protection Institute.<sup>39</sup> The institute would be an independent organization, funded by the GSEs that would monitor

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<sup>32</sup> See Edwin McDowell, *Appraisers and the Pressure to Inflate Valuations*, THE NEW YORK TIMES, Sept. 2, 2001, <http://www.nytimes.com/2001/09/02/realestate/appraisers-and-the-pressure-to-inflate-valuations.html>; *Most Appraisers Asked to Inflate Home Values*, May 19, 2008, <http://www.thetruthaboutmortgage.com/most-appraisers-asked-to-inflate-home-values/>

<sup>33</sup> Michael D. Larson, *Appraisers Can Burst Your Bubble by Inflating the Value of Your Home*, BANKRATE.COM, Nov. 14, 2002, <http://www.bankrate.com/brm/news/mtg/20000525.asp>

<sup>34</sup> *Id.*

<sup>35</sup> Les Christie, *Taming Inflated Home Appraisals*, CNNMONEY.COM, Jan. 14, 2009, [http://money.cnn.com/2009/01/14/real\\_estate/appraisal\\_reform/index.htm](http://money.cnn.com/2009/01/14/real_estate/appraisal_reform/index.htm)

<sup>36</sup> Home Valuation Code of Conduct, available at:

[http://www.freddiemac.com/singlefamily/docs/030308\\_valuationcodeofconduct.pdf](http://www.freddiemac.com/singlefamily/docs/030308_valuationcodeofconduct.pdf)

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

compliance with the HVCC rules and investigate any complaints of improper influence being asserted on appraisers.<sup>40</sup>

#### D. Industry Reactions

The design of the HVCC was met with wide disdain by the lending industry, appraisal groups, and a variety of other governmental groups. Due to this response, the parties to the Cuomo settlement permitted interested parties and affected groups to make written comments on the HVCC for a period of 45 days, even though the code had been created and agreed to without any opportunity for public comment.<sup>41</sup> Generally, these written comments contained wide approval of the goal of the agreement, but institutions expressed a variety of concerns about the impact of the agreement. The Appraisal Foundation, for example, noted that there was little evidence that the only appraisers feeling pressure to inflate values were those working directly for lenders.<sup>42</sup> In fact, the appraisers' group contended that independent appraisers were just as likely to be encouraged to inflate values and the HVCC would therefore be ineffective.<sup>43</sup> The Appraisal Institute agreed, and further noted that the HVCC would destroy "well-established business relationships between honest appraisers and reputable mortgage professionals."<sup>44</sup>

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<sup>40</sup> *Id.*

<sup>41</sup> For unknown reasons, the original 90-day comment period was cut in half by the OFHEO: "[a]fter first announcing that there would be 90 days to comment on the proposed new rule, OFHEO reduced the time period to 45 days, ending April 30th." Dave Biggers, *The Five Fronts of the HVCC War*, APPRAISAL PRESS, 2008, [http://www.appraisalpress.com/news/articles/the\\_five\\_fronts\\_of\\_the\\_hvcc\\_war](http://www.appraisalpress.com/news/articles/the_five_fronts_of_the_hvcc_war)

<sup>42</sup> Letter from David S. Bunton, President, The Appraisal Foundation, to Senior Vice President, Credit Risk Oversight, Freddie Mac (Apr. 29, 2008) <http://www.appraisalinstitute.org/newsadvocacy/downloads/TAFCommentLetter.pdf>

<sup>43</sup> *Id.*

<sup>44</sup> Letter from The Appraisal Institute, The American Society of Appraisers, The American Society of Farm Managers and Rural Appraisers, and The National Association of Independent Fee Appraisers to Fannie Mae and Freddie Mac (April 30, 2008) [http://www.appraisalinstitute.org/myappraisalinstitute/downloads/AI-ASA-ASFMRA-NAIFA\\_HVCCFinal.pdf](http://www.appraisalinstitute.org/myappraisalinstitute/downloads/AI-ASA-ASFMRA-NAIFA_HVCCFinal.pdf)

The Office of Thrift Supervision stated that “[i]mposing a requirement that all lenders must outsource appraisals will not ensure appraiser independence and may make regulatory enforcement more difficult.”<sup>45</sup> The Office of the Comptroller of Currency noted that “the organizational placement of the function that provides an appraisal is not determinative of the appraisal’s quality.”<sup>46</sup> These government agencies both agreed that existing laws may be sufficient to protect the independence of the appraisal process and that the best way to achieve the goal of independent appraisals was not “by dictating the corporate and internal organizational structures of lenders.”<sup>47</sup>

The Mortgage Bankers Association, National Association of Mortgage Bankers, and other lender groups had similar complaints.<sup>48</sup> Consensus in the industry seemed to be that the HVCC would likely result in job losses for appraisers, the proliferation of automated valuation models (which are not covered by the HVCC), and more expensive mortgage costs for consumers. Worst of all, few of the interested parties seemed to believe that the new code would, in fact, ensure independence between appraisers and lenders.<sup>49</sup>

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<sup>45</sup> Letter from Timothy T. Ward, Deputy Director, Examinations, Supervision, and Consumer Protection, Office of Thrift Supervision, to Senior Vice President, Credit Risk Oversight, Freddie Mac (Apr. 30, 2008) [http://appraisalnewsonline.typepad.com/appraisal\\_news\\_for\\_real\\_e/files/OTS\\_HVCC\\_Response.pdf](http://appraisalnewsonline.typepad.com/appraisal_news_for_real_e/files/OTS_HVCC_Response.pdf)

<sup>46</sup> Letter from John C. Dugan, Comptroller, The Office of the Comptroller of the Currency to James B. Lockhart III, Director, Office of Federal Housing Enterprise Oversight (June 19, 2008) [http://www.appraisalinstitute.org/newsadvocacy/downloads/OCC\\_OFHEO.pdf](http://www.appraisalinstitute.org/newsadvocacy/downloads/OCC_OFHEO.pdf)

<sup>47</sup> *Id.*

<sup>48</sup> Letter from The Mortgage Bankers Association to James B. Lockhart III, Director, Office of Federal Housing Enterprise Oversight (Apr. 30, 2008) [http://www.appraisalpress.com/pdf/Final\\_Joint\\_Trade\\_Appriaisal\\_Letter\\_\(4-30-08\).pdf](http://www.appraisalpress.com/pdf/Final_Joint_Trade_Appriaisal_Letter_(4-30-08).pdf); *see also*, Letter from The National Association of Mortgage Bankers to Fannie Mae (Apr. 30, 2008) [https://www.namb.org/images/namb/NAMB%20Fannie%20Mae%20Comment%20Letter%20on%20Appraisal%20Agreement.Final%20\(April%2030,%202008\).pdf](https://www.namb.org/images/namb/NAMB%20Fannie%20Mae%20Comment%20Letter%20on%20Appraisal%20Agreement.Final%20(April%2030,%202008).pdf)

<sup>49</sup> The negative response to the Cuomo agreement attracted legislative notice. Republicans in the Senate Committee on Banking, Housing, and Urban Affairs briefly considered proposing legislation that would mandate that all appraisal standards be set by federal legislation. Most notably, Elizabeth Dole (R – N. Carolina) introduced an amendment to the Housing and Economic Recovery Act of 2008 to include a provision which would have made the HVCC unenforceable, but ultimately withdrew her amendment. *See*

### E. Changes to Regulatory Structure and the HVCC

Both the HVCC itself and the regulatory structure of mortgage industry oversight changed substantially between the creation of the Code and its scheduled implementation. First, on July 24, 2008, the Housing and Economic Recovery Act of 2008 was passed.<sup>50</sup> This legislation created the FHFA, a combination of the OFHEO and the Federal Housing Finance Board.<sup>51</sup> Accordingly, as a matter of institutional organization, the OFHEO became a subpart of the FHFA. However, this transfer had no impact on the substance or applicability of the Cuomo agreement. Pursuant the Housing and Economic Recovery Act, all existing decisions made by the OFHEO were to remain effective until and unless modified by the FHFA.<sup>52</sup>

On September 7, 2008, the federal government went a step further to prop up Fannie and Freddie, when it bought out the two companies.<sup>53</sup> The two GSEs had been suffering through mounting losses after the housing bubble burst.<sup>54</sup> Rather than allow the companies to shut down, the government seized control; top executives were removed, and the U.S. Treasury took an immediate \$1 billion equity in each company's stock.<sup>55</sup> The conservatorship agreement additionally meant that the FHFA would operate Freddie and Fannie, and that the U.S. Treasury would extend additional funding to the

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*Update: Dole Amendment, HVCC Movement*, Appraisal Press, 2008,  
[http://www.appraisalpress.com/news/articles/update\\_dole\\_amendment\\_hvcc\\_movement](http://www.appraisalpress.com/news/articles/update_dole_amendment_hvcc_movement)

<sup>50</sup> Pub. L. No. 110-289, 122 Stat. 2654.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> Glenn Somerville, *U.S. seizes Fannie, Freddie, Aims to Calm Markets*, REUTERS, Sept. 7, 2008,  
<http://www.reuters.com/article/wtMostRead/idUSN0527106320080907>

<sup>54</sup> *Id.*

<sup>55</sup> Press Release, Henry M. Paulson, Jr., Secretary of the Treasury, Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008) <http://www.treas.gov/press/releases/hp1129.htm>

companies.<sup>56</sup> This action undoubtedly caused some major changes at the GSEs and fundamentally shifted the relationship between government agencies and Freddie and Fannie. However, the Cuomo agreement was unaffected. The conservatorship did not effect any of the existing contracts to which the GSEs were a party,<sup>57</sup> and the OFHEO maintained that the agreement imposing the HVCC on lenders wishing to sell mortgages to the GSEs would go forward as planned.<sup>58</sup>

As for the HVCC itself, in late December, the FHFA announced that it was rescheduling the effective date for May 1, 2009.<sup>59</sup> The delay to the agreement's effective date was imposed largely because the FHFA made substantial changes to the HVCC based on comments received from interested parties after the agreement was first announced.<sup>60</sup> The FHFA maintained that the revised HVCC would "increase the reliability of appraisals . . . and help assure that borrowers, homebuyers and secondary mortgage market investors receive fair and independent property valuations."<sup>61</sup> Most significantly, the revised HVCC included several exceptions to the original rule that lenders could not use appraisals generated by the lender or its affiliates.<sup>62</sup>

More specifically, the revised version of the HVCC only applies to appraisals used for single-family mortgage loans sold to the GSEs; it does not impose restrictions on

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<sup>56</sup> *Id.*

<sup>57</sup> Statement of Federal Housing Finance Agency Regarding Contracts of Enterprises in Conservatorship (Sept. 7, 2008) <http://www.ofheo.gov/newsroom.aspx?ID=459&q1=0&q2=4>

<sup>58</sup> FHFA Statement of Support for Multifamily Housing Finance Activities of the Enterprises while in Conservatorship (Sept. 12, 2008) <http://www.fhfa.gov/webfiles/21/FHFASTMTMultifamily.pdf>

<sup>59</sup> The previous effective date had been scheduled for Jan. 1, 2009. Press Release, Fed. Hous. Fin. Agency, FHFA Announces Home Valuation Code of Conduct, (Dec. 23, 2008) <http://www.fhfa.gov/webfiles/277/HVCC122308.pdf>

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> Home Valuation Code of Conduct, December 2008, available at: <https://www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/appcode/pdf/hvcc.pdf>

other loans.<sup>63</sup> It allows lenders to use reports prepared by in-house appraisers and affiliates as long as certain conditions are met. First, an appraiser cannot report directly to a sales or loan production department.<sup>64</sup> Second, sales or loan production employees cannot select, retain, recommend, or influence the selection of appraisers.<sup>65</sup> Third, nor can the sales or production employees have substantive communications with an appraisers relating to or having an impact on valuations.<sup>66</sup> Fourth, the lender or its agents cannot provide the appraiser any estimated or target value of the property or the loan.<sup>67</sup> Fifth, an appraiser's compensation cannot depend on the value arrived at in an appraisal or upon the closing of a loan.<sup>68</sup> Sixth, the lender must have written policies implementing HVCC, including procedures for training and discipline.<sup>69</sup> Seventh, a lender's appraisal functions must be annually and independently audited, with reports to the GSEs of irregular findings.<sup>70</sup> Additionally, the revised HVCC allows lenders, to accept an appraisal prepared for a different lender that has adopted the Code.<sup>71</sup>

#### F. Pending Legal Action

Undoubtedly, the FHFA must have hoped that the substantive changes to the HVCC would garner the code more support amongst the mortgage industry. This has not been the case. Appraisers continue to warn that the HVCC does not apply to appraisal

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<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

management companies, although the Director of the FHFA disagrees.<sup>72</sup> More recently, the National Association of Mortgage Bankers (“NAMB”) filed a lawsuit over the HVCC in the U.S. District Court for the District of Columbia.<sup>73</sup> The NAMB maintains that the HVCC will result in “unavoidable increase in costs to consumers.”<sup>74</sup> Additionally and more intriguingly, the NAMB lawsuit argues that the HVCC is a *de facto* informal agency rulemaking and should therefore be subject to the notice and comment requirements of the APA.<sup>75</sup> The implementation of the HVCC may now be put on hold until this lawsuit is resolved, or, if the NAMB argument is persuasive, the HVCC may be abandoned all together.

The second portion of this article will discuss the different types of agency action as well as the procedural requirements imposed by the APA for each. Then in the third part, the article discusses whether the Cuomo agreement should, as the NAMB believes, be thought of as an informal rulemaking.

## II. Administrative Procedures

Before assessing whether the Cuomo Agreement is, as the NAMB lawsuit contends, an informal rulemaking subject to notice and comment requirements, one must first understand the differences between the four categories of agency action as well as the procedural requirements that exist for each.

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<sup>72</sup> See Chad Terhune, *Housing Appraisals: Still Blowing Bubbles?*, BUSINESS WEEK, Feb, 5, 2009, [http://www.businessweek.com/magazine/content/09\\_07/b4119042628146.htm?chan=top+news\\_top+news+index+++temp\\_news+%2B+analysis](http://www.businessweek.com/magazine/content/09_07/b4119042628146.htm?chan=top+news_top+news+index+++temp_news+%2B+analysis)

<sup>73</sup> Press Release, National Association of Mortgage Bankers, NAMB Files Lawsuit Over Controversial HVCC (Feb. 23, 2009) <http://www.namb.org/namb/NewsBot.asp?MODE=VIEW&ID=257&SnID=1072545743>

<sup>74</sup> *Id.*

<sup>75</sup> See NAMB Complaint at 2. Available at: [https://www.namb.org/images/namb/GovernmentAffairs/NAMB\\_Lawsuit\\_HVCC%20\(Feb%202023,%20202009\).pdf](https://www.namb.org/images/namb/GovernmentAffairs/NAMB_Lawsuit_HVCC%20(Feb%202023,%20202009).pdf)

### A. The Four Categories of Agency Action

First and foremost, it bears noting that the APA divides the universe of agency actions into two broad categories: rulemakings and adjudications. The APA defines a rule as

the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefore or of valuations, costs, or accounting, or practices bearing on any of the foregoing.<sup>76</sup>

A rulemaking includes formulating, amending, or repealing a rule.<sup>77</sup> Adjudication, on the other hand, is the “agency process for the formulation of an *order*.”<sup>78</sup> ‘Order’ is defined as “the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter *other than rulemaking*.”<sup>79</sup> In other words, the APA broadly defines what a rule is, and then defines adjudication in the negative: adjudications are agency actions that are not rules.

The APA also distinguishes between formal and informal rules and adjudications. Formality is not a term specifically defined by the APA; however, additional procedural steps are outlined for rulemakings that are “required by statute to be made on the record after opportunity for an agency hearing.”<sup>80</sup> In today’s world, these “formal” rulemakings are rare.<sup>81</sup> Similarly, formal adjudications are those adjudications that are required by

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<sup>76</sup> 5 U.S.C. § 551(4).

<sup>77</sup> 5 U.S.C. § 551(5).

<sup>78</sup> 5 U.S.C. § 555(7) (emphasis added).

<sup>79</sup> 5 U.S.C. § 555(6) (emphasis added).

<sup>80</sup> 5 U.S.C. § 553(c)

<sup>81</sup> In fact statutory language only authorizing agency action “after hearing” was been held to create only an informal rulemaking equivalent because it did not require that the rule be made “on the record after opportunity for an agency hearing.” *U.S. v. Florida East Coast Ry. Co.*, 410 U.S. 224, 234-235 (1973).

statute to be determined on the record and with an opportunity for a hearing.<sup>82</sup> All other rules and adjudications are informal.

### B. Procedural Differences

Of course, the distinction between rulemaking and adjudication is important because the APA imposes different procedural requirements on agencies depending on what type of activity the agency is engaged in. Similarly, different requirements apply depending on whether the rulemaking or adjudication in question is formal or informal. In other words, an agency must comply with different procedural requirements depending on which type of action it is taking: informal rulemaking, informal adjudication, formal rulemaking, or formal adjudication.

The informal rulemaking process laid out by the APA requires, first, that the agency creating the rule supply “notice of [the] proposed rule . . . in the Federal Register, unless persons subject thereto are . . . personally served or . . . have actual notice.”<sup>83</sup> This notice must include the time, place, and nature of the rulemaking proceedings, a statement of legal authority to make the rule, and the terms of the rule or at least a description thereof.<sup>84</sup> After providing notice, an agency engaging in rulemaking must provide an avenue for interested parties “to participate in the rulemaking through submission of written data, views, or arguments.”<sup>85</sup>

Formal rulemakings and formal adjudications, on the other hand, have different procedural requirements. For both types of *formal* agency actions, the APA requires that a variety of procedures be undertaken by the agency. These requirements include but are

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<sup>82</sup> 5 U.S.C. § 553(a)

<sup>83</sup> 5 U.S.C. § 553(b)

<sup>84</sup> 5 U.S.C. § 553(b)(1-3)

<sup>85</sup> 5 U.S.C. § 553(c)

not limited to permitting interested and affected parties to present evidence to the agency, the cross examination of witnesses supporting that evidence, and the right of interested parties to appeal the agency decision.<sup>86</sup> Furthermore, all of the information brought before the agency must be put into an official record.<sup>87</sup> On the other end of the spectrum, informal agency adjudications have no specific procedural requirements set forth by the APA.

There can be little doubt whether the Cuomo agreement is a formal agency action. It is not. As mentioned above, the APA establishes similar procedural requirements for both formal rulemakings and formal adjudications. These requirements are triggered when the agency action is required by statute to be made on the record and after an opportunity for a hearing.<sup>88</sup> But, in the case at hand, the Cuomo agreement was not made pursuant to a statute at all. The agreement settled a judicial suit; there is no statutory requirement requiring that an agency make such determinations on the record or with an opportunity for a hearing.

### C. Distinguishing Between Rulemaking and Adjudication

Though the APA clearly defines both rulemakings and adjudications, distinguishing between the two can be challenging at the margins. To reiterate, the APA defines a rule, in pertinent part, as “the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy.”<sup>89</sup> Courts have gone so far as to hold that this definition “includes

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<sup>86</sup> See 5 U.S.C. § 556-557

<sup>87</sup> 5 U.S.C. §556-557

<sup>88</sup> 5 U.S.C. § 553(a); 5 U.S.C. § 553(c)

<sup>89</sup> 5 U.S.C. §551 (4)

‘virtually every statement an agency may make.’”<sup>90</sup> However, the APA definition of “order” implicitly acknowledges that some informal agency actions fall outside the realm of rulemakings and should be considered informal adjudications.<sup>91</sup> The clearest long-standing distinction between rulemakings and adjudications actually comes from two cases that preceded the APA: *Londoner v. City and County of Denver*, and *Bi-Metallic Investment Co. v. State Board of Equalization*.

### 1. The *Londoner/Bi-Metallic* Distinction

Both *Londoner* and *Bi-Metallic* concerned Colorado tax provisions, and established that Constitutional due process rights apply to agency adjudications, but not agency rulemakings. First, in *Londoner*, the City of Denver, via its Board of Public Works, levied a tax on only a limited number of properties in the city.<sup>92</sup> The assessment of the tax was clearly permitted by the city charter, but the individuals being assessed were only permitted to challenge the tax via a filed complaint, without an opportunity for a hearing.<sup>93</sup> The Supreme Court held that the individuals had a due process right to be heard in person and to present evidence to the tax board, because the tax constituted an adjudicative, rather than rulemaking, action.<sup>94</sup> The *Londoner* Court justified its holding, first and foremost, by noting that the tax was assessed on a limited number of individuals, based on particularized individual facts and circumstances for each individual.<sup>95</sup> Because

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<sup>90</sup> *National Treasury Employees Union v. Reagan* 685 F. Supp. 1346, 1356 (E.D. La., 1988) (quoting *Avoyelles Sportsmen's League, Inc. v. Marsh*, 715 F.2d 897 (5th Cir. 1983))

<sup>91</sup> See 5 U.S.C. § 551 (6)

<sup>92</sup> *Londoner v. City and County of Denver*, 210 U.S. 373, 378 (1908).

<sup>93</sup> *Id.* at 380.

<sup>94</sup> *Id.* at 385-386.

<sup>95</sup> *Id.*

the tax was not generally applicable, the Court held it was more likely to be adjudicatory in nature.<sup>96</sup>

But, conversely, the Supreme Court in *Bi-Metallic* held that a different Colorado tax was a rulemaking, and not an adjudication, in nature. In that case, the State Board of Equalization and the Colorado Tax Commission assessed an increased property tax on all property in the city of Denver.<sup>97</sup> *Bi-Metallic* argued that, following the Court's reasoning in *Londoner*, due process had been violated because individuals affected by the decision of the Board were not given an opportunity to individually comment on and present evidence concerning the tax increase.<sup>98</sup> The Supreme Court reiterated the *Londoner* rule that adjudicative agency actions require due process whereas rulemakings do not.<sup>99</sup> However, the Court distinguished the tax assessed in *Londoner* from the tax assessed in *Bi-Metallic*, and determined that the *Bi-Metallic* tax was a rulemaking, not an adjudication.<sup>100</sup> The primary distinction offered by the Supreme Court concerned the impact of the tax.<sup>101</sup> The Court reasoned that broad policies and principles of general application were legislative in nature and therefore more likely to be rulemakings, not adjudications.<sup>102</sup>

## 2. Additional Distinguishing Factors

This *Londoner/Bi-Metallic* distinction provides a basic framework for analyzing whether an agency action is adjudicatory, but it does not provide a clear test for determining whether a particular action is a rulemaking or adjudication. Two factors that

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<sup>96</sup> *Id.* at 386.

<sup>97</sup> *Bi-Metallic Inv. Co. v. State Bd. of Equalization*, 239 U.S. 441, 443 (1915).

<sup>98</sup> *Id.* at 444.

<sup>99</sup> *Id.* at 445.

<sup>100</sup> *Id.* at 446.

<sup>101</sup> *Id.* at 445-446.

<sup>102</sup> *Id.*

can further explain the distinction are whether the agency action is individualized in nature and whether the action will have a future effect.

#### a. Individualized Agency Actions

The first factor to consider when determining whether an agency action is a rulemaking or adjudication is what class of individuals the action will impact. Professor Lawrence Tribe contends that the measure of adjudication may be whether the action singles out identifiable individuals; an action that does should be considered adjudicatory in nature.<sup>103</sup> This reasoning gets support from the *Bi-metallic* Court, which noted that it would be infeasible to allow every citizen of Denver to have an individualized hearing concerning their tax.<sup>104</sup> The Court stated that if it would be infeasible to provide hearings to each party affected by an action, the action was more likely to be a rulemaking.<sup>105</sup> A similar approach distinguishes adjudication and rulemaking based on the type of facts in question, noting that “adjudicative facts usually answer the questions of who did what, here, when, how, why,” whereas legislative facts are “facts . . . of law and policy and discretion.”<sup>106</sup> The distinction relies on the idea that legislative facts “transcend individual disputes;” accordingly, actions involving legislative facts are more likely to be rulemakings.<sup>107</sup>

#### b. Agency Actions with Future Effect

The second important factor in determining whether an agency action is a rulemaking or adjudication comes from the APA definition itself. The APA specifically

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<sup>103</sup> See TRIBE, LAWRENCE, AMERICAN CONSTITUTIONAL LAW § 10-6, at 657, § 10-7, at 663-77 (2d ed. 1988).

<sup>104</sup> *Id.* at 445.

<sup>105</sup> *Id.*

<sup>106</sup> KENNETH CULP DAVIS, ADMINISTRATIVE LAW TEXT, § 7.03 at 160 (3d ed., 1972).

<sup>107</sup> DAVID L. FAIGMAN, CONSTITUTIONAL FICTIONS: A UNIFIED THEORY OF CONSTITUTIONAL FACTS 44 (2008).

states that rulemakings have “future effect designed to implement, interpret, or prescribe law or policy.”<sup>108</sup> The District of Columbia Appeals Court recognized the importance of the term “future effect” in *Sugar Cane Growers Cooperative of Florida v. Veneman*.<sup>109</sup> At issue in that case was a Department of Agriculture renewal of a sugar price support program.<sup>110</sup> The agency argued that the renewal should not have to abide by the APA’s notice and comment requirements because it was an informal adjudication, not a rulemaking.<sup>111</sup> The court firmly disagreed; in finding that the renewal *was* a rulemaking, the Court relied substantially on the fact that “the sanctions . . . [would] be imposed on participants . . . in *future* years.”<sup>112</sup> The court concluded that “[i]t is simply absurd to call this anything but a rule by any other name.”<sup>113</sup>

As *Sugar Cane Growers* shows, an agency’s determination that it is undertaking a rulemaking or adjudication is not dispositive. Where an agency incorrectly attempts to frame its action as something other than a substantive rulemaking, courts will enforce the APA notice and comment requirements for informal rulemakings. For example, in *National Treasury Employees Union v. Reagan*, the Eastern District of Louisiana held that an agency guidance letter was subject to the APA’s notice and comment requirements.<sup>114</sup> Though guidance letters are usually considered interpretative rules, and therefore exempted from notice and comment, because the letter’s guidelines

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<sup>108</sup> 5 U.S.C. § 551(4)

<sup>109</sup> 289 F.3d 89 (D.C. Cir. 2002).

<sup>110</sup> *Id.* at 91-92.

<sup>111</sup> *Id.* at 96.

<sup>112</sup> *Id.* (Emphasis original).

<sup>113</sup> *Id.* (Internal quotations omitted).

<sup>114</sup> 685 F. Supp. 1346, 1356 (E.D. La. 1988).

“contain[ed] mandatory instructions” which were not imposed by law, the letter was considered an informal rulemaking, subject to notice and comment.<sup>115</sup>

In the next part, this article will use these factors and existing case law to determine whether the Cuomo Agreement is best thought of as a rulemaking or adjudication.

### III. Categorizing the Cuomo Agreement

Though it is technically a litigation decision, a strong argument can be made that as a matter of law and policy, the Cuomo agreement may be best thought of as an informal rulemaking, not an informal adjudication.

#### A. Typical Litigation Decisions

Generally speaking, “a litigation decision to enter into a settlement agreement does not require notice and comment.”<sup>116</sup> This follows the *Londoner/Bi-Metallic* reasoning. An agency’s litigation decisions generally involve a discrete number of parties: the parties to the lawsuit. If the Environmental Protection Agency (“EPA”) brings an individual facility to court for persistent permit violations and later determines that it wants to settle the case with the facility, the decision to settle is clearly an informal adjudication. The EPA’s litigation decision affects only the one facility. Additionally, the decision to settle has no “*future effect* designed to implement, interpret, or prescribe law or policy.”<sup>117</sup>

That being said, agreements between agencies and individual private parties can be rulemakings as opposed to adjudications. For example, in *Chem Service v.*

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<sup>115</sup> *Id.*

<sup>116</sup> *Miccosukee Tribe v. U.S.* 6 F.Supp.2d 1346, 1350 (S.D. Fla. 1998).

<sup>117</sup> 5 U.S.C. § 551(4) (emphasis added).

*Environmental Monitoring Systems Laboratory – Cincinnati of United States*

*Environmental Protection Agency*, the Third Circuit Court of Appeals held that a memorandum of understanding between a single chemical accrediting association and the EPA was an agency rulemaking.<sup>118</sup> The memorandum in question established technical specifications that a manufacturer had to meet in order to label its products as ‘certified.’<sup>119</sup> Under the agreement, the EPA and the accrediting institution “develop[ed] equivalent technical specifications and requirements for reference materials.”<sup>120</sup> The court held that the memorandum was a rule because it was “a statement of general applicability and future effect designed to implement” a particular policy; though the agreement was between just the agency and the accrediting group, the standards set forth by the agreement applied more broadly to all manufacturers.<sup>121</sup>

The District Court of Colorado made a similar determination in *National Association of Psychiatric Treatment Centers for Children v. Weinberger*.<sup>122</sup> In that case, the Office of Civilian Health and Medical Program of the Uniformed Services, a government agency, published a notice in the Federal Register indicating that each of the “Residential Treatment Centers” under its auspices would need to enter a new participation agreement with the agency.<sup>123</sup> The agency further defined the contents of its future participation agreements.<sup>124</sup> The plaintiffs contended that this constituted a rulemaking; the agency defended itself by arguing that the proposals only applied to treatment centers that chose to enter into a participation agreement, and that the implementation of a single participation

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<sup>118</sup> 12 F.3d 1256, 1267 (3d Cir. 1993)

<sup>119</sup> *Id.*

<sup>120</sup> *Id.* at 1260.

<sup>121</sup> *Id.* at 1267.

<sup>122</sup> 658 F.Supp. 48 (D. Co. 1987)

<sup>123</sup> *Id.* at 50.

<sup>124</sup> *Id.* at 53.

agreement was an adjudication, not a rulemaking.<sup>125</sup> The court, however, disagreed, finding that the agency action had “the characteristics of a rule;”<sup>126</sup> the notice created “a new standard or policy to apply to future facts” and “impose[d] obligations on . . . groups, not only isolated persons.”<sup>127</sup> Accordingly, the court held that the notice was a rulemaking and was subject to the notice and comment requirements of the APA.<sup>128</sup>

### B. The Argument that Cuomo Agreement is an Adjudication

In determining whether the Cuomo agreement is an adjudication or rulemaking, one should first understand that neither the NY AG nor the OFHEO has the power to impose regulations upon the entire mortgage industry. The NY AG, obviously, has no legislative power; attorneys general are part of the executive branch of government, giving legal advice to executive governmental administrations and overseeing the prosecution of violators of the law.<sup>129</sup> The OFHEO, though an administrative agency, is constrained in the scope of its regulatory powers by its authorizing statute. That statute granted the OFHEO, through the Department of Housing and Urban Development, “general regulatory power over each enterprise [Fannie and Freddie].”<sup>130</sup> Accordingly, the OFHEO’s mission is “to promote housing and a strong national housing finance system by ensuring the safety and soundness of [Fannie and Freddie].”<sup>131</sup>

The settlement agreement appears to be a way for the NY AG and the OFHEO to get around this obvious constraint. Because the agreement only applies definite duties to the GSEs (leaving lenders free to choose whether they wish to abide by the HVCC or to

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<sup>125</sup> *Id.* at 53-54.

<sup>126</sup> *Id.* at 54.

<sup>127</sup> *Id.* at 53.

<sup>128</sup> *Id.* at 55.

<sup>129</sup> See BLACK’S LAW DICTIONARY (8<sup>th</sup> ed. 2004).

<sup>130</sup> 12 U.S.C. § 4541

<sup>131</sup> Mission Statement of the Office of Fed. Hous. Enter. Oversight (June 6, 2007)

<http://www.ofheo.gov/about.aspx?Nav=55>

cease selling mortgages to Fannie and Freddie) the OFHEO may argue that it is within the scope of its authorization. But, of course, the OFHEO may not engage in rulemaking concerning the GSEs without fulfilling the procedural requirements of the APA. Were the HVCC requirement simply imposed by the OFHEO without any notice and comment period, then, the analysis would be simple: that would be a clear violation of the APA. But, because the NY AG was investigating the GSEs in relation to a criminal prosecution, the NY AG may argue that he is only making a strategic prosecutorial decision. Accordingly, the OFHEO can argue that its participation in creating and imposing the HVCC requirement was not a rulemaking, but an acceptable informal adjudicatory action to resolve a lawsuit.

On its face, this argument that the agreement is adjudicatory in nature is appealing. The Cuomo agreement does only apply to two parties: Freddie and Fannie.<sup>132</sup> And, ostensibly, the agreement only applies to the two GSEs; lenders are given the option of complying with the HVCC or no longer doing business with the GSEs. Following that conclusion, the *Londoner/Bi-metallic* rule would seem to suggest that the agreement should be thought of as an adjudication because it has a very discrete impact.

### C. Why the Cuomo Agreement is Actually a Rulemaking

However, in reality, the Cuomo agreement is in many ways more similar to the agreement in *Chem Service* and the notice in *Psychiatric Treatment Centers* than to a typical settlement rising out of a litigation decision. When one considers who will be impacted by the agreement as well as its future effect, it becomes clear that the agreement

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<sup>132</sup> In fact, the two GSEs actually each signed a separate but identical agreement, along with the OFHEO and the NY AG.

is best thought of as a rulemaking. Therefore, it should be forced to abide by the notice and comment requirements set forth by the APA.

### 1. The Broad Impact of the Agreement

First, the impact of the agreement is very broad. In this instance, the brunt of the agreement's effect actually falls upon third parties. Though the agreement itself only applies to the GSEs, the impact on lenders will, in a practical sense, be severe. Of course, broad impact was the intent behind the agreement. Cuomo stated when announcing the settlement that the "agreement with Fannie Mae and Freddie Mac begins to set right what had gone so horribly wrong in the mortgage industry – rampant appraisal fraud."<sup>133</sup> Clearly, the settlement was intended to implement a new policy standard on the mortgage industry as a whole.

Looking at the broad scope of who is impacted by the agreement in this way is supported by the courts in *Chem Service* and *Psychiatric Treatment Centers*. In *Chem Service*, an agency action that directly applied only to one institution was held to be a rulemaking because the institution was an accreditor, and the true impact of the agency action was to impose new requirements on all the institutions seeking accreditation.<sup>134</sup> In *Psychiatric Treatment Centers*, the court noted that although the new conditions of the agreements between the agency and treatment centers only directly impacted the individual treatment centers, the practical impact would be felt by numerous individual patients; accordingly, there was broad applicability.<sup>135</sup> The Cuomo agreement is

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<sup>133</sup> Press Release, N.Y. Attorney Gen., New York Attorney General Cuomo announces agreement with Fannie Mae, Freddie Mac, and OFHEO (Mar. 3, 2008), [http://www.oag.state.ny.us/media\\_center/2008/mar/mar3a\\_08.html](http://www.oag.state.ny.us/media_center/2008/mar/mar3a_08.html)

<sup>134</sup> 12 F.3d at 1267.

<sup>135</sup> 658 F.Supp. at 54.

extremely similar to these situations. The agreement only applies to the GSEs directly, but as a practical matter, every mortgage lender will be impacted.

Furthermore, the argument that the lenders are not required to follow the HVCC if they don't want to do business with the GSEs is insufficient under a *Chem Service* or *Psychiatric Treatment Centers* analysis. In *Chem Service*, the manufacturers could have similarly chosen to 'opt-out' and not seek accreditation, simply not labeling their products as certified.<sup>136</sup> Nevertheless, the court maintained that the agency had created a rule by imposing the new standards; the impact, for purposes of a *Londoner/Bi-Metallic* analysis, was not limited to the single accrediting institution.<sup>137</sup> Likewise, in *Psychiatric Treatment Centers*, the court expressly rejected the argument that "the proposals apply only to [treatment centers] which choose to sign a participation agreement."<sup>138</sup>

Similarly, then, the HVCC still should be considered a rulemaking even though it technically only applies to lenders that choose to deal with the GSEs; because the practical impacts will be felt broadly. There are thousands of mortgage lenders and appraisers in the U.S., each which may be impacted by the newly imposed appraisal standards. The HVCC does not single out any individuals; it applies broadly to any lender wishing to deal with the GSEs.

## 2. The Future Effect of the Agreement

The conclusion that the Cuomo agreement is a rulemaking is reached if one considers its future impact too. It may be argued that the only direct effect the agreement itself has is to end the NY AG investigation into the GSEs. But, as discussed above, the agreement does, practically, force lenders to change their business practices, by creating

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<sup>136</sup> 12 F.3d at 1260.

<sup>137</sup> *Id.* at 1267

<sup>138</sup> 658 F.Supp. at 53.

numerous rules as to who is permitted to conduct an appraisal and how appraisals are ordered. This type of required change in how lenders will operate in the future is precisely what is meant by the language of the APA where it defines a rule as a statement of “future effect designed to . . . prescribe law or policy”<sup>139</sup> Though the agreement is between only the NY AG, the GSEs, and the OFHEO, the intended and actual future effect of the agreement is to impact the future practices of mortgage lenders and appraisers whom are removed from the agency action itself.

In *Sugar Cane Growers*, the court recognized that where it was impossible to deny that an agency action would impose future requirements on a broad group of institutions and individuals, “is simply absurd to call [that] anything but a rule by any other name.”<sup>140</sup> The Cuomo agreement will have a future effect, both on lending institutions and individual appraisers, because of the imposition of the HVCC. The effect will not be limited to just a few individuals, but across the board to all participants in the mortgage industry. Accordingly, the Cuomo settlement ought to be thought of as an informal agency rulemaking, not adjudication, and should be subject to the rulemaking procedures of the APA.<sup>141</sup>

#### IV. Conclusion

If the reasonable conclusion is that the Cuomo agreement should be thought of as an agency rulemaking, what is the practical implication? First and foremost, the NAMB

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<sup>139</sup> 5 U.S.C. § 551(4).

<sup>140</sup> 289 F.3d at 96 (Internal quotations omitted).

<sup>141</sup> The APA does list a variety of exceptions to the general procedural requirements for informal rulemakings, including, but not limited to: interpretive rules, rules pertaining to agency organization or procedure, and general policy statements. See 5 U.S.C. § 553. To examine each exception is beyond the scope of this article, however, it should be noted that these exceptions are generally construed narrowly. See *Committee For Fairness v. Kemp*, 791 F.Supp. 888 (D.D.C. 1992). It is highly unlikely that any of the exceptions would apply to the Cuomo agreement.

lawsuit appears to at least have a solid footing. As a final defense, the OFHEO may attempt to argue something akin to “no harm no foul.” After all, after announcing the agreement and receiving nearly immediate criticism, the OFHEO and NY AG permitted written comments from interested parties.<sup>142</sup> These comments were taken into consideration and the FHFA made substantive changes to the HVCC to address some concerns.<sup>143</sup> However, recent precedent suggests that this argument will fall on deaf ears. For example, in *Sierra Club v. E.P.A.*, the Supreme Court recognized that the Sierra Club had standing to challenge an EPA rulemaking that failed to comply with the notice and comment procedures of the APA, even where the Club had *actual* notice of the rulemaking and could not prove that any interested parties lacked notice.<sup>144</sup> In other words, the requirements set forth by the APA must be followed, even if there’s no evidence that the agency failure did no harm.

Accordingly, as discussed above, the most appropriate conclusion concerning the appropriateness of the Cuomo agreement is that “[i]t is simply absurd to call this anything but a rule by any other name.”<sup>145</sup> Based on this reasoning, the NAMB suit should be successful. The Cuomo settlement should be rejected as an impermissibly promulgated agency rulemaking. This result not only follows logical interpretation of the APA and case law, but would additionally establish important precedent to avoid potential future efforts by agencies and attorneys general to get around rulemaking procedures by entering into settlement agreements.

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<sup>142</sup> See Biggers, *supra* note 41.

<sup>143</sup> Press Release, Fed. Hous. Fin. Agency, FHFA Announces Home Valuation Code of Conduct, (Dec. 23, 2008) <http://www.fhfa.gov/webfiles/277/HVCC122308.pdf>

<sup>144</sup> See 551 F.3d 1019 (2008).

<sup>145</sup> 289 F.3d at 96 (Internal quotations omitted).

This does not necessarily mean that the HVCC couldn't or shouldn't become the policy of the future, though. In fact, the wide-spread support for the goal of the HVCC—appraiser independence from lender influence—suggests that a regulation similar to the HVCC may be able to garner support industry-wide. But in order to create such a restriction, the OFHEO must go through the appropriate rulemaking processes to require the GSEs to impose appraisal standards on the mortgages it purchases. This would require compliance with the APA, including the receipt of comments from appraisal and lender groups. It cannot be denied that these processes are time consuming and expensive. But they also ensure that interested parties have an opportunity to speak out, that suggestions regarding efficacy and efficiency are heard, and that the agency is acting within its bounds.