

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

FAIRHOLME FUNDS, INC., *et al.*,

Plaintiffs,

v.

FEDERAL HOUSING FINANCE AGENCY, *et al.*,

Defendants.

Civil Action No. 13-cv-1053 (RCL)

ARROWOOD INDEMNITY COMPANY,
et al.,

Plaintiffs,

v.

FEDERAL NATIONAL MORTGAGE
ASSOCIATION, *et al.*,

Defendants.

Civil Action No. 13-cv-1439 (RCL)

In re Fannie Mae/Freddie Mac Senior Preferred
Stock Purchase Agreement Class Action Litigations

This document relates to:
ALL CASES

Misc. Action No. 13-mc-01288 (RCL)

NOTICE OF SUPPLEMENTAL AUTHORITY BY DEFENDANTS FEDERAL HOUSING FINANCE AGENCY AS CONSERVATOR FOR FANNIE MAE AND FREDDIE MAC, FHFA DIRECTOR MELVIN L. WATT, FANNIE MAE, AND FREDDIE MAC IN FURTHER OPPOSITION TO PLAINTIFFS' MOTION FOR SUPPLEMENTATION OF THE ADMINISTRATIVE RECORDS, FOR LIMITED DISCOVERY, FOR SUSPENSION OF BRIEFING ON DEFENDANTS' DISPOSITIVE MOTIONS, AND FOR A STATUS CONFERENCE

Defendants the Federal Housing Finance Agency (“FHFA” or the “Conservator”), as Conservator of the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac,” together with Fannie Mae, the “Enterprises”), FHFA Director Melvin L. Watt, Fannie Mae, and Freddie Mac¹ hereby notify the Court of a recent ruling (attached as **Exhibit A**)—issued in a related litigation—in further opposition to Plaintiffs’ Motion for Supplementation of the Administrative Records, for Limited Discovery, for Suspension of Briefing on Defendants’ Dispositive Motions, and for a Status Conference, *Fairholme Funds, Inc. v. FHFA*, No. 1:13cv01053 (Feb. 12, 2012) (Doc. # 31) (the “Motion for Supplementation”). In this recent decision, another federal district court denied essentially the same relief Plaintiffs seek here—to conduct discovery and expand the administrative record before resolving threshold legal issues.

On February 5, 2014, Continental Western Insurance Company, initiated an action in the U.S. District Court for the Southern District of Iowa against FHFA, its director, and the Department of the Treasury (“Treasury”). *See Continental Western Ins. Co. v. FHFA, et al.*, No. 4:14cv0042 (S.D. Iowa) (the “Iowa Action”); *see also* Doc. # 49 (1:13cv1053) (identifying the Iowa Action as a related action). The Iowa Action is directly related to the actions pending in this Court. The plaintiff in the Iowa Action is a corporate subsidiary of one of the Plaintiffs in the *Fairholme* action (Berkeley Regional Insurance Company) and is represented by the same counsel as the *Fairholme* plaintiffs (Cooper & Kirk, PLLC). The Iowa Action presents the same controversy as the present actions—whether the FHFA as Conservator and Treasury acted unlawfully by executing the Third Amendment to the Senior Preferred Stock Purchase Agreements (“PSPAs”)—and the same claims as the present actions. Defendants filed their

¹ The Department of the Treasury also joins this Notice of Supplemental Authority.

motions to dismiss in the present actions on January 17, 2014. Fairholme's subsidiary commenced the Iowa Action less than three weeks later.

FHFA and Treasury filed motions to dismiss the Iowa Action. In response, the plaintiff filed a Motion to Compel Production of the Administrative Record and for Suspension of the Briefing Schedule (the "Iowa Motion to Compel"). In that motion, the plaintiff sought to compel Defendants to produce "complete" administrative records—that is, beyond the administrative record and document compilation already produced in the actions pending before this Court—and to suspend briefing on the motions to dismiss until such production. The plaintiff argued that this relief was mandated because Defendants' briefs in support of the motions to dismiss allegedly raised factual issues "about the necessity and purpose of the net worth sweep [that were] inconsistent with the Complaint's allegations on the same subjects." Ex. A at 4.

On August 5, 2014, the court denied the Iowa Motion to Compel. *See* Ex. A at 6-7. The court held that no discovery was warranted because Defendants' motions to dismiss presented only facial challenges to the court's jurisdiction that can be resolved purely as a matter of law.

Id. at 6. The court explained:

As noted, defendants contend that they make only a facial challenge to the Complaint. It is true that in their briefing they describe the net worth sweep in positive terms as a means to save the Companies from the insolvency they were facing under the dividend structure in effect prior to the Third Amendment. It is natural they would explain the sweep from their perspective in view of the allegations in the Complaint about the invalidity of the sweep, but that does not mean defendants make a factual challenge to jurisdiction. ***At bottom the motions to dismiss do appear to advance purely legal arguments. Defendants having disclaimed a factual challenge,*** the Court must take Continental Western's factual assertions bearing on its jurisdictional theory -- that the net worth sweep was unnecessary and improperly motivated -- as true. ***There is no need to adjudicate the truth of the matter in order to determine the motions to dismiss.***

Id. (emphases added). The court also observed that there were other, potentially dispositive issues raised by the motions concerning the plaintiff's standing to pursue its claims that "clearly present purely legal issues which may be decided without resort to an administrative record." *Id.* Finally, the court identified various practical problems with granting the relief requested:

The Court is also concerned with the practical consequences to the progression of the case if Continental Western's motion is granted. The time necessary to put together an administrative record, the inevitable disputes about its adequacy, requests for additional discovery at which Continental Western hints, and the time required to digest and incorporate the administrative record in what promises to be extensive briefing, all portend ***months of delay in resolving the motions to dismiss to no obvious benefit or purpose.***

Id. at 6-7 (emphasis added). Accordingly, the court denied the Motion to Compel and ordered the plaintiff to file its brief in response to the motions to dismiss by August 29, 2014. *Id.* at 7.

The Iowa Order is directly relevant here because Plaintiffs in this action are pursuing substantially the same strategy as is the plaintiff in Iowa. Here, Plaintiffs accuse Defendants of "rely[ing] on disputed material facts to support their motion to dismiss." *See* Memo in Supp. of Motion for Suppl. at 4 (Doc. # 32); *see also id.* at 29 (arguing that Defendants "responded to Plaintiffs' well-pled factual allegations by disputing them on the merits."). As in Iowa, Plaintiffs argue that the Defendants have made "factual contentions regarding the purposes underlying" the Third Amendment that are "in direct conflict with those allegations [in the complaint]," and thus warrant discovery. *Id.* at 30. Further, as in Iowa, Plaintiffs argue that the discovery issues they raise should be addressed before the Court resolves the (now fully-briefed) motions to dismiss. *Id.* at 34-37.

This Court also should reject each of these arguments, deny the Motion for Supplementation, and resolve the motions to dismiss on the basis of the briefing already completed.

Dated: August 26, 2014

Respectfully submitted,

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IN THE UNITED STATES DISTRICT COURT
 FOR THE SOUTHERN DISTRICT OF IOWA
 CENTRAL DIVISION

CONTINENTAL WESTERN INSURANCE)	
COMPANY,)	4:14-cv-00042-RP-RAW
))
Plaintiff,))
))
vs.)	RULING ON PLAINTIFF'S
)	MOTION TO COMPEL
THE FEDERAL HOUSING FINANCE)	PRODUCTION OF THE
AGENCY, MELVIN L. WATT, in)	ADMINISTRATIVE RECORD
his official capacity as)	AND FOR SUSPENSION OF
Director of the Federal)	THE BRIEFING SCHEDULE
Housing Finance Agency, and)	AND DISCOVERY-RELATED
THE DEPARTMENT OF THE)	DEADLINES
TREASURY,))
))
Defendants.))

The above resisted motion [31] is before the Court following hearing. Plaintiff Continental Western Insurance Company ("Continental Western") brings this action against The Federal Housing Finance Agency and its Director (collectively "FHFA") and The Department of The Treasury ("Treasury"). Counts I - IV of the Complaint are under the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 551-706, and challenge the conduct of the agency and department relating to FHFA's conservatorships of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, "the Companies") under the authority of the Housing and Economic Recovery Act of 2008 ("HERA"), 12 U.S.C. §§ 1455, 1719, 4617. In addition, under the Court's supplemental jurisdiction the Complaint includes a number of common law claims against FHFA for breach of contract, the associated covenant of good faith and fair dealing,

and breach of fiduciary duty (Counts V - VII). Both defendants have filed motions to dismiss for lack of subject matter jurisdiction [23][24]. Fed. R. Civ. P. 12(b)(1). Alternatively defendants urge the Court should transfer this case to the U.S. District Court for the District of Columbia where some ten similar, earlier-filed actions are pending, or stay this case until the resolution of the actions in that court.¹

By the present motion Continental Western seeks an order compelling production of an administrative record, suspending briefing on the motions to dismiss until the record is produced, and suspending discovery-related deadlines. Defendants do not resist suspending discovery-related deadlines (to include submission of a proposed scheduling order and discovery plan) but do resist the motion to compel and to suspend briefing on their motions to dismiss.

In 2008 Congress enacted HERA in response to the financial crisis at that time which had much to do with the housing market. HERA authorized FHFA to place the Companies into

¹ As the Court understands it, in one of the District of Columbia cases in which Continental Western's parent is a party (and Continental Western's current counsel are involved), FHFA has filed a motion to dismiss or in the alternative for summary judgment which, according to FHFA, raises many of the same arguments presented by defendants in their motions to dismiss in this Court. The motion is fully briefed. Given the summary judgment context FHFA agreed to provide a compilation of documents in the District of Columbia case, the adequacy of which is disputed and currently the subject of a motion before that court. (Tr. [40] at 10, 18-19, 20).

conservatorship and that is what FHFA did in September 2008. FHFA, as conservator, subsequently entered into preferred stock purchase agreements with Treasury under which Treasury committed billions of dollars to the Companies in exchange for senior preferred stock. For reasons the validity of which is in dispute, Treasury and FHFA in 2012 entered into a Third Amendment to the preferred stock agreements which altered the dividend structure to accomplish what Continental Western refers to as a "net worth sweep."² The sweep resulted in all of the Companies' future profits going to Treasury, effectively, as Continental Western characterizes it, nationalizing the Companies and resulting in the confiscation of the value of Continental Western's preferred stock. The core of Continental Western's Complaint is that FHFA, at Treasury's prompting, acted in excess of its HERA statutory authority and without legitimate motive when it agreed to the net worth sweep, an action therefore arbitrary and capricious entitling Continental Western to relief under the APA.

In their motions to dismiss defendants argue the Court lacks jurisdiction because HERA prohibits the relief sought in the Complaint. Specifically, 12 U.S.C. § 4617(f) states that "[e]xcept as provided in this section or at the request of the Director, no court may take any action to restrain or affect the exercise of

² The Complaint states FHFA's then-acting Director used this phrase in describing the Third Amendment. (Complaint [1] ¶ 12).

powers or functions of the Agency as a conservator or a receiver," a provision defendants contend precludes judicial review of FHFA's exercise of its powers as conservator. Defendants further argue that FHFA's succession to the rights and privileges of the Companies and their stockholders as provided in 12 U.S.C. § 4617(b)(2)(A)(i) divests Continental Western of the ability as stockholder to sue for damages directly or derivatively. For this and other reasons defendants argue Continental Western lacks standing.

Continental Western's 56-page Complaint is highly fact specific. The Complaint alleges the net worth sweep was not necessary, other options were available, and the sweep was the product of a Treasury directive aimed simply at giving Treasury all of the Companies' profits. The present motion is prompted by the fact that in their briefs on the motions to dismiss defendants make factual assertions about the necessity and purpose of the net worth sweep inconsistent with the Complaint's allegations on the same subjects. In particular, Continental Western targets statements in defendants' briefs which justify the net worth sweep as necessary to save the Companies from insolvency. (Treasury Motion to Dismiss Brief [24-1] at 9-10; FHFA Motion to Dismiss Brief [23-13] at 9-10). Continental Western argues it needs an administrative record to rebut defendants' assertions about the necessity and purpose of the net worth sweep and to support its contrary factual assertions,

and until then briefing on the motions to dismiss should be suspended. Defendants respond that their motions make only a facial challenge to subject matter jurisdiction and that even accepting all of the many facts stated in the Complaint as true, they are nonetheless entitled to dismissal.

There are two types of challenges to subject matter jurisdiction, a "facial" challenge and a "factual" challenge. See *Titus v. Sullivan*, 4 F.3d 590, 593 (8th Cir. 1993). A facial challenge analyzes the face of the Complaint, the jurisdiction-related factual allegations of which are taken as true. *Smith v. Dep't of Agriculture*, 888 F. Supp. 2d 945, 948 (S.D. Iowa 2012)(citing *Biscanin v. Merrill Lynch & Co.*, 407 F.3d 905, 907 (8th Cir. 2005)); *Dolls, Inc. v. City of Coralville, Iowa*, 425 F. Supp. 2d 958, 969 (S.D. Iowa 2006)(also citing *Biscanin*). In a factual challenge the Court may look outside the pleadings to determine its jurisdiction, and the facts of the complaint are not presumed to be true. *Dolls, Inc.*, 425 F. Supp. 2d at 970 (citing *Osborn v. United States*, 918 F.2d 724, 729-30 n.6 (8th Cir. 1990). See 2 *Moore's Federal Practice* § 12.30[4] at 12-46 - 12-47 (3d ed. 2014); 5B Charles Wright and Arthur Miller, *Federal Practice and Procedure: Civil*, § 1350 at 187-98 (3d ed. 2004).

As noted, defendants contend that they make only a facial challenge to the Complaint.³ It is true that in their briefing they describe the net worth sweep in positive terms as a means to save the Companies from the insolvency they were facing under the dividend structure in effect prior to the Third Amendment. It is natural they would explain the sweep from their perspective in view of the allegations in the Complaint about the invalidity of the sweep, but that does not mean defendants make a factual challenge to jurisdiction. At bottom the motions to dismiss do appear to advance purely legal arguments. Defendants having disclaimed a factual challenge, the Court must take Continental Western's factual assertions bearing on its jurisdictional theory -- that the net worth sweep was unnecessary and improperly motivated -- as true. There is no need to adjudicate the truth of the matter in order to determine the motions to dismiss.

The other issues raised by the motions, whether HERA or other standing principles deprive the Court of jurisdiction to consider Continental Western's common law claims, and the alternative request for transfer, clearly present purely legal issues which may be decided without resort to an administrative record.

The Court is also concerned with the practical consequences to the progression of the case if Continental

³ See Tr. [40] at 17-18, 33-34.

Western's motion is granted. The time necessary to put together an administrative record, the inevitable disputes about its adequacy, requests for additional discovery at which Continental Western hints, and the time required to digest and incorporate the administrative record in what promises to be extensive briefing, all portend months of delay in resolving the motions to dismiss to no obvious benefit or purpose.

Continental Western's motion to compel production of the administrative record and for suspension of briefing schedule and discovery-related deadlines [31] is **granted in part and denied in part**. The motion is granted to the extent that discovery-related deadlines including the deadline under the local rules for submission of a proposed scheduling order and discovery plan are **stayed**. In all other respects the motion is denied. Continental Western may have to and including **August 29, 2014** to submit its response to defendants' motions to dismiss.

IT IS SO ORDERED.

Dated this 5th day of August, 2014.



ROSS A. WALTERS
UNITED STATES MAGISTRATE JUDGE