NOTE

FANNIE, FREDDIE, AND FAIRNESS: JUDICIAL REVIEW OF FEDERAL CONSERVATORS

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In the wake of the 2008 financial crisis, the federal government assumed control of the government-sponsored mortgage entities Fannie Mae and Freddie Mac. This Note analyzes the "net worth sweep" amendment subsequently entered into by the Treasury Department and the Federal Housing and Finance Agency. The Note argues that the amendment provides an example of why shareholder derivative lawsuits can provide a critical check on executive agency action when the government takes over failing financial institutions.

I. INTRODUCTION

In the fall of 2008, the worst financial crisis since the Great Depression hit the United States, leaving millions of Americans unemployed and resulting in the loss of trillions of dollars in wealth.[1] In an effort to stabilize the collapsing economy, the federal government spent an estimated $16 trillion to "bail out" hundreds of large private institutions—ranging from banks, to auto manufacturers, to insurance companies.[2] As a part of this effort, Congress enacted the 2008 Housing and Economic Recovery Act ("HERA"), pursuant to which the federal government became the conservator of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (together, "the GSEs").[3] Subsequently, the government provided Fannie Mae and Freddie

[1] *Wall Street Reform: The Dodd-Frank Act*, THE WHITE HOUSE, https://www.whitehouse.gov/economy/middle-class/dodd-frank-wall-street-reform [https://perma.cc/SH2Y-7YPH].

[2] *See* U.S. GOV'T ACCOUNTABILITY OFFICE REPORT, GAO-11-696, FEDERAL RESERVE SYSTEM 131 (2011).

[3] Congress has granted some federal agencies—such as the Federal Housing and Finance Agency ("FHFA") and the Federal Deposit Insurance Corporation ("FDIC")—the power to take control of the assets of failed federally insured institutions as either conservator or receiver. *See* L. BAXTER DUNAWAY, 2 LAW OF DISTRESSED REAL ESTATE § 21:6 (2015). As conservator, a federal agency assumes the role of protector, guardian, or preserver of the entity with the goal of rehabilitating and stabilizing it. *See Conservator*, BLACK'S LAW DICTIONARY (10th ed. 2014). If the FHFA had elected instead to liquidate the GSEs by placing them into bankruptcy, it would have invoked its powers as a receiver as permitted by HERA. 2008 Housing and Economic Recovery Act (HERA), 12 U.S.C. § 4617(a)(2) (2012) ("The Agency may, at the discretion of the Director, be appointed conservator or receiver for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity.").

Mac with a combined $187.5 billion[4] in order to ensure the solvency of the failing housing market underlying the crisis.[5]

These government bailouts occurred in varying arrangements and resulted in extensive litigation over the legality of the government's actions. These lawsuits raise important questions about the proper role of judicial checks on executive power after the federal government assumes control of failing or undercapitalized institutions. Recently, for example, the Court of Federal Claims held in *Starr Int'l Co. v. United States* that the government's rescue and takeover of the American International Group, Inc., ("AIG") during the 2008 financial crisis constituted an illegal exaction.[6]

This Note explores the role of the traditional shareholder derivative lawsuit to challenge executive agency action in the context of the government takeover of Fannie Mae and Freddie Mac. Derivative suits—a traditional corporate law tool—permit shareholders to sue on behalf of a corporation[7] for harm done to the corporation by its fiduciaries, such as its officers, directors, or controlling shareholders.[8] This Note highlights one recent government transaction—the "net sweep" amendment entered into by the Department of Treasury ("Treasury") and the Federal Housing Finance Agency ("FHFA") in 2012—as an example of how derivative suits can provide a key mechanism for the public to ensure fairness and accountability of executive agency action.

Part II provides a brief history of the events leading up to the government takeover of Fannie Mae and Freddie Mac and describes the details of the net sweep amendment. Part III analyzes whether HERA permits judicial review of derivative suits during conservatorship and concludes that courts should review such claims when the federal agency faces a conflict of interest in a transaction. After determining that Treasury and FHFA faced such a conflict of interest when they enacted the net sweep amendment, Part IV turns to the merits of the net sweep amendment derivative claims. Using corporate law principles, it determines that the transaction would likely fail judicial fairness review. The Note concludes that the net sweep amendment

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[4] Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 217 (D.D.C. 2014). This figure does not include the additional $1 billion in reserves Treasury provided to each GSE.

[5] These funds were provided through the Stock Purchase Agreements entered into between Treasury and the GSEs in September 2008, as discussed in detail *infra* Part III.

[6] 121 Fed. Cl. 428, 465 (2015). The *Starr* court held that the takeover was an illegal exaction because while the Federal Reserve had the authority to make loans to AIG, it did not possess the authority to become the owner of AIG under the language of the Federal Reserve Act. *Id.* Because the government's actions in *Starr* were governed by the Federal Reserve Act, this holding is not directly relevant to the government's actions with regard to Fannie Mae and Freddie Mac, which are governed by HERA. *See id.*

[7] Shareholders may sue corporations derivatively or directly. Whether an action is derivative or direct turns on whether the corporation itself or the shareholder individually suffered the alleged harm and would therefore receive the benefit of any remedy. *See* Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1035 (Del. 2004).

[8] *See* Kramer v. W. Pac. Indus., Inc., 546 A.2d 348, 351 (Del. 1988). Federal conservators are likewise fiduciaries of the entities they assume control of. *See, e.g.*, Gibralter Fin. Corp. v. Fed. Home Loan Bank Bd., No. 89-3489, 1990 WL 394298, at *2 (C.D. Cal. June 15, 1990).

highlights the importance of the derivative suit mechanism as a way to check federal conservator power.

II. The Government Takeover of Fannie Mae and Freddie Mac and the Enactment of the Net Sweep Amendment

Fannie Mae and Freddie Mac are GSEs, initially chartered by Congress to increase liquidity in the residential mortgage market.[9] These GSEs raise money—from sources such as pension and mutual funds—in order to buy mortgages so that lenders can then use the freed-up capital for additional loans to borrowers.[10] Although Congress created the GSEs, they are considered "government-sponsored," rather than "government-owned," because they have functioned as public companies since 1989.[11] While the mortgages purchased by Fannie Mae and Freddie Mac are not officially government-insured, a perception exists that they "carry an implicit government guarantee [because] the companies are so large that the government would never let them fail."[12] At the time of HERA's enactment, the GSEs were owned by preferred and common stockholders and listed on the New York Stock Exchange.[13] In their corporate bylaws, Fannie Mae elected to follow Delaware corporate law,[14] while Freddie Mac elected to follow the corporate law of Virginia,[15] where its principal office is located.[16]

By the summer of 2008, the U.S. economy was in apparent decline, fueled largely by instability in the housing market.[17] Pervasive subprime mortgage lending caused widespread home foreclosures,[18] and as a result, about one in four U.S. homebuyers—approximately 11 million in total—

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[9] *See Perry*, 70 F. Supp. 3d at 214.

[10] *See* Kate Pickert, *A Brief History of Fannie Mae and Freddie Mac*, Time (July 14, 2008), http://content.time.com/time/business/article/0,8599,1822766,00.html [http://perma.cc/W5DQ-DHMH].

[11] *Id.*

[12] *Id.*

[13] *See Frequently Asked Questions about Freddie Mac*, Freddie Mac, http://www.freddiemac.com/corporate/company_profile/faqs/ [http://perma.cc/ZH98-8DZ8]; *see also History of the Government Sponsored Enterprises*, Fed. Housing Fin. Agency, http://fhfaoig.gov/LearnMore/History [http://perma.cc/ZUF9-4FN9].

[14] *See* Fannie Mae, Bylaws § 1.05 (Jan. 30, 2009), http://www.fanniemae.com/resources/file/aboutus/pdf/bylaws.pdf [http://perma.cc/E7VU-THNJ].

[15] *See* Freddie Mac, Bylaws § 11.3(a) (June 3, 2011), http://www.freddiemac.com/governance/pdf/bylaws_1009.pdf [http://perma.cc/RZR4-HRSD].

[16] This Note focuses on Delaware corporate law. However, Virginia corporate law requires a similar fairness review of conflict of interest transactions, and thus the analysis is essentially the same for both GSEs. *See* Va. Code Ann. § 13.1-691 (2010).

[17] *See* Martin Feldstein, *How to Shore Up America's Crumbling Housing Market*, Fin. Times (Aug. 26, 2008), http://www.ft.com/cms/s/0/29e69ebc-736f-11dd-8a66-0000779fd18c.html#axzz3jNmOsrug [http://perma.cc/RB5A-8Z8C] ("The risk of a downward spiral of house prices is the primary danger facing the American economy . . . this risk has the potential to cause a global financial crisis.").

[18] For a detailed explanation of the subprime mortgage crisis, see John R. Duca, *Subprime Mortgage Crisis*, Fed. Reserve History (Nov. 22, 2013), http://www.federalreservehistory.org/Events/DetailView/55 [https://perma.cc/AM8H-LHEK].

faced foreclosure between 2008 and 2012.[19] The average household lost almost $100,000 in property and retirement portfolio values from 2008 to 2009 alone, exacerbating the broader economic recession.[20] This decline in the housing market impacted Fannie Mae and Freddie Mac significantly, and the value of their assets began to deteriorate in 2008.[21] While the GSEs attempted to raise capital in the private markets to offset these losses, their efforts were largely unsuccessful.[22]

Anticipating the severe ramifications a Fannie Mae or Freddie Mac collapse would have on the fragile housing market—and therefore on the U.S. economy as a whole—Congress passed HERA in July 2008. Modeled after the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), enacted in response to the savings and loan crisis of the 1980s, HERA established the independent Federal Housing and Finance Agency ("FHFA"), and tasked it with overseeing and regulating Fannie Mae and Freddie Mac.[23] HERA modeled FHFA's regulatory power over the GSEs after those granted in FIRREA to the Federal Deposit Insurance Corporation ("FDIC") to assume control of failing banks and financial institutions.[24] In September 2008, pursuant to this authority, FHFA placed Fannie Mae and Freddie Mac into conservatorship, where they remain today.[25] As conservator, FHFA assumed "all rights, titles, powers, and privileges" belonging to the GSEs, as well as their stockholders, officers, or directors.[26]

In order to provide Fannie Mae and Freddie Mac with the capital necessary to ensure their stability, HERA also granted the Treasury Department temporary authorization to purchase stock in the GSEs.[27] Just one day after FHFA assumed control of the GSEs, Treasury acted on this authority by

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[19] *See* NOVA GOODWIN ET AL., MACROECONOMICS IN CONTEXT 337–56 (2d ed. 2014), http://www.ase.tufts.edu/gdae/Pubs/te/MAC/2e/MAC_2e_Chapter_15.pdf [http://perma.cc/3QAB-YE64].

[20] *Id.*

[21] FHFA Mot. to Dismiss at 7, Perry Capital LLC v. Lew, 70 F. Supp. 3d 208 (D.D.C. 2014) (No. 1:13-cv-01025-RLW) [hereinafter FHFA Mot.].

[22] *See id.* at 7–8.

[23] *See* 12 U.S.C. § 4511 (2012).

[24] *See* HERA, 12 U.S.C. § 4617 (2012); Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), 12 U.S.C. § 1821 (2012). *See also* CONG. RESEARCH SERV., RL34657, FINANCIAL INSTITUTION INSOLVENCY: FEDERAL AUTHORITY OVER FANNIE MAE, FREDDIE MAC, AND DEPOSITORY INSTITUTIONS 1, 6 (Sept. 10, 2008) (noting that HERA contains "extensive provisions providing the FHFA with powers that substantially parallel those accorded the . . . FDIC . . . to deal with every aspect of insolvencies of any bank or thrift institution that holds federal insured deposits").

[25] *See FHFA as Conservator of Fannie Mae and Freddie Mac*, FED. HOUS. & FIN. AGENCY, http://www.fhfa.gov/Conservatorship/pages/history-of-fannie-mae—freddie-conservatorships.aspx [http://perma.cc/3FTB-5ATR].

[26] *See* 12 U.S.C. § 4617 (2012). The full text of the provision reads: "The Agency shall, as conservator or receiver, and by operation of law, immediately succeed to—(i) all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity and the assets of the regulated entity; and (ii) title to the books, records, and assets of any other legal custodian of such regulated entity."

[27] *See* 12 U.S.C. §§ 1455(e)(1), 1719(g) (2012).

entering into a Preferred Stock Purchase Agreement ("PSPA") with the GSEs through their new conservator, FHFA.[28] In exchange for Treasury's infusion of $100 billion in capital support, the PSPA provided Treasury with, among other things, $1 billion in senior preferred stock, an annual 10% fixed-rate dividend on the investment, warrants for 79.9% of the GSEs' common stock,[29] and control over the management and boards of the GSEs.[30]

In May 2009, Treasury and FHFA amended the terms of the PSPA for the first time, raising the cap on available Treasury funds from $100 billion to $200 billion.[31] Six months later, in December 2009, a second amendment to the PSPA removed the cap entirely through 2012.[32] The legality of these first two amendments to the PSPA has not been challenged, nor have the original terms of the PSPA.[33] However, the third amendment to the agreement—entered into by Treasury and FHFA on August 17, 2012, approximately four years into conservatorship—raises serious legal and policy questions.[34]

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[28] *See FHFA as Conservator*, *supra* note 25.

[29] *See id.*

[30] *See* U.S. Dep't of Treasury, Office of Public Affairs, Fact Sheet: Treasury Senior Preferred Stock Purchase Agreement (Aug. 7, 2008), http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2008-8-7_SPSPA_FactSheet_508.pdf [http://perma.cc/9ASL-LVD4]. Notably, this arrangement is similar to the one the government reached with AIG as was at issue in the *Starr* case. *See* Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 465 (2015). There, the Federal Reserve Board of New York took 79.9% equity ownership and voting control of AIG in what the court found to be an illegal exaction. *See id.* at 431. However, as discussed above, the grounds for the illegal exaction conclusion rested in the statutory language of the Federal Reserve Act. *See id.* at 465.

[31] *See* U.S. Dep't of Treasury, Federal Home Loan Mortgage Corporation, First Amendment to Senior Stock Purchase Agreement § 4 (May 6, 2009), http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2009-5-6_SP-SPA_FannieMae_Amendment_508.pdf [http://perma.cc/YTW9-8YSW] (Fannie Mae amendment); U.S. Dep't of Treasury, Federal Home Loan Mortgage Corporation, First Amendment to Senior Stock Purchase Agreement § 4 (May 6, 2009), http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2009-5-6_SP-SPA_FreddieMac_Amendment_508.pdf [http://perma.cc/PX99-PBWK] (Freddie Mac amendment).

[32] *See* U.S. Dep't of Treasury, Federal Home Loan Mortgage Corporation, Second Amendment to Senior Stock Purchase Agreement § 3 (Dec. 24, 2009), http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2009-12-24_SPSPA_FannieMae_Amendment2_508.pdf [http://perma.cc/AU4D-VMY9] (Fannie Mae amendment); U.S. Dep't of Treasury, Federal Home Loan Mortgage Corporation, Second Amendment to Senior Stock Purchase Agreement § 3 (Dec. 24, 2009), http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2009-12-24_SPSPA_FreddieMac_Amendment2_N508.pdf [http://perma.cc/B9VV-YH6C] (Freddie Mac amendment).

[33] *See* Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 217–18 (D.D.C. 2014).

[34] *See* U.S. Dep't of Treasury, Federal Home Loan Mortgage Corporation, Third Amendment to Senior Stock Purchase Agreement § 3 (Aug. 17, 2012) [hereinafter Third Fannie Mae Amendment], http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2012-8-17_SPSPA_FannieMae_Amendment3_508.pdf [http://perma.cc/8MW3-AE7Y]; U.S. Dep't of Treasury, Federal Home Loan Mortgage Corporation, Third Amendment to Senior Stock Purchase Agreement § 3 (Aug. 17, 2012) [hereinafter Third Freddie Mac Amendment], http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2012-8-17_SPSPA_FreddieMac_Amendment3_N508.pdf [http://perma.cc/NUB2-8R5M].

The third amendment replaced the original 10% fixed-rate dividend on the investment with a requirement that each GSE provide Treasury with dividends equal to its entire net worth (above a minimal capital reserve) in perpetuity.[35] According to Treasury, this arrangement was necessary to end a "vicious circle" in which the GSEs were paying dividends to Treasury, drawing funds from Treasury, and paying further dividends on those draws.[36] Under the new "net worth sweep" agreement, existing stockholders in the publicly traded[37] companies receive no future dividend payments, regardless of how profitable the GSEs might become in the near or distant future.[38]

The impact of the net sweep amendment on GSE shareholders became readily apparent when the housing market rebounded shortly after the transaction. Fannie Mae and Freddie Mac returned to profitability almost immediately, triggering substantial dividend payments to Treasury under the new arrangement. In 2013, the GSEs paid $130 billion in dividend payments to Treasury under the net sweep amendment,[39] and as a result, by the end of the 2013 fiscal year Treasury had fully recouped its initial 2008 investment in the GSEs.[40] Treasury has continued to profit from the net sweep amendment: as of November 2015, Fannie Mae had paid Treasury a total of $144.8 billion in dividends—$28.7 billion more than it had initially received[41]—while Freddie Mac had paid a total of $96.5 billion to Treasury—$25.3 billion more than it had received.[42] In 2014, economists estimated that, as a result of the recovering housing market, Treasury will receive an additional $81.5 billion in dividend payments under the net sweep amendment over the next decade.[43]

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[35] *See* Third Fannie Mae Amendment, *supra* note 34; Third Freddie Mac Amendment, *supra* note 34.

[36] *See* Treasury Defendant's Reply in Support of Dispositive Motions at 43, Perry Capital LLC v. Lew, 70 F. Supp. 3d 208 (D.D.C. 2014) (No. 1:13-cv-1025-RCL).

[37] The GSEs were delisted from the New York Stock Exchange in 2010. Fannie Mae and Freddie Mac are both now traded on the over-the-counter (OTC) market. *See OTC Markets Company Directory*, OTC Markets, http://www.otcmarkets.com/research/companyDirectory [http://perma.cc/9RRN-BKXT].

[38] *See* Individual Plaintiffs' Complaint at 85, *Perry*, 70 F. Supp. 3d 208 (No. 1:13-cv-1439-RCL).

[39] *See* Memorandum of Law of Plaintiffs at 3, *Perry*, 70 F. Supp. 3d 208 (Nos. 13-cv-1053-RCL, 13-cv-1439-RCL).

[40] *See* Fannie Mae, Annual Report (Form 10-K) (Feb. 21, 2014); Freddie Mac, Annual Report (Form 10-K) (Feb. 27, 2014).

[41] *See* Fannie Mae, Quarterly Annual Results (Nov. 5, 2015), http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2015/q32015_release.pdf.

[42] Both Fannie Mae and Freddie Mac's profits declined in the third quarter of 2015, the most recent quarter for which this Note has data. For the first time in four years, Freddie Mac reported a loss and therefore did not issue a dividend to Treasury. Fannie Mae's profits were down about 50% as compared with the second quarter of 2015, but the Fannie Mae still reported $2 billion in net income, triggering a $2.2 billion dividend to Treasury for the quarter. *See* Freddie Mac, Freddie Mac Reports Third Quarter 2015 Financial Results (Nov. 3, 2015), http://www.freddiemac.com/investors/er/pdf/2015er-3q15_release.pdf.

[43] *See* Office of Mgmt. & Budget, Fiscal Year 2015 Analytical Perspectives: Budget of the U.S. Government 323 (2014).

The shareholders of the GSEs challenged the legality and the fairness of the net sweep amendment in the United States District Court for the District of Columbia in the ongoing case of *Perry Capital LLC v. Lew*.[44] In addition to asserting violations of the Constitution's takings clause and administrative law claims,[45] the shareholders sued the government derivatively on behalf of the GSEs. The derivative claims allege that FHFA, as conservator, and Treasury, as a controlling shareholder, breached the fiduciary duties of loyalty they owed to the shareholders because the net sweep agreement was a self-dealing transaction that fails to survive corporate law fairness review.[46] On September 30, 2014, the claims were dismissed on the grounds that, inter alia, the shareholders lacked standing to bring derivative claims under the language of HERA.[47]

III. Judicial Review of Derivative Claims Under HERA

A. HERA's General Bar on Derivative Suits During Conservatorship

As a threshold matter, shareholders seeking to sue the government must establish that they have standing to bring their common law derivative claims under governing federal statutes. In the context of the net sweep amendment, shareholders must establish that the statutory language of HERA permits the advancement of derivative claims. Given the dearth of HERA precedent, courts have relied heavily on FIRREA precedent when interpreting HERA's provisions.[48] As with HERA, Congress enacted FIRREA in response to an economic crisis—the savings and loan crisis of the 1980s—that caused "a destabilization [of the financial industry] that was destroying the institutions themselves and the rights of depositors, creditors, insurers, and investors."[49] Both FIRREA and HERA accordingly grant a federal government agency—the FDIC and FHFA, respectively—broad authority to place failing or unstable institutions into government conservatorship or receivership.[50] Courts agree that FIRREA's "provisions regarding the powers of federal bank receivers and conservators are substantially identical to those of HERA,"[51] as both statutes grant the federal conservator broad

[44] 70 F. Supp. 3d 208 (D.D.C. 2014), *appeal docketed*, No. 13-1025 (D.C. Cir. Oct. 2, 2014).

[45] The shareholders also filed related takings claims in the Court of Federal Claims in *Fairholme Funds, Inc. v. United States*, 118 Fed. Cl. 795, 796 (2014).

[46] *See* discussion *infra* Part IV.

[47] *See Perry*, 70 F. Supp. 3d at 233. As of the writing of this Note, an appeal of this decision was pending with the Court of Appeals for the D.C. Circuit.

[48] *See, e.g.*, *In re* Lehman Bros. Holding Inc., No. 13-07481, 2013 WL 6633431, at *2 (S.D.N.Y. Dec. 17, 2013).

[49] Pareto v. FDIC, 139 F.3d 696, 701 (9th Cir. 1998).

[50] *See* 12 U.S.C. § 4617 (2012) (HERA); 12 U.S.C. § 1821 (2012) (FIRREA).

[51] *In re* Fed. Home Loan Mortg. Corp. Derivative Litig., 643 F. Supp. 2d 790, 797 (E.D. Va. 2009), *aff'd sub nom.* Louisiana Mun. Police Emps. Ret. Sys. v. Fed. Hous. Fin. Agency, 434 F. App'x 188 (4th Cir. 2011).

power to regulate failing institutions[52] and limit judicial review of the conservator's actions through nearly identical anti-injunction clauses.[53] It is clear from the language and structure of the statutes that the FDIC "is the model on which the FHFA's conservatorship and receivership authorities are based."[54]

Important to the question of derivative suit standing, both HERA and FIRREA contain provisions stating that, when the government places an institution into conservatorship, the conservator succeeds to all rights and privileges owned by any stockholder of the entity.[55] In a series of legal decisions following the enactment of FIRREA, most courts concluded that this provision in FIRREA generally bars shareholder derivative suits during conservatorship by transferring shareholders' right to sue derivatively—i.e., to sue on behalf of the institution—exclusively to the FDIC as conservator.[56]

Courts applying HERA have followed this precedent in the context of the GSEs, concluding that HERA's language also prohibits shareholders from suing derivatively on behalf of the GSEs during conservatorship.[57] As the D.C. Circuit unambiguously held, "this language plainly transfers shareholders' ability to bring derivative suits—a 'right[ ], title[ ], power[ ], [or] privilege[ ]'—to FHFA."[58] Other courts considering the question have concluded that "[t]his language clearly demonstrates Congressional intent to transfer as much control of Freddie Mac as possible to the FHFA, including any right to sue on behalf of the corporation,"[59] and that "[i]t is undisputed that the plain language of HERA provides that only the Conservator may bring suit on behalf of Fannie Mae."[60] It is therefore likely that the language of HERA generally bars derivative suits during conservatorship. However, a

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[52] *See, e.g.*, 12 U.S.C. §§ 4617(b)(2)(B), 1821(d)(2)(B) (2012).

[53] *See* 12 U.S.C. §§ 4617(f), 1821(j) (2012).

[54] *See* CONG. RESEARCH SERV., *supra* note 24, at 1.

[55] *See* 12 U.S.C. § 4617(b)(2)(A)(i) (2012) (stating that the FHFA as conservator succeeds to "all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity"); 12 U.S.C. § 1821(d)(2)(A)(i) (2012) (stating that the FDIC as conservator succeeds to "all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution").

[56] *See, e.g.*, Pareto v. FDIC, 139 F.3d 696, 700 (9th Cir. 1998); FDIC v. American Cas. Co. of Reading, Pa., 998 F.2d 404, 409 (7th Cir. 1993); Bauer v. Sweeny, 964 F.2d 305, 308 (4th Cir. 1992), *as amended* (Sept. 3, 1992). While courts were not uniform in this interpretation of FIRREA, courts of appeals that held otherwise did so in dicta without much analysis. *See, e.g.*, American Cas. Co. of Reading, Pa. v. FDIC, 39 F.3d 633, 637 (6th Cir. 1994); *In re* Sunrise Sec. Litig., 916 F.2d 874, 879 (3d Cir. 1990). *See also* Branch v. FDIC, 825 F. Supp. 384, 405 (D. Mass. 1993) ("[The provision] does not alter the settled rule that shareholders of failed national banks may assert derivative claims.").

[57] *See* 12 U.S.C. § 4617(b)(2)(A)(i) (2012).

[58] Kellmer v. Raines, 674 F.3d 848, 850 (D.C. Cir. 2012) (quoting 12 U.S.C. § 4617(b)(2)(A) (2012)).

[59] *In re* Fed. Home Loan Mortg. Corp. Derivative Litig., 643 F. Supp. 2d 790, 797 (E.D. Va. 2009).

[60] Gail C. Sweeney Estate Marital Tr. on behalf of Fed. Nat'l Mortg. Ass'n v. United States Treasury Dep't, 68 F. Supp. 3d 116, 119 (D.D.C. 2014); *see also* Esther Sadowsky Testamentary Tr. v. Syron, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009).

key exception to this rule has been recognized in the context of FIRREA and, if applicable to HERA, could provide an avenue for shareholder relief through derivative actions.

B. The "Manifest Conflict Of Interest" Exception in FIRREA

1. The Exception as Recognized in FIRREA

When the FDIC faces a conflict of interest, shareholders may retain standing to sue derivatively despite FIRREA's general bar on derivative suits.[61] This "conflict of interest" exception is compatible with the conclusion that the language of FIRREA generally transfers derivative rights to the conservator—indeed, both the Ninth and Federal Circuit agree with this reading of the statute.[62] The exception recognizes that, despite the rights and privileges provision of FIRREA, standing must be granted in derivative suits when the federal conservator faces a conflict of interest in the questioned transaction.[63]

The Federal Circuit first recognized this exception in *First Hartford*.[64] *First Hartford* involved a derivative suit brought against Treasury by a shareholder of Dollar Bank, which had been placed into receivership by the FDIC.[65] The claim alleged that the FDIC had breached its contractual obligations to Dollar Bank.[66] The shareholder submitted multiple requests to the FDIC to bring suit against Treasury on behalf of Dollar Bank, but the FDIC failed to do so, responding only that it would "consider the matter."[67] The Federal Circuit held that the FDIC's clear conflict of interest excepted the claim from the general bar on derivative suits, given that, "in the circumstances presented in this case, the FDIC was asked to decide on behalf of the depository institution in receivership whether it should sue the federal government based upon a breach of contract, which, if proven, was caused by the FDIC itself."[68] Thus, the court concluded, "while we do not infer any bad faith or improper motive on the part of the FDIC, we conclude that the

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[61] *See* Delta Savs. Bank v. United States, 265 F.3d 1017, 1022 (9th Cir. 2001); First Hartford Corp. Pension Plan & Tr. v. United States, 194 F.3d 1279, 1295 (Fed. Cir. 1999).

[62] *See* Pareto v. FDIC, 139 F.3d 696, 700 (9th Cir. 1998) ("Congress has transferred everything it could to the FDIC, and that includes a stockholder's right, power, or privilege to demand corporate action or sue others when action is not forthcoming"); *First Hartford*, 194 F.3d at 1295 ("We agree . . . that, as a general proposition, the FDIC's statutory receivership authority includes the right to control the prosecution of legal claims on behalf of the insured depository institution now in its receivership").

[63] *See First Hartford*, 194 F.3d at 1295; *Delta Savs. Bank*, 265 F.3d at 1024. Both of these cases appear to identify an actual conflict of interest. Courts have not explicitly weighed in as to whether an apparent or possible conflict of interest would suffice.

[64] *First Hartford*, 194 F.3d at 1295.

[65] *See id.*

[66] *See id.*

[67] *Id.*

[68] *Id.*

manifest conflict of interest presented here warrants standing for a derivative suit."[69]

While the Federal Circuit expressly limited its *First Hartford* holding to situations in which "a government contractor with a putative breach by a federal agency is being operated by that very same federal agency,"[70] the Ninth Circuit later adopted a broader conflict of interest exception in *Delta Savings Bank*. The case involved a claim brought by shareholders of Delta Savings Bank against the United States and individual employees of the Office of Thrift Supervision ("OTS"), following OTS's investigation of the bank's financial condition and the agency's subsequent decision to place the bank into Resolution Trust Corporation ("RTC") conservatorship, which the FDIC succeeded.[71] An individual shareholder sued derivatively and directly on federal civil rights grounds, claiming that OTS was motivated by racial bias during its investigation and in its decision to place the bank into conservatorship.[72]

The Ninth Circuit acknowledged that, unlike *First Hartford*, *Delta Savings Bank* involved two separate federal agencies: the FDIC, as conservator of the bank, and OTS, the target of the lawsuit, which investigated the bank and made the decision to place it into conservatorship.[73] The court nevertheless concluded that because the FDIC and OTS were "interdependent entities with managerial and operational overlap . . . [and] play complementary roles in the process of bailing out failing thrifts," a "manifest conflict of interest" was present for the FDIC akin to that in *First Hartford*.[74] The court reasoned that because "[t]he FDIC was asked to demand a lawsuit, refuse this demand, and proceed derivatively with the lawsuit *against one of its closely-related, sister agencies*," a conflict of interest arose, and this request "was one hat too many to be placed atop the head of the FDIC."[75] The Ninth Circuit thus concluded that, "the fact that this case involves separate federal agencies does not distinguish it from *First Hartford* and we adopt the *First Hartford* exception."[76]

First Hartford and *Delta Savings Bank* therefore establish that shareholders may have standing to pursue derivative suits during federal conser-

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[69] *Id.*
[70] *Id.*
[71] *See* Delta Savs. Bank v. United States, 265 F.3d 1017, 1019–20 (9th Cir. 2001).
[72] *See id.*
[73] *See id.* at 1019–1020, 1022.
[74] *See id.* at 1022–23. Other factors the Ninth Circuit considered included: (1) the fact that the Director of OTS was also a member of the Board of Directors of the FDIC by statute; (2) that employees of the FDIC and OTS could serve in both agencies concurrently; (3) the fact that the two agencies published joint regulations and reports, and undertook joint investigations; and (4) that FIRREA created both agencies. *See* Gail C. Sweeney Estate Marital Tr. on behalf of Fed. Nat'l Mortg. Ass'n v. United States Treasury Dep't, 68 F. Supp. 3d 116, 121 (D.D.C. 2014) (summarizing the *Delta Savings Bank* factors). The application of these factors to FHFA's relationship with Treasury is discussed further in Part IV.A.2, *infra*.
[75] *Delta Savs. Bank*, 265 F.3d at 1024 (emphasis in original).
[76] *Id.* at 1022.

vatorship if the conservator faces a manifest conflict of interest in the matter. Such a conflict of interest can arise either because the conservator's actions are the subject of the lawsuit, as in *First Hartford*, or because the actions of a closely related, interdependent agency are at issue, as in *Delta Savings Bank*. In both scenarios, the Ninth and Federal Circuits agreed that a "common-sense, conflict of interest exception to the commands of FIRREA warrants granting standing" to shareholder derivative suits because it is "unrealistic to expect the FDIC to be able to evaluate the claims impartially under the circumstances."[77]

2. Acknowledgment of the Exception in HERA Case Law

While it is not clear whether the FIRREA conflict of interest exception applies in the context of HERA, numerous courts of appeals have acknowledged the exception when evaluating derivative claims involving FHFA and the GSEs. In dicta, the D.C. Circuit acknowledged the potential applicability of a conflict of interest exception to HERA's bar on derivative suits, noting that, "*absent a manifest conflict of interest by the conservator* not at issue here, the statutory language [of HERA] bars shareholder derivative actions."[78] Likewise, the Fourth Circuit affirmed the conclusion that, "[*a*]*bsent a showing of a clear conflict of interest* similar to the conflicts at issue in *First Hartford* and *Delta Savings*, the plaintiffs lack standing to pursue these claims."[79]

District courts assessing the viability of actions brought on behalf of the GSEs have also consistently determined whether a conflict of interest exists before dismissing derivative claims.[80] While no case has yet concluded that a conflict of interest is in fact present, district courts' thorough analysis of the exception's potential applicability signals that the FIRREA exception might also apply in the context of HERA. For example, one recent district court opinion evaluating a derivative claim brought on behalf of Fannie Mae was devoted almost entirely to an analysis of the conflict of interest exception, delving into a detailed comparison of the case's facts with those in *First Hartford* and *Delta Savings*.[81] In the context of the net sweep amendment, the district court in *Perry* likewise contrasted the details of the net sweep amendment with the transactions at issue in *First Hartford* and *Delta Sav-*

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[77] *See id.* at 1024; *In re* Fed. Home Loan Mortg. Corp. Derivative Litig., 643 F. Supp. 2d 790, 797 (E.D. Va. 2009).

[78] Kellmer v. Raines, 674 F.3d 848, 850 (D.C. Cir. 2012) (citing First Hartford Corp. Pension Plan & Tr. v. United States, 194 F.3d 1279, 1295 (Fed. Cir. 1999)) (emphasis added).

[79] *See In re* Fed. Home Loan Mortg. Corp. Derivative Litig., 643 F. Supp. 2d at 798 (emphasis added) ("Having carefully considered the record, the briefs and arguments of the parties, and the controlling and persuasive authorities, we conclude that the district court's analysis was correct.").

[80] *See, e.g., Sweeney*, 68 F. Supp. 3d at 124 (concluding no manifest conflict of interest was at issue); Esther Sadowsky Testamentary Tr. v. Syron, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009) (finding plaintiff failed to show conflict of interest).

[81] *See Sweeney*, 68 F. Supp. 3d. at 119–25.

ings Bank and concluded that no conflict of interest existed between FHFA and Treasury.[82]

Given that courts' interpretations of HERA have relied so strongly on FIRREA-related precedent, and that the language of the operative provision in HERA is virtually identical to that in FIRREA, there is a compelling legal argument that a conflict of interest exception to HERA's general bar on derivative suits likewise exists. The next sections undertake an independent analysis of HERA's text and legislative purpose and conclude that a conflict of interest exception should be recognized in HERA as a matter of sound statutory interpretation and public policy.

C. Legal Arguments for Recognizing a Conflict of Interest Exception in HERA

1. Textual and Structural Analysis of HERA

The question of whether a conflict of interest exception should be recognized in HERA "begins where all such inquiries must begin: with the language of the statute itself."[83] As discussed above, the text of § 4617(b)(2)(A)(i) transfers to the FHFA, as conservator, "all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director."[84] In addition to this generous grant of power to FHFA, HERA also strictly limits judicial oversight and review of FHFA's actions. The statute's unambiguous anti-injunction provision, § 4617(f), states: "[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 powers or functions of the [FHFA] as conservator or receiver."[85] This provision has been interpreted as "a sweeping ouster of courts' power to grant equitable remedies," including all injunctive relief and any declaratory judgments which would "restrain" the conservator's action in any way.[86] This provision does not apply straightforwardly in the context of derivative suits, as the language does not impact a court's ability to provide non-equitable relief, such as monetary damages. In fact, other sections of HERA state that FHFA may be liable for "actual direct compensatory damages" in some situations.[87] The anti-injunction provision therefore prohibits derivative claims

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[82] *See* Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 232 (D.D.C. 2014) (finding no conflict of interest); *see also* discussion *infra* Part IV.A.2.

[83] United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989).

[84] *See* 12 U.S.C. § 4617(b)(2)(A)(i) (2012); discussion *supra* Part III.A.

[85] *See* 12 U.S.C. § 4617(f) (2012).

[86] *See* Freeman v. FDIC, 56 F.3d 1394, 1399 (D.C. Cir. 1995) (discussing the question in the context of FIRREA); *see also* County of Sonoma v. FHFA, 710 F.3d 987, 990 (9th Cir. 2013); Town of Babylon v. FHFA, 669 F.3d 221, 228 (2nd Cir. 2012) (interpreting HERA's anti-injunction provision).

[87] *See, e.g.*, 12 U.S.C. § 4617(d)(3)(A)(i) (2012).

seeking equitable relief, but likely does not bar one requesting monetary damages.

Some courts considering this question have concluded that HERA's language transferring stockholder rights to the FHFA, when viewed in conjunction with the text of the anti-injunction provision, definitively bars all derivative suits during conservatorship, without exception.[88] In the context of the net sweep amendment, the *Perry* court therefore concluded that a conflict of interest exception "would contravene the plain language of the statute," reasoning:

> It strikes this Court as odd that a statute like HERA, through which Congress grants immense discretionary power to the conservator, § 4617(b)(2)(A), and prohibits courts from interfering with the exercise of such power, § 4617(f), would still house an *implicit* end-run around FHFA's conservatorship authority by means of the shareholder derivative suits that the statute explicitly bars.[89]

However, the conclusion that this language indeed does contain an "implicit end-run" in the form of a conflict of interest exception is precisely the one reached by the Ninth and Federal Circuit in the context of FIRREA.[90] Not only does FIRREA contain a provision nearly identical to § 4617(b)(2)(A)(i) of HERA, which transfers broad shareholder and director rights to the FDIC during conservatorship, but the statute also contains a similar anti-injunction clause which states that, "[e]xcept as provided in this section, no court may take any action, except at the request of the Board of Directors by regulation or order, to restrain or affect the exercise of powers or functions of the Corporation as a conservator or a receiver."[91] As with other provisions in the two statutes, FIRREA's anti-injunction provision is generally considered to be the model for interpreting the nearly identical provision in HERA, and courts, including the *Perry* court itself, have relied on FIRREA anti-injunction case law when interpreting the scope of § 4617(f) of HERA.[92]

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[88] *See* Gail C. Sweeney Estate Marital Tr. on behalf of Fed. Nat'l Mortg. Ass'n v. United States Treasury Dep't, 68 F. Supp. 3d 116, 126 (D.D.C. 2014) ("[T]o permit plaintiff to bring an action which the conservator has declined to bring . . . would 'affect' and 'interfere' with the Conservator's exercise of its powers."); Esther Sadowsky Testamentary Tr. v. Syron, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009) ("[M]aintenance of this suit with the shareholders acting as Plaintiffs would be inconsistent with the Conservator's exercise of its statutory powers.").

[89] Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 230–31 (D.D.C. 2014) (emphasis in original).

[90] *See* Delta Savs. Bank v. United States, 265 F.3d 1017, 1024 (9th Cir. 2001); First Hartford Corp. Pension Plan & Tr. v. United States, 194 F.3d 1279, 1283 (Fed. Cir. 1999).

[91] *See* 12 U.S.C. § 1821(j) (2012).

[92] *See Perry*, 70 F. Supp. 3d at 220 ("[C]ourts interpreting the scope of [HERA's anti-injunction provision] § 4617(f) have relied on decisions addressing the nearly identical jurisdictional bar applicable to the [FDIC] conservatorships contained in 12 U.S.C. § 1821(j).") (quoting Natural Res. Def. Council, Inc. v. FHFA, 815 F. Supp. 2d 630, 641 (S.D.N.Y. 2011), *aff'd sub nom.* Town of Babylon v. FHFA, 699 F.3d 221 (2d Cir. 2012).

It is therefore clear that the text of HERA provides FHFA with broad power as a conservator and strictly limits the judiciary's ability to interfere with that power. Yet the Ninth and Federal Circuits' conclusions that identical language in FIRREA, on which HERA's text was based, is compatible with a conflict of interest exception undermines the *Perry* court's conclusion that the plain text of HERA definitively prohibits recognition of the exception. Furthermore, other tools of statutory construction support the conclusion that a conflict of interest exception should be recognized in HERA.

2. Congressional Intent and Other Tools of Statutory Construction

Even if the text of HERA bars all derivative suits, the meaning of the plain language of a statute can be overcome where a strict reading of the text would "lead to absurd or impracticable consequences."[93] Even where the text of a law is unambiguous, "[g]eneral terms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence," and thus the Supreme Court has recognized that "[i]t will always, therefore, be presumed that the legislature intended exceptions to its language which would avoid results of this character."[94] While this tool of statutory interpretation is often referred to as the "absurdity doctrine," the Supreme Court has recognized that the principle applies broadly, noting that "[f]requently . . . even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words."[95]

In the context of the conflict of interest exception, the Ninth Circuit concluded that, while the text of FIRREA generally bars derivative actions, "exceptions to this absolute rule would be justified if the result would otherwise be 'absurd or impracticable'" and therefore recognized such an exception for derivative claims when the conservator faces a manifest conflict of interest.[96] The court noted that, given the importance of the derivative suit in ensuring fairness, "adherence to an absolute rule would be at least impracticable, and arguably absurd," because:

> [T]he very object of the derivative suit mechanism is to permit shareholders to file suit on behalf of a corporation when the managers or directors of the corporation, perhaps due to a conflict of

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[93] *See* United States v. Missouri Pac. R. Co., 278 U.S. 269, 278 (1929).

[94] *See* United States v. Kirby, 74 U.S. 482, 486–87 (1868).

[95] United States v. American Trucking Ass'ns, 310 U.S. 534, 543 (1940); *see also* Public Citizen v. United States Dep't of Justice, 491 U.S. 440, 442 (1989) (concluding that construing the term "utilize" in the Federal Advisory Committee Act as applicable to the Department of Justice's use of the American Bar Association Committee in advising on potential judicial nominees would be contrary to legislative purpose).

[96] *Delta Savs. Bank*, 265 F.3d at 1023.

> interest, are unable or unwilling to do so despite it being in the best interests of the corporation.[97]

Application of the absurdity doctrine is most compelling in situations where "the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters."[98] HERA's impact on derivative suits—and the potential incorporation of FIRREA's conflict of interest exception—was not a significant factor when drafting HERA. What is clear, however, is that Congress intended FHFA to have authority like the FDIC. As a summary of the bill noted, "[t]he legislation would provide this regulator with broad new authority, equivalent to the authority of other federal financial regulators, to ensure the safe and sound operations of the GSEs."[99] The nearly identical language of FIRREA and HERA further reinforces that Congress intended for FHFA's powers as conservator to mirror those exercised by the FDIC.[100]

Moreover, while the Supreme Court has not endorsed the conflict of interest exception, no federal court of appeals disagreed with the *First Hartford* or *Delta Savings Bank* holdings in the decade leading up to HERA's enactment, nor has any court rejected the exception since. It is therefore possible to construe Congress's "positive inaction"[101] as an implicit endorsement of the conflict of interest exception. The Court has recognized that the "long time failure of Congress to alter [legislation] after it had been judicially construed, and the enactment by Congress of legislation which implicitly recognizes the judicial construction as effective, is persuasive of legislative recognition that the judicial construction is the correct one."[102] By failing to amend FIRREA to repudiate the conflict of interest exception, and by then utilizing nearly identical language in HERA with the goal of modeling FHFA's power off of the FDIC's existing authority, Congress therefore may have intended to incorporate the existing conflict of interest exception in HERA. Such an interpretation is in line with the Court's guidance that "where . . . Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute."[103]

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[97] *Id.* at 1024; *First Hartford*, 194 F.3d at 1295.

[98] Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982).

[99] S. Democratic Policy Committee, H.R. 3221, the Housing and Economic Recovery Act of 2008: Summary and Background (July 25, 2008), http://www.dpc.senate.gov/dpcdoc.cfm?doc_name=1b-110-2-123 [http://perma.cc/5W85-Q8FS].

[100] *See* discussion *supra* Part III.A.1.

[101] Flood v. Kuhn, 407 U.S. 258, 283 (1972).

[102] Apex Hosiery Co. v. Leader, 310 U.S. 469, 488 (1940).

[103] Lorillard v. Pons, 434 U.S. 575, 581 (1978).

D. Public Policy Justifications for Reviewing HERA Derivative Suits

Compelling public policy considerations also support the recognition of a conflict of interest exception, because the shareholder derivative suit is considered one of the most "ingenious of accountability mechanisms for large formal organizations."[104] While corporate law usually protects reasoned corporate decision-making from judicial second-guessing, derivative suits give individual shareholders the power to protect the corporation from "misfeasance and malfeasance of 'faithless directors and managers.'"[105] Fairness considerations therefore demand strict judicial review of transactions in which a corporate fiduciary faces a conflict of interest.[106]

Corporate fairness review stems from the concern that corporate fiduciaries "are unlikely to treat one of their number with the degree of wariness with which they would approach a transaction with a third party."[107] The derivative suit mechanism therefore seeks to ensure that officers and directors do not place their own private interests above those of the corporation.[108] Transactions in which a corporate fiduciary faces a conflict of interest thus represent "the paradigmatic circumstance" in which judicial review of corporate decision-making is appropriate.[109]

These fairness concerns are heightened when a federal agency, rather than a traditional corporate director, is the party facing a conflict of interest. In a traditional corporate setting, shareholders elect the directors to whom they entrust the day-to-day affairs of the corporation,[110] and unsatisfied shareholders can engage in a proxy fight to remove directors between elections with or without cause.[111] In stark contrast to the corporate setting, the directors of FHFA and the FDIC are appointed by the president with the advice and consent of the Senate[112] and can only be removed by the president.[113] The absence of traditional corporate mechanisms to ensure accountability, such as the basic shareholder right to vote for and remove directors,

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[104] Kramer v. Western Pac. Indus., Inc., 546 A.2d 348, 351 (Del. 1988) (quoting ROBERT CLARK, CORPORATE LAW 639–40 (1986)).

[105] Kamen v. Fin. Servs., 500 U.S. 90, 95 (1991) (quoting Cohen v. Beneficial Loan Corp., 337 U.S. 41 (1949)).

[106] *See* discussion *infra* Part IV.D.

[107] Melvin Eisenberg, *Self-Interested Transactions in Corporate Law*, 13 J. CORP. L. 997, 1002 (1988).

[108] *See* State *ex rel.* Hayes Oyster Co. v. Keypoint Oyster Co., 391 P.2d 979, 985 (Wash. 1964) ("[T]he law will not permit the agent to place himself in a situation in which he may be tempted by his own private interest to disregard that of his principal.").

[109] *See* WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 269 (4th ed. 2012).

[110] *See* DEL. CODE ANN. tit. 8, § 141 (2014).

[111] *See id.*

[112] *See* 12 U.S.C. §§ 4512(b)(1), 1812 (2012).

[113] While the Director of the FHFA can only be removed for cause, 12 U.S.C. § 4512(b)(2) (2012), there is no such restriction on the Directors of the FDIC, 12 U.S.C. § 1812 (2012).

therefore elevates the derivative suit's importance as a means of promoting transparency and fairness during federal conservatorship.

However, legitimate competing interests in protecting the conservator's flexibility and efficiency would be at risk if a conflict of interest exception were recognized. Congress quickly enacted HERA to support the failing housing market and thus mitigate the effects of an impending national economic crisis.[114] In order to ensure rapid protection for homeowners facing potentially ruinous financial losses, Congress gave FHFA broad authority and flexibility to regulate the GSEs and to ensure their stability.[115] In the context of the PSPA, it is also true that the "Treasury represented the only feasible entity—public or private—capable of injecting sufficient liquidity into and serving as a backstop for the GSEs within the short timeframe necessary to preserve their existence in September 2008" and that "[t]here was no other investment partner at FHFA's disposal."[116] Agencies' concerns about future litigation over federal conservator actions through shareholder derivative suits could therefore weaken the government's ability to act quickly and decisively in the public interest during times of crisis.

Moreover, permitting shareholder derivative suits against federal conservators could burden the judicial system. Granting standing to plaintiffs in derivative claims when the conservator faces a conflict of interest could "cure . . . otherwise defective shareholder derivative action[s] by a simple matter of pleading,"[117] because any shareholder derivative suit, regardless of its principal claim, could reasonably include a claim that the FHFA is unable to objectively determine whether or not to bring a suit against itself.[118] If a conflict of interest exception to HERA is recognized, this additional claim could grant plaintiffs standing to bring a variety of claims.[119] This concern is heightened because Congress intended to limit judicial review of FHFA's actions through HERA's anti-injunction provision.[120]

Ultimately, however, these concerns can be successfully managed through the judicial process. First, it is important to recall that the conflict of interest exception is a narrow exception to what is otherwise a complete bar to derivative suits during federal conservatorship. Recognizing the exception therefore would not open the floodgates to any and all derivative claims. Courts can discern at the dismissal phase whether a shareholder attempting to bring a claim derivatively has pled a legitimate conflict of interest. Indeed, this is precisely what courts have done in the recent GSE derivative suits, as they have assumed, arguendo, that a conflict of interest exception

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[114] *See* discussion *supra* Part II.

[115] *See* discussion *supra* Part III.C.1.

[116] Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 232 (D.D.C. 2014).

[117] Treasury Defendants' Reply in Support of Their Dispositive Motions and Opposition to Plaintiffs' Summary Judgment Motions at 22, *Perry*, 70 F. Supp. 3d (No. 1:13-cv-1025-RCL).

[118] *See id.*

[119] *See id.*

[120] *See* discussion *supra* Part III.C.1.

might exist.[121] The concerns about judicial administrability are assuaged by the narrowness of the exception itself, and can be effectively managed by courts during the dismissal phase of litigation.

The interest in ensuring agency flexibility can be protected if courts permitting derivative claims give appropriate weight to the unique circumstances of federal conservatorship during fairness review. Traditional corporate law fairness review already requires courts take into account "the economic and financial considerations" of the transaction.[122] Rather than asking courts "to ignore the harsh economic realities facing the GSEs—and the national financial system if the GSEs collapsed," judicial review therefore can, and should, take such circumstances into account. This type of review might also allay the *Perry* court's concern that "[c]ourts, generally, should be wary of labeling a transaction with an investor of last resort as a conflict of interest" by asking judges instead to be wary of labeling such transactions as unfair.[123] This approach—allowing derivative claims to proceed where a conservator conflict of interest is present, while asking courts to consider relevant circumstances unique to federal conservatorship during fairness review—can balance the law's interest in ensuring accountability and fairness with the public interest in ensuring flexible and swift conservator action during a national crisis. Part IV's analysis of the net sweep amendment claim highlights the value of this approach, because it demonstrates that some federal conservator actions would likely fail judicial fairness review, even when relevant circumstances are appropriately considered. Judicial review therefore provides an important check on the fairness of conservator actions.

IV. Fairness Analysis of the Net Sweep Derivative Claims

A. The Application of the Conflict of Interest Exception to the Net Sweep Claims

1. FHFA's Conflict of Interest with Regard to the Claim Against FHFA

The question of whether a federal conservator faces a conflict of interest when it is also the target of the derivative suit is one of first impression in both the FIRREA and HERA contexts. While *First Hartford* involved an alleged breach by the conservator itself, the FDIC was not the target of the derivative suit—rather, the shareholders sued Treasury on the basis of the

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[121] *See Perry*, 70 F. Supp. 3d at 232; Gail C. Sweeney Estate Marital Tr. on behalf of Fed. Nat'l Mortg. Ass'n v. United States Treasury Dep't, 68 F. Supp. 3d 116, 126 (D.D.C. 2014).

[122] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

[123] *See Perry*, 70 F. Supp. 3d at 233.

FDIC's alleged breach of contract.[124] Common sense indicates that if a federal agency faces a "manifest conflict of interest," as was the case in *First Hartford*, such a conflict would certainly arise when the agency itself is both the cause of the alleged breach of fiduciary duty and the target of the lawsuit, as is the case for FHFA here. The net sweep derivative suit claims allege, in part, that FHFA breached its fiduciary duty of loyalty when it entered into the net sweep amendment.[125] This claim is asserted derivatively by the shareholders on behalf of the GSEs against FHFA for a breach the agency carried out in its capacity as conservator of Fannie Mae and Freddie Mac.[126] Thus, the basic impartiality interest underlying the conflict of interest exception recognized by *First Hartford* applies even more strongly to this type of derivative claim against FHFA.

The government argues that a derivative claim against the conservator itself is clearly barred by the language of § 4617(b)(2)(A)(i) of HERA, despite the potential existence of a conflict of interest exception. It argues that because Congress "transferred everything it could" to the FHFA in HERA,[127] the statute thus "eliminates the distinction between shareholder interests on the one hand, and officer and director interest on the other, underlying the traditional derivative analysis."[128] Instead, the statute "unif[ies] and vest[s] all control over the corporation . . . in the conservator or receiver alone."[129] As a result, the government concludes that the conflict of interest exception does not apply to a derivative suit against the FHFA itself because such an exception "would render the Conservator's succession to all shareholder rights meaningless."[130]

While the government's argument relates to the question of whether Congress intended a conflict of interest exception to be recognized at all in HERA,[131] it is unconvincing in its contention that such an exception, if recognized, would not apply to a derivative suit against the conservator itself. As the shareholders argue, "FHFA obviously cannot and did not succeed to shareholders' causes of action against FHFA *itself*" if a conflict of interest exception is recognized.[132] Indeed, it seems clear that the situation presented here, where a derivative suit against a federal conservator stems from the alleged breach of that conservator's fiduciary duty of loyalty, would be the

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[124] *See* First Hartford Corp. Pension Plan & Tr. v. United States, 194 F.3d 1279, 1295 (Fed. Cir. 1999).

[125] *See* discussion *infra* Part IV.C.1.

[126] *See id.*

[127] Defendants' Motion to Dismiss at 36, *Perry*, 70 F. Supp. 3d 208 (No. 1:13-cv-1053-RCL) (citing Kellmer v. Raines, 674 F.3d 848, 851 (D.C. Cir. 2012) (quoting Pareto v. FDIC, 139 F.3d 696, 700 (9th Cir. 1998))).

[128] *Id.* at 52.

[129] *Id.*

[130] *Id.*

[131] *See* discussion *supra* Part III.C.2.

[132] *See* Supplemental Memorandum of Law of Plaintiffs, *Perry*, 70 F. Supp. 3d 208 (Nos. 13-cv-1053-RCL, 13-cv-1439-RCL) (emphasis in original).

paradigmatic situation where a manifest conflict of interest of the type envisioned in *First Hartford* is presented.

2. *FHFA's Conflict of Interest with Regard to the Claim Against Treasury*

In addition to the claim against FHFA itself, the shareholders also assert a derivative claim that Treasury breached its fiduciary duty as controlling shareholder of the GSEs.[133] For the shareholders to have standing, it therefore must be established that FHFA faced a manifest conflict of interest in the decision to sue Treasury over the net sweep amendment. Such a conflict of interest does not arise under the limited scenario covered by *First Hartford* in which the alleged breach is caused by the very same agency that acts as conservator, since FHFA, not Treasury, is conservator of the GSEs. Thus, the question becomes whether FHFA and Treasury are the type of closely interrelated "sister agencies" that the court described in *Delta Savings Bank*.

The *Delta Savings Bank* court listed a number of factors it found persuasive in determining that the FDIC could not effectively exercise its independent judgment to sue OTS due to a conflict of interest. First, the court was influenced by the "operational and managerial overlap" between the agencies, given that the Director of OTS also served on the Board of Directors of the FDIC, and employees of the FDIC and OTS were permitted to serve in both agencies concurrently.[134] Furthermore, OTS and the FDIC shared a "common genesis" as both agencies were created and established by FIRREA.[135] Secondly, the court was persuaded by the "complementary roles" the agencies played in bailing out financial institutions, as OTS investigated and made the decision to place failing banks into FDIC conservatorship or receivership.[136] Finally, OTS and the FDIC often undertook joint investigations and published joint regulations and reports.[137]

The relationship between Treasury and FHFA is not directly analogous to the relationship between OTS and the FDIC. Most notably, Treasury does not make the decision to place institutions into FHFA conservatorship.[138] Nor do the agencies share a common statutory genesis—in fact, the circumstances surrounding their creations differ significantly: Treasury is one of the oldest federal agencies in existence, created in 1789 by the First Congress, while FHFA is one of the newest federal agencies, created by the 110th Congress in 2008.[139] The only two courts to consider whether FHFA has a conflict of interest with regard to Treasury's actions have concluded that the

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[133] Complaint at 28, *Perry*, 70 F. Supp. 3d 208 (Nos. 13-cv-1053-RCL, 13-cv-1439-RCL).
[134] *See* Delta Savs. Bank v. United States, 265 F.3d 1017, 1023 (9th Cir. 2001).
[135] *Id.*
[136] *Id.*
[137] *See id.*
[138] *See* Gail C. Sweeney Estate Marital Tr. on behalf of Fed. Nat'l Mortg. Ass'n v. United States Treasury Dep't, 68 F. Supp. 3d 116, 121 (D.D.C. 2014).
[139] *See id.*

two agencies are not interrelated under the *Delta Savings Bank* test, based on these differences.[140]

Nonetheless, it is clear that Treasury and FHFA play complementary roles in regulating the GSEs and that they are interrelated in several ways important to the *Delta Savings Bank* analysis. HERA carved out a unique and powerful role for Treasury in stabilizing the GSEs. HERA temporarily authorized the agency to purchase any securities issued by the GSEs "on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine."[141] HERA further grants the Secretary of the Treasury the power to "at any time, exercise any rights received in connection with such purchases."[142] Moreover, similar to the board overlap relevant in *Delta Savings Bank*, the Secretary of the Treasury holds one of the four seats on the Federal Housing Finance Oversight Board, which advises the Director of the FHFA.[143]

Treasury and FHFA have also closely coordinated efforts to stabilize the GSEs. The fact that Treasury entered into a PSPA with the GSEs one day after FHFA placed them into conservatorship was clearly not coincidental. Rather, the two agencies undertook a joint effort to stabilize Fannie Mae and Freddie Mac through a coordinated approach by placing the entities into FHFA conservatorship and infusing them with capital support through Treasury, just as §§ 1455 and 1719 of HERA envisioned. As a result of these efforts, Treasury now acts as controlling shareholder of the GSEs, owning $1 billion in senior preferred stock and warrants for 79.9% of the GSEs' common stock, wielding broad power over their day-to-day affairs.[144] The agencies have continued to work together to manage and regulate the GSEs during conservatorship by issuing joint regulations[145] and by amending Treasury's original PSPA several times to account for changing circumstances.[146]

The net sweep amendment itself provides further evidence of the interrelatedness of the two agencies. As discussed below, Treasury appears to have designed the net sweep amendment independently,[147] and FHFA purportedly made no effort to negotiate the agreement with Treasury on behalf

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[140] *See id.* (considering a derivative claim against Treasury for its failure to sell $3 billion in low-income housing tax credits belonging to Fannie Mae); Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 214 (D.D.C. 2014) (undertaking the analysis in dicta in the context of the net sweep amendment).

[141] 12 U.S.C. §§ 1455 (l)(1)(A), 1719 (g)(1)(A) (2012).

[142] 12 U.S.C. §§ 1455 (l)(2)(A), 1719 (g)(2)(A) (2012).

[143] *See Sweeney*, 68 F. Supp. 3d at 121.

[144] *See* discussion *infra* Part IV.C.2.

[145] *See*, *e.g.*, Credit Risk Retention, 78 Fed. Reg. 183 (proposed Sept. 20, 2013) (to be codified at 12 C.F.R. pts. 43, 244, 373, et al., 17 C.F.R. pt. 246, 24 C.F.R pt. 267)

[146] *See* discussion *supra* Part I.

[147] *See* Office of Inspector General, FHFA, White Paper: WPR-2013-002, Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements 10 (Mar. 20, 2013), http://www.fhfaoig.gov/Content/Files/WPR-2013-002_2.pdf [http://perma.cc/NUB2-8R5M].

of the GSEs.[148] Other shareholders of the GSEs have thus cited to the net sweep amendment as evidence of the clear conflict of interest between FHFA and Treasury in unrelated derivative claims, noting that "[a]s a practical matter, any entity that has so capitulated to Treasury that it allows Treasury to perform 'a full income sweep' of all its profits, cannot realistically be expected to have the independence or objectivity to make a reasoned decision to sue Treasury."[149]

Given the complementary roles the two agencies have played in stabilizing the GSEs pursuant to HERA, it seems that FHFA and Treasury are the kind of "closely-related, sister agencies" that would give rise to a conflict of interest,[150] because asking FHFA to sue Treasury over this transaction would be "one hat too many" for FHFA as conservator to wear impartially.[151]

B. FHFA and Treasury's Duty of Loyalty to the Minority Shareholders

1. FHFA's Duty of Loyalty as Conservator and de facto Director of the GSEs

Corporate directors have a duty to exercise their power in a good-faith effort to advance the interests of the company.[152] This duty of loyalty requires directors to "deal with the company on terms that are intrinsically fair in all respects," and not to do so "in any way that benefits themselves at its expense."[153] Fannie Mae's and Freddie Mac's bylaws instruct the GSEs to follow the "corporate governance practices and procedures of [applicable state] law," which recognize this duty of directors.[154] The bylaws also explicitly acknowledge this duty by including the common stipulation that directors are not indemnified against breaches of the duty of loyalty.[155]

When FHFA became conservator of the GSEs, it succeeded to "all rights, titles, powers, and privileges of [any] officer or director of [the Companies]" and assumed the authority of the management and boards of the GSEs.[156] FHFA thus functions as a de facto director of Fannie Mae and Freddie Mac. The remaining directors of the GSEs "exercise [their] authority as directed by the conservator" and must "consult with and obtain the consent of the conservator before taking action" on most major decisions,

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[148] *See* Supplemental Memorandum of Law of Plaintiffs, *Perry*, 70 F. Supp. 3d 208 (Nos. 1:13-cv-1053-RCL, 1:13-cv-1439-RCL).

[149] Plaintiff's Opposition to Motion to Substitute, *Sweeney*, 68 F. Supp. 3d 116 (No. 1:13-cv-00206-ABJ).

[150] Delta Savs. Bank v. United States, 265 F.3d 1017, 1024 (9th Cir. 2001).

[151] *Id.*

[152] *See* ALLEN ET AL., *supra* note 109, at 267.

[153] *Id.*

[154] *See* FANNIE MAE, *supra* note 14, at 1; FREDDIE MAC, *supra* note 15, at 29.

[155] *See* FREDDIE MAC, *supra* note 15, at 27; FANNIE MAE, *supra* note 14, at 15.

[156] *See* 12 U.S.C. § 4617.

including all matters related to Treasury's PSPA.[157] Government conservators, like corporate directors, therefore generally owe fiduciary duties to corporations they oversee and to those corporations' shareholders.[158]

2. *Treasury's Duty of Loyalty as Controlling Shareholder of the GSEs*

Controlling shareholders likewise owe a duty of loyalty to the company and to minority shareholders.[159] It is settled corporate law that "the same considerations of fundamental justice" which impose fiduciary duties on directors also apply to controlling shareholders, as they have "placed upon themselves the same sort of fiduciary character which the law impresses upon the directors in their relation to all the stockholders."[160]

Whether a shareholder is "controlling," and thus owes a duty of loyalty, is determined by a "practical test rather than a formalistic one."[161] A stockholder who owns more than fifty percent of the company's voting power clearly qualifies,[162] but Treasury is not a controlling shareholder by virtue of its majority voting power. While the PSPA granted Treasury $1 billion in senior preferred stock and warrants for 79.9% of the GSEs common stock, the agreement clearly states that the senior preferred stock "shall not be entitled to voting rights," and Treasury's common stock warrants remain unexercised.[163]

However, a shareholder without majority voting power may still be controlling if she exercises "actual control" over the corporate conduct of the company.[164] The terms of the PSPA grant Treasury tremendous managerial power over the day-to-day affairs of Fannie Mae and Freddie Mac. The PSPA prohibits the GSEs, absent Treasury's consent, from: (1) issuing capital stock of any kind; (2) paying any dividends (other than on Treasury's senior preferred stock); (3) terminating FHFA's conservatorship; (4) increasing its debt by more than 110%; (5) selling, conveying, or transferring any of its assets outside the ordinary course of business; (6) entering into any new or adjusting any existing compensation agreements with executive officers; or

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[157] Fannie Mae, Corporate Governance Guidelines 1 (2014), http://www.fanniemae.com/resources/file/aboutus/pdf/corpgovguidelines.pdf [http://perma.cc/2BFU-YB9C].

[158] *See, e.g.*, Gibralter Fin. Corp. v. Fed. Home Loan Bank Bd., No. 89-3489, 1990 WL 394298, at *2 (C.D. Cal. June 15, 1990) ("where a governmental agency has assumed control of a financial institution and has therefore ventured beyond its normal regulatory or supervisory role . . . the case law, and common sense, indicates that a duty does arise . . . [a shareholder] may state a claim for breach of fiduciary duty").

[159] *See* Allen et al., *supra* note 109, at 295–96.

[160] Allied Chem. & Dye Corp. v. Steel & Tube Co. of Am., 120 A. 486, 491 (Del. 1923).

[161] Allen et al., *supra* note 109, at 296.

[162] *See id.*

[163] U.S. Treasury Dep't, Office of Public Affairs, *supra* note 30, at 2; *see also* Treasury Defendants' Reply, *Perry*, 70 F. Supp. 3d 208 (No. 1:13-cv-1025-RCL).

[164] *See* Zimmerman v. Crothall, 62 A.3d 676, 700 (Del. Ch. 2013).

(7) acquiring, consolidating with, or merging into another entity.[165] This arrangement grants Treasury "such formidable voting and managerial power that [it], as a practical matter, [is] no differently situated than if [it] had majority voting control,"[166] thus confirming its status as a controlling shareholder.

C. Fairness Review of the Net Sweep Amendment

1. The Net Sweep Amendment as Self-Dealing Transaction

Exercising its actual control over the GSEs, Treasury entered into the agreement with FHFA with the knowledge that it stood to incur a significant financial benefit from the transaction at the expense of the minority shareholders. Indeed, Treasury publicly stated that a key objective of the amendment was to "make sure that every dollar of earnings each firm generates is used to benefit taxpayers."[167] Akin to a freeze-out merger in the corporate context, the net sweep amendment left Treasury functionally as the sole shareholder of the GSEs—the definition of a self-dealing transaction.

FHFA likewise stood on both sides of the net sweep amendment. As de facto director of the GSEs, FHFA, a federal agency, entered into the net sweep agreement with Treasury, another federal agency.[168] While FHFA is statutorily an independent agency tasked with ensuring the stability and solvency of the GSEs, it also shared Treasury's interest in accruing federal dollars. FHFA's 2012 strategic report, released just months before the net sweep amendment, highlighted the agency's goal of developing "ways for the taxpayers to ultimately derive value" from the GSE conservatorships.[169] FHFA's individual financial interests in the net sweep amendment were thus in conflict with the interests of the GSEs.

2. Fairness Review of the Net Sweep Amendment

Corporate law recognizes that "[t]he requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts."[170] While this fairness review formally has

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[165] *See* U.S. Treasury Dep't, Office of Public Affairs, *supra* note 30, at 2.

[166] *Zimmerman*, 62 A.3d at 700.

[167] *See* Press Release, Treasury Dep't, Treasury Department Announces Further Steps to Expedite Wind Down of Fannie Mae and Freddie Mac (Aug. 17, 2012), http://www.treasury.gov/press-center/press-releases/Pages/tg1684.aspx [http://perma.cc/CU83-R75Q].

[168] *See* Supplemental Memorandum of Law of Plaintiffs, *Perry*, 70 F. Supp. 3d 208 (Nos. 1:13-cv-1053-RCL, 1:13-cv-1439-RCL).

[169] *See* FHFA, Strategic Plan for Enterprise Conservatorships 3 (Feb. 21, 2012), http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/20120221_StrategicPlanConservatorships_508.pdf [http://perma.cc/69H6-SQRX].

[170] Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

two prongs—fair dealing and fair price—they "must be considered as a whole since the question is one of entire fairness."[171] Moreover, as discussed in Part III.D, fairness review in this context should appropriately consider the unique circumstances of federal conservatorship.

The fair dealing prong considers "when the transaction was timed, how it was initiated, structured, negotiated, disclosed . . . and how the approvals of the directors and the stockholders were obtained," with disclosure being the most important factor.[172] Fannie Mae and Freddie Mac disclosed the material facts of the net sweep amendment after the fact in 8-K forms filed with the SEC.[173] Treasury also disclosed the terms of the amendment publicly through a press release.[174] However, the amendment was neither approved by a majority of minority shareholders nor approved by a committee of disinterested directors—rather, FHFA and Treasury were apparently the sole parties involved in the transaction. Thus, the disclosure did not serve to obtain the type of informed, independent approval corporate law urges for self-dealing transactions.[175]

The shareholders allege that "Treasury officials invented the net-worth sweep concept" and that FHFA made no attempt to conduct its own independent analysis or negotiate the terms of the agreement on behalf of the GSEs.[176] Indeed, FHFA's own white paper on the topic describes the dealings in a way that demonstrates Treasury's control over the transaction:

> Treasury decided to focus on ways to ensure that the Enterprises would no longer be required to take draws just to make dividend payments. A number of options were considered for reformulating the dividend structure. In the end, in 2012, Treasury settled on the "positive net worth" model, in which Treasury would simply take, as dividends, the entire positive net worth of each Enterprise each quarter.[177]

The negotiation therefore does not appear to represent the type of arms-length dealing the law prefers self-dealing transactions to mimic.[178]

The *Perry* court warned against "downplay[ing] the need for a GSE bailout in the first place" by "ignor[ing] the harsh economic realities facing the GSEs—and the national financial system as a whole if the GSEs col-

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[171] *Id.* at 711.

[172] *Id.*

[173] *See* Fannie Mae, Current Report (Form 8-K) (Aug. 17, 2012); Freddie Mac, Current Report (Form 8-K) (Aug. 17, 2012).

[174] *See* Treasury Dep't, *supra* note 167.

[175] *See, e.g.*, State *ex rel.* Hayes Oyster Co. v. Keypoint Oyster Co., 391 P.2d 979, 985 (Wash. 1964).

[176] Supplemental Memorandum of Law of Plaintiffs, *Perry*, 70 F. Supp. 3d 208 (Nos. 1:13-cv-1053-RCL, 1:13-cv-1439-RCL).

[177] FHFA, Office of Inspector General, *supra* note 147, at 10.

[178] *See* Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

lapsed—when FHFA and Treasury executed the PSPAs in 2008."[179] As argued in Part III.D, it is indeed critical that fairness review of federal conservatorship transactions consider these realities and appropriately weigh them against other elements of the transaction's dealings. However, the minority shareholders do not claim that the initial PSPA was unfair—rather, their claim questions the legality of the net sweep amendment, enacted almost four years later. Thus, while the context of the 2008 economic crisis is important, fairness review of the net sweep amendment should focus primarily on the external factors facing the government in August 2012, when the transaction was executed.

A close look at the timing and broader economic context of the net sweep amendment actually raises significant doubts as to the transaction's fairness. While Treasury justified the amendment on the grounds that it was necessary to ensure the continued stability of the GSEs, the minority shareholders pointed to clear signs that Fannie Mae and Freddie Mac were returning to profitability weeks before the transaction.[180] Both GSEs reported profits for the first time since entering conservatorship in the second quarter of 2012—the last quarterly report before the amendment—and commercial analysts noted that this trend might mitigate the need for government action.[181] While some other forecasters still doubted the long-term stability of the GSEs,[182] "it was likely a prospect in the minds of government regulators that both firms were about to become profitable, as indeed they immediately did."[183]

Despite these potentially unfair dealings, a showing of fair price could still establish the net sweep amendment's overall fairness because, in the absence of fraud, "price may be the preponderant consideration outweighing other features."[184] The fair price inquiry considers "the economic and financial considerations" of the transaction, typically through judicial discounted cash flow valuation analysis.[185] One academic valuation analysis concluded that the GSEs' equity was valueless when the net sweep amendment was enacted.[186] Others contend that the GSEs' stock had residual value at the time

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[179] *Perry*, 70 F. Supp. 3d at 233.

[180] *See* Supplemental Memorandum of Law of Plaintiffs, *Perry*, 70 F. Supp. 3d 208 (Nos. 13-cv-1053-RCL, 13-cv-1439-RCL).

[181] *See* Fannie Mae, Q2 Report (Form 10-Q) (Aug. 2012); Freddie Mac, Q2 Report (Form 10-Q) (Aug. 2012); *see also Improved GSEs Results May Ease Push for Immediate Reform*, Fitch Ratings (Aug. 13, 2012), https://www.fitchratings.com/gws/en/fitchwire/fitchwirearticle/Improved-GSE-Results?pr_id=757914 [http://perma.cc/DV7W-J6VW].

[182] *See, e.g.*, Moody's Investor Services, Fannie Mae's and Freddie Mac's Return to Profitability is Fleeting, Issuer Comment (Aug. 13, 2012).

[183] Steven Davidoff Solomon & David Zaring, *After the Deal: Fannie, Freddie and the Financial Crisis Aftermath*, 95 B.U. L. Rev. 371 (2015).

[184] *Weinberger*, 457 A.2d at 711.

[185] *See id.* at 711–12.

[186] *See* Adam Badawi & Anthony Casey, *The Fannie and Freddie Bailouts Through the Corporate Lens* 26 (Coase-Sandor Institute for Law & Economics, Working Paper No. 684, 2014).

due to profit potential from the recovering housing market.[187] Indeed, if the stock had any value at all, an argument can be made that because there was "*no* new consideration to Fannie and Freddie . . . the transaction was all *quid* without any *pro quo*" and therefore likely did not result in a fair price.[188] Ultimately, the fair price inquiry "is a matter for expert testimony and further analysis" best determined through judicial valuation.[189] Regardless of the ultimate valuation analysis, however, it is clear that both Treasury and FHFA engaged in a self-dealing transaction when they entered into the net sweep amendment, and thus, the agreement should be reviewed for fairness.

V. Conclusion

The question of when—and how—courts should review federal conservator transactions highlights the tension between the goals of ensuring agency flexibility and accountability of agency action. Unique fairness concerns arise when a federal agency like FHFA or the FDIC assumes control of an existing corporation as conservator—particularly when that corporation is publicly held prior to conservatorship. In these situations, specific individual property interests become beholden to government action in a way that is distinct from traditional rulemaking and other traditional exercises of agency authority. Moreover, the anti-injunction provisions in FIRREA and HERA likely render traditional vehicles for ensuring agency accountability under the Administrative Procedure Act ("APA") unavailable.[190] As a result, the mechanisms that typically ensure transparency and accountability of agency action—such as notice and comment requirements or judicial review of "arbitrary and capricious" government action—fail to provide any check on conservator decision-making. This result is contrary to the APA's general presumption in favor of reviewability of agency action.[191]

These underlying concerns bolster the *First Hartford* and *Delta Savings Bank* courts' conclusions that the derivative suit's function in ensuring fairness and accountability should be preserved in the narrow situations in which government conservators face a conflict of interest and therefore are most susceptible to engaging in unfair transactions. The scale of the net sweep amendment reinforces the importance of subjecting federal conservator actions to some kind of judicial fairness review where a conflict of interest is at play. Decisions involving billions of dollars of shareholder property

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[187] *See* Solomon & Zaring, *supra* note 183, at 22–23.

[188] Richard A. Epstein, *The Government Takeover of Fannie Mae and Freddie Mac: Upending Capital Markets with Lax Business and Constitutional Standards*, 12 NYU J. L. & Bus. (forthcoming 2015).

[189] *See* Solomon & Zaring, *supra* note 183, at 24.

[190] The shareholders also plead APA claims, but the *Perry* court dismissed these on the grounds that the anti-injunction provision of HERA bars their claims because Treasury did not act outside the scope of the authority granted to it in HERA. *See* Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 220–29 (D.D.C. 2014).

[191] *See, e.g.*, Abbott Laboratories v. Gardner, 387 U.S. 136 (1967).

should, at the very least, be made with the kind of procedural care and consideration typically required of either directors of corporations, who are traditionally checked by shareholder voting rights and derivative suit mechanisms, or by administrative agencies, who are traditionally checked by the requirements of the APA. When the federal government assumes control of a publicly held corporation, thereby assuming the role of a de facto director of the entity, corporate law mechanisms are better suited to ensuring agency accountability than the more general provisions of the APA. At the very least, relieving federal conservators of all judicial review, without exception, poses too great a risk that the government will engage in unfair actions that administrative and corporate law both seek to avoid.