IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

DAVID JACOBS and GARY HINDES, on behalf of themselves and all others similarly situated, and derivatively on behalf of the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, *Plaintiffs*, v. THE FEDERAL HOUSING FINANCE AGENCY, in its capacity as Conservator of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, and THE UNITED STATES DEPARTMENT OF THE TREASURY, *Defendants*, and THE FEDERAL NATIONAL MORTGAGE ASSOCIATION and THE FEDERAL HOME LOAN MORTGAGE CORPORATION, *Nominal Defendants.*	Civil Action No.: 15-708-GMS **CLASS ACTION** **JURY TRIAL DEMANDED**

PLAINTIFFS' BRIEF IN OPPOSITION TO
DEFENDANTS' MOTIONS TO DISMISS

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TABLE OF CONTENTS

NATURE AND STAGE OF PROCEEDINGS 1

SUMMARY OF THE ARGUMENT 1

STATEMENT OF FACTS 5

A. Fannie Mae And Freddie Mac 5

B. Despite Being "Adequately Capitalized" And "Safe And Sound," FHFA Places The Companies Into Conservatorship..6

C. The Companies Return To Profitability, But FHFA And Treasury Seize All Of Their Net Worth In Perpetuity Through The Net Worth Sweep..10

ARGUMENT..14

A. Legal Standards..14

B. Plaintiffs Have Stated Claims Under Delaware and Virginia Law.......................14

1. Neither HERA Nor The Certificates Of Designation Preempt Delaware and Virginia Corporate Law.......................................15

2. The Net Worth Sweep Is Void And Unenforceable 20

3. The Complaint States Claims Against FHFA and Treasury For Breaches Of Fiduciary Duty..24

C. Plaintiffs' Claims Against Treasury Are Not Barred By Sovereign Immunity..28

D. Plaintiffs' Claims Are Not Barred By HERA..30

1. Section 4617(f) Does Not Bar Plaintiffs' Claims for Equitable Relief Against FHFA……………………………………………………………31

a. Section 4617(f) Does Not Insulate Conduct That Exceeds or Contravenes FHFA's Authority Under HERA…………………..31

b. The Net Worth Sweep Exceeds and Contravenes FHFA's Authority Under HERA. 34

c. FHFA's Asserted Statutory Authorizations for the Net Worth Sweep All Lack Merit. 38

d. The District Court's Decision in *Perry Capital* Does Not Support Defendants' Argument That Section 4617(f) Bars Plaintiffs' Claims 41

2. Section 4617(f) Does Not Bar Plaintiffs' Claims for Equitable Relief Against Treasury....42

3. HERA Does Not Bar Stockholders From Prosecuting Claims During The Conservatorships....44

a. Plaintiffs Have Stated Direct Claims For Relief....44

b. HERA Does Not Strip Plaintiffs Of Their Rights In Their Stock. 48

i. Plaintiffs Have Standing To Prosecute Their Direct Claims Based On Their Ownership Of Stock. 48

ii. Plaintiffs Have Standing To Prosecute Their Derivative Claims Because FHFA Has A Manifest Conflict of Interest....50

E. Plaintiffs' Contract Claims Are Ripe....54

F. Plaintiffs' Claims Are Not Precluded By *Perry Capital* 55

CONCLUSION....60

TABLE OF AUTHORITIES

CASES

Page(s)

Allen v. El Paso Pipeline GP Co., LLC
90 A.3d 1097 (Del. Ch. 2014)....36

American Petroleum Inst. v. EPA,
906 F.2d 729 (D.C. Cir. 1990)....55

Arduini v. Hart,
774 F.3d 622 (9th Cir. 2014)....60

Arizona v. Inter Tribal Council of Ariz., Inc.,
133 S. Ct. 2247 (2013)....15

Arkansas Game & Fish Comm'n v. United States,
133 S. Ct. 511 (2012)....49

Ashcroft v. Iqbal,
556 U.S. 662 (2009)....14

B&B Hardware, Inc. v. Hargis Indus., Inc.,
135 S. Ct. 1293 (2015)....56

Bank of Manhattan, NA v. FDIC,
778 F.3d 1133 (9th Cir. 2015)....32, 35-37

Barnes v. Harris,
783 F.3d 1185 (10th Cir. 2015)....50

Bartlett v. Bowen,
816 F.2d 695 (D.C. Cir. 1987)....51

Battaglia v. General Motors Corp.,
169 F.2d 254 (2d Cir. 1948)....51

Bell Atlantic Corp. v. Twombly,
550 U.S. 544 (2007)....14

Black v. Hollinger Int'l Inc.,
872 A.2d 559 (Del. 2005)....24

Blair v. Wal-Mart Stores Inc.,
2004 WL 2283560 (D. Del. Sept. 30, 2004)....14

Boilermakers Local 154 Retirement Fund v. Chevron Corp.,
73 A.3d 934 (Del. Ch. 2013)....................36

Bowen v. Massachusetts,
487 U.S. 879 (1988)....................29

Bowen v. Michigan Acad. of Family Physicians,
476 U.S. 667 (1986)....................30, 51

Brown v. Scott County Tobacco Warehouses,
1983 WL 489237 (Va. Cir. Ct. Feb. 22, 1983)....................17, 24

Chemical Futures & Options, Inc. v. RTC,
832 F. Supp. 1188 (N.D. Ill. 1993)....................32

Cities Serv. Co. v. Dep't of Energy,
520 F. Supp. 1132 (D. Del. 1981)....................55

City of Arlington v. FCC,
133 S. Ct. 1863 (2013)....................33

Cnty. of Sonoma v. FHFA,
710 F.3d 987 (9th Cir. 2013)....................31-34

Coit Independence Joint Venture v. Fed. Sav. & Loan Ins. Corp.,
489 U.S. 561 (1989)....................40, 42-43

Colonial Penn Ins. Co. v. Heckler,
721 F.2d 431 (3d Cir. 1983)....................54

Continental Western Insurance Company v. FHFA,
83 F. Supp. 3d 828 (S.D. Iowa 2015)....................42, 50

Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.,
1991 WL 277613 (Del. Ch. Dec. 30, 1991)....................17

Dawyot v. Catawba Capital Mgmt., Inc.,
82 Va. Cir. 521 (2011)....................24

Delta Sav. Bank v. United States,
265 F.3d 1017 (9th Cir. 2001)....................51

Dep't of the Army v. Blue Fox, Inc.,
525 U.S. 255 (1999)....................29

Drewry, Hughes Co. v. Throckmorton,
92 S.E. 818 (Va. 1917)....................23

English v. Gen. Elec. Co.,
496 U.S. 72 (1990)....................16

Ercklentz v. Inverness Mgmt. Corp.,
1985 WL 11535 (Del. Ch. Feb. 22, 1985)....................58

Ernst & Young v. Depositors Econ. Prot. Corp.,
45 F.3d 530 (1st Cir. 1995)....................55

Esther Sadowsky Testamentary Trust v. Syron,
639 F. Supp. 2d 347 (S.D.N.Y. 2009)....................50, 52

Fairholme Funds, Inc. v. United States,
No. 13-465C (Fed. Cl. Dec. 9, 2013)....................51

Firestone v. Wiley,
485 F. Supp. 2d 694 (E.D. Va. 2007)....................36

First Hartford Corp. Pension Plan & Trust v. United States,
194 F.3d 1279 (Fed. Cir. 1999)....................51, 53

Fleischer v. FDIC,
70 F. Supp. 2d 1238 (D. Kan. 1999)....................35

Freeman v. FDIC,
56 F.3d 1394 (D.C. Cir. 1995)....................32

Gade v. Nat'l Solid Wastes Mgmt. Ass'n,
505 U.S. 88 (1992)....................15

Gatz v. Ponsoldt,
925 A.2d 1265 (Del. 2007)....................45

Gentile v. Rossette,
906 A.2d 91 (Del. 2006)....................45, 47

Gosnell v. FDIC,
1991 WL 533637 (W.D.N.Y. Feb. 4, 1991)....................41

Gradient OC Master, Ltd. v. NBC Universal, Inc.,
930 A.2d 104 (Del. Ch. 2007)....................47

Great-West Life & Annuity Ins. Co. v. Knudson,
534 U.S. 204 (2002)....................30

Gross v. Bell Sav. Bank PaSA,
974 F.2d 403 (3d Cir. 1992)....................32

Guenther v. Pacific Telecom, Inc.,
123 F.R.D. 341 (D. Or. 1987) 56

Hamilton Partners, L.P. v. Highland Capital Mgmt., L.P.,
2014 WL 1813340 (Del Ch. May 7, 2014) 27

Henik ex rel. LaBranche & Co., Inc. v. LaBranche,
433 F. Supp. 2d 372 (S.D.N.Y. 2006)...58

Hindes v. FDIC,
137 F.3d 148 (1998)..33, 43

Howard Hess Dental Labs. Inc. v. Dentsply Int'l, Inc.,
602 F.3d 237 (3d Cir. 2010)...55

In re Beach First Nat'l Bancshares, Inc.,
702 F.3d 772 (4th Cir. 2012) 50

In re Cysive, Inc. S'holders Litig.,
836 A.2d 531 (Del. Ch. 2003)..25, 27

In re: El Paso Pipeline Partners, L.P. Deriv. Litig.,
2015 WL 7758609 (Del. Ch. Dec. 2, 2015) 46-48

In re Fed. Home Loan Mortg. Corp. Deriv. Litig.,
643 F. Supp. 2d 790 (E.D. Va. 2009) 44, 50, 52

In re Fed. Nat'l Mortg. Ass'n Sec., Deriv. & ERISA Litig.,
629 F. Supp. 2d 1 (D.D.C. 2009) 52

In re Fisker Auto. Holdings, Inc. S'holder Litig.,
2015 WL 6039690 (D. Del. Oct. 15, 2015) 14

In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.,
134 F.3d 133 (3d Cir. 1998)..59

In re Hechinger Inv. Co. of Delaware,
274 B.R. 71 (D. Del. 2002) 15

In re Loral Space & Commc'ns Inc.,
2008 WL 4293781 (Del. Ch. Sept. 19, 2008) 27

In re Maxxam, Inc.,
659 A.2d 760 (Del. Ch. 1995)...17

In re Sonus Networks, Inc., S'holder Derivative Litig.,
499 F.3d 47 (1st Cir. 2007) 57, 59

In re Tri-Star Pictures, Inc. Litig.,
634 A.2d 319 (Del. 1993) 46-47

Johnson v. Johnson & Briggs, Inc.,
122 S.E. 100 (Va. 1924) 23

Kahn v. Lynch Commc'n Sys., Inc.,
638 A.2d 1110 (Del. 1994) 27

Kaplan v. Block,
31 S.E.2d 893 (Va. 1944) 20

Kellmer v. Raines,
674 F.3d 848 (D.C. Cir. 2012) 50, 52

King v. Burwell,
135 S. Ct. 2480 (2015) 40

Klang v. Smith's Food & Drug Ctrs., Inc.,
702 A.2d 150 (Del. 1997) 23

Kuriakose v. Fed. Home Loan Mortg. Co.,
674 F. Supp. 2d 483 (S.D.N.Y. 2009) 44

Lee v. Virginia Education Association, Inc.,
2 Va. Cir. 319, 1969 WL 101681 (1969) 36

Leon Cnty. v. FHFA,
700 F.3d 1273 (11th Cir. 2012) 31-32, 34

Levin v. Miller,
763 F.3d 667 (7th Cir. 2014) 50

LNV Corp. v. Outsource Serv. Mgmt., LLC,
2014 WL 834977 (D. Minn. Mar. 4, 2014) 44

Lockerty v. Phillips,
319 U.S. 182 (1943) 51

Lubin v. Skow,
382 F. App'x 866 (11th Cir. 2010) 50

Maio v. Aetna, Inc.,
221 F.3d 472 (3d Cir. 2000) 14

Marshall v. Fredericksburg Lumber Co.,
173 S.E. 553 (Va. 1934) 17

Massachusetts v. FHFA,
54 F. Supp. 3d 94 (D. Mass) 34

MCG Capital Corp. v. Maginn,
2010 WL 1782271 (Del. Ch. May 5, 2010) 45

Medtronic, Inc. v. Lohr,
518 U.S. 470 (1996) 16

Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit,
547 U.S. 71 (2006) 52

NAF Holdings, LLC v. Li & Fung (Trading) Ltd.,
118 A.3d 175 (Del. 2015) 45

National Fed'n of Indep. Bus. v. Sebelius,
132 S. Ct. 2566 (2012) 49

NE Hub Partners, L.P. v. CNG Transmission Corp.,
239 F.3d 333 (3d. Cir. 2001) 55

Nebraska Pub. Power Dist. v. MidAmerican Energy Co.,
234 F.3d 1032 (8th Cir. 2000) 55

O'Melveny & Myers v. FDIC,
512 U.S. 79 (1994) 34-36

Pac. Gas & Elec. Co. v. State Energy Res. Conserv. & Dev. Comm'n,
461 U.S. 190 (1983) 55

Pareto v. FDIC,
139 F.3d 696 (9th Cir. 1998) 50

Parsch v. Massey,
2009 WL 7416040 (Va. Cir. Ct. Nov. 5, 2009) 17, 25, 27

Perry Capital LLC v. Lew,
70 F. Supp. 3d 208 (D.D.C. 2014) 5, 50, 52

Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust ex rel. Fed. Nat. Mortg. Ass'n v. Raines,
534 F.3d 779 (D.C. Cir. 2008) 30, 35

Plaintiffs in All Winstar-Related Cases at the Ct. v. United States,
44 Fed. Cl. 3 (1999) 50

Prod. Res. Grp., LLC v. NCT Grp., Inc.,
863 A.2d 772 (Del. Ch. 2004) 17, 25

Pyott v. Louisiana Mun. Police Employees' Retirement System,
74 A.3d 612 (Del. 2013) 60

Quadrant Structured Prods. Co. v. Vertin,
102 A.3d 155 (Del. Ch. 2014)....................24

Rafter v. Department of Treasury,
No. 1:14-cv-01404-RCL, Slip Op. (D.D.C. Jan. 21, 2015) 57

Reich v. Collins,
513 U.S. 106 (1994)....................51

Remora Invs., LLC v. Orr,
673 S.E.2d 845 (Va. 2009)....................45

Reno v. Catholic Soc. Servs. Inc.,
509 U.S. 43 (1993)....................31

Rice v. Santa Fe Elevator Corp.,
331 U.S. 218 (1947)....................15

Ridder v. City Fed Fin. Corp.,
47 F.3d 85 (3d Cir. 1995)....................35

Rosa v. RTC,
938 F.2d 383 (3rd Cir. 1991) 33

Schnell v. Chris-Craft Indus., Inc.,
285 A.2d 437 (Del. 1971) 24

Sharpe v. FDIC,
126 F.3d 1147 (9th Cir. 1997) 32, 35, 37

Shintom Co., Ltd. v. Audiovox Corp.,
888 A.2d 225 (Del. 2005) 20

Smith v. Bayer Corp.,
131 S. Ct. 2368 (2011)....................59

Step-Saver Data Sys. v. Wyse Tech.,
912 F.2d 643 (3d Cir. 1990)....................55

Stickley v. Stickley,
1997 WL 33622770 (Va. Cir. Ct. July 22, 1997) 24

Stommel v. LNV Corp.,
2014 WL 1340676 (D. Utah Apr. 4, 2014)....................44

Taylor v. Sturgell,
553 U.S. 880 (2008) 56, 59

Telematics Int'l, Inc. v. NEMLC Leasing Corp.,
967 F.2d 703 (1st Cir. 1992) 44

Thorpe v. CERBCO, INC.,
1993 WL 443406 (Del. Ch. Oct. 29, 1993) 17

Tooley v. Donaldson, Lufkin & Jenrette, Inc.,
845 A.2d 1031 (Del. 2004) 44-45, 47

Town of Babylon v. FHFA,
699 F.3d 221 (2d Cir. 2012) 31

Treasury of New Jersey v. U.S. Dep't of Treasury,
684 F.3d 382 (3rd Cir. 2012) 28-29

U.S. Inspect Inc. v. McGreevy,
2000 WL 33232337 (Va. Cir. Ct. Nov. 27, 2000) 46

United States v. LTV Corp.,
746 F.2d 51 (D.C. Cir. 1984) 58

United States v. Security Indus. Bank,
459 U.S. 70 (1982) 40

Ward v. RTC,
996 F.2d 99 (5th Cir. 1993) 33

Webster v. Doe,
486 U.S. 592 (1988) 51

Zimmerman v. Crothall,
2012 WL 707238 (Del. Ch. Mar. 5, 2012) 25

STATUTES

Page(s)

8 DEL. C. § 102 19

8 DEL. C. § 104 19

8 DEL. C. § 151 .... 19, 21-22

8 DEL. C. § 158 19

8 DEL. C. § 170 23-24

5 U.S.C. § 702 28-30

12 U.S.C. § 1455 .... 7, 8, 17

12 U.S.C. § 1719 .... 7, 8, 17

12 U.S.C. § 1821 .... 35, 49, 51

12 U.S.C. § 4617 .... passim

28 U.S.C. § 1367 30

Fed. R. Civ. P. 12 .... 14-15, 24

VA. CODE 13.1-603 19

VA. CODE 13.1-619 19

VA. CODE 13.1-638 .... 19, 21, 23

VA. CODE 13.1-639 19

VA. CODE 13.1-647 19

VA. CODE 13.1-653 24

REGULATIONS

Page(s)

12 C.F.R § 1237.5 36

12 C.F.R.§ 1239.3 6

12 C.F.R.§ 1710.10 .... 6, 15, 17-18

67 Fed. Reg. 38,361 18

76 Fed. Reg. at 35,730 39

OTHER AUTHORITIES

Page(s)

Black's Law Dictionary (8th ed. 1999)....22

CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE & PROCEDURE § 1840....58

11 *Fletcher Cyclopedia of the Law of Corporations* § 5283....21

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Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 Del. J. Corp. L. 27 (1996)....21

NATURE AND STAGE OF PROCEEDINGS

On August 17, 2015, Plaintiffs David Jacobs and Gary Hindes, on behalf of themselves and all others similarly situated, and derivatively on behalf of the Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac," and, together with Fannie Mae, the "Companies"), filed a Class Action and Derivative Complaint (the "Complaint") in this Court against Defendants Federal Housing Finance Agency ("FHFA"), in its capacity as conservator of the Companies, and the United States Department of the Treasury ("Treasury"). On November 13, 2015, FHFA and Treasury moved to dismiss the Complaint and submitted opening briefs in support thereof. This is Plaintiffs' Answering Brief in Opposition to FHFA's and Treasury's motions to dismiss.

SUMMARY OF THE ARGUMENT[1]

This case concerns amendments to the constitutive documents of two publicly traded, stockholder-owned corporations—Fannie Mae and Freddie Mac—to grant to their controlling stockholder all of their profits forever in return for no consideration. The controlling stockholder—the federal government—called these 2012 amendments the "Net Worth Sweep." The Companies were on the verge of earning hundreds of billions of dollars in 2012 when FHFA—their conservator since 2008—and Treasury—owner of their senior preferred stock and warrants for 80% of their common stock—implemented the Net Worth Sweep, pursuant to which Treasury took any and all profits the Companies earn each quarter from that point forward ***in perpetuity***. At the time of the Net Worth Sweep, the Companies were profitable, the federal government was acting in a commercial capacity, and it controlled the affairs of the Companies. This action challenges the validity and enforceability of the Net Worth Sweep.

[1] Capitalized terms not defined above are defined in the Statement of Facts or Argument.

There is no federal corporate law relevant to this case. In fact, the applicable federal law incorporates Delaware and Virginia law to govern the constitutive documents and internal affairs of Fannie Mae and Freddie Mac, respectively.

Under Delaware and Virginia law, the Net Worth Sweep is an absurdity. Preferred stock of a corporation cannot be given a cumulative dividend right equal to all the net worth of the corporation in perpetuity, to the necessary exclusion of any dividends ever being paid on junior stock. Because the Net Worth Sweep purports to do this, it is void and unenforceable.

The Net Worth Sweep, ***in return for which the Companies received no consideration***, expropriates to the federal government all of the economic interests held by the Companies' private stockholders and makes it impossible for the Companies to rebuild their capital reserves, exit conservatorship, and return to normal business operations. As Defendants anticipated when they imposed the Net Worth Sweep, their scheme has been tremendously profitable for Treasury. Altogether, Fannie Mae and Freddie Mac have paid Treasury over ***$241 billion***—approximately $54 billion ***more*** than Treasury disbursed to the Companies to obtain their senior preferred stock. But due to the terms of the Net Worth Sweep, these payments have not reduced the Companies' outstanding obligation to Treasury under the senior preferred stock by even one dollar, and both Companies must continue to pay all of their net worth each quarter to Treasury ***in perpetuity***.

As explained herein, the Net Worth Sweep is an invalid term for any preferred stock instrument, whether or not held by the government. Pursuant to their enabling legislation, Fannie Mae and Freddie Mac have chosen for their internal affairs to be governed by Delaware and Virginia law, respectively. HERA—the federal law pursuant to which FHFA and Treasury purported to act when placing them in conservatorship and implementing the Net Worth Sweep—did not change that. Neither Delaware nor Virginia law permits a corporation to

contract away all of its net worth and profits for all time to a single preferred stockholder by way of an infinite, perpetual dividend. Because the Net Worth Sweep violates these states' corporate laws, it is void and unenforceable, and Plaintiffs are entitled to the relief they have requested in the Complaint. The Net Worth Sweep also violates the contractual rights and fiduciary duties owed to the Companies' minority stockholders—rights and duties that are preserved by the applicable federal statutes and that govern the corporate activities of the Companies, whether before, during, or after conservatorship, thus warranting the relief sought by Plaintiffs.

The Court should reject FHFA's and Treasury's arguments and deny their motions to dismiss. First, contrary to the government's contentions, Plaintiffs have stated claims under Delaware and Virginia law that the Net Worth Sweep is void and unenforceable.[2]

Second, neither HERA nor the Certificates of Designation governing Treasury's Senior Preferred Stock preempt Delaware and Virginia law. HERA does not conflict with Delaware or Virginia law. Indeed, the application of those states' corporate laws is fully consistent with HERA and the Companies' enabling legislation. Further, the Certificates of Designation cannot preempt state law because they are creatures of, and must comply with, state law. Relatedly, Treasury is incorrect in disputing that it owes fiduciary duties to the Companies and their other stockholders. To be sure, Treasury is the Companies' controlling stockholder based on its ownership of the Senior Preferred Stock and warrants to acquire nearly 80% of the Companies' common stock, as well as its extensive rights under the PSPAs that confer it with actual control over FHFA and the Companies' business and affairs.

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[2] Because of the significant questions of Delaware and Virginia law involved in this case, including matters of first impression that could result in early resolution of this litigation, contemporaneously with the filing of this brief, Plaintiffs are filing an application requesting that this Court certify questions of law to the Delaware and Virginia Supreme Courts.

Third, Plaintiffs' claims against Treasury are not barred by sovereign immunity because they fall squarely within the waiver of immunity under the APA for actions seeking relief other than money damages (such as the equitable, injunctive, and declaratory relief sought against Treasury here) and alleging unlawful conduct by a federal agency, officer, or employee. Contrary to Treasury's contentions, this waiver of immunity applies to the state law claims here.

Fourth, FHFA's and Treasury's arguments that Plaintiffs' claims are barred by HERA are wrong. While FHFA and Treasury repeatedly emphasize that HERA bars equitable relief that would "restrain or affect the exercise of powers or functions of [FHFA] as a conservator," this restriction does not apply here because FHFA blatantly exceeded its conservatorship authority in implementing the Net Worth Sweep through the creation of stock that is void under applicable state law. Because HERA did not give FHFA the authority to *transgress* the state law governing Fannie Mae's and Freddie Mac's operations, this suit challenging the Net Worth Sweep is not barred by HERA. FHFA's and Treasury's reliance on another provision of HERA, which provides that when FHFA took over as conservator it "immediately succeed[ed] to . . . all rights, titles, powers, and privileges of . . . any stockholder . . . of [Fannie and Freddie] with respect to the [Companies] and the assets of the [Companies] . . . ," similarly is misplaced. This provision does not affect direct claims, and many of Plaintiffs' claims are direct. It also does not grant to FHFA the right to control derivative claims *against itself and a sister federal agency.*

Defendants also are incorrect in asserting that Plaintiffs' contract claims are not ripe. As explained below and in the Complaint, FHFA has violated the contractual rights of the Companies' private stockholders. The Net Worth Sweep effectively nullified Plaintiffs' contracts and transferred their entire value to Treasury, breaching both the express terms of the contracts

and the implied covenant of good faith and fair dealing that inheres in those contracts. The Net Worth Sweep thus has caused Plaintiffs to suffer present injury, making this case ripe for review.

Finally, Defendants' motions rely on *Perry Capital LLC v. Lew,* 70 F. Supp. 3d 208 (D.D.C. 2014), but Plaintiffs raise claims that are distinct from those raised in *Perry Capital*. At any rate, the *Perry Capital* court's reasoning is utterly bankrupt, and this Court should repudiate it. Further, and contrary to Defendants' contentions, Plaintiffs' claims here are not precluded by rulings against different stockholders in different cases challenging the Net Worth Sweep.

STATEMENT OF FACTS

A. Fannie Mae And Freddie Mac

Fannie Mae and Freddie Mac are for-profit, stockholder-owned corporations organized and existing under the Federal National Mortgage Association Charter Act and the Federal Home Loan Mortgage Corporation Act, respectively. Compl. ¶ 30. Congress established Fannie Mae in 1938 as a federal agency to provide the mortgage market with supplemental liquidity, and converted it to a private corporation in 1968. *Id.* Congress created Freddie Mac as an alternative to Fannie Mae to make the secondary mortgage market more competitive and efficient. *Id.*

The Companies' enabling legislation and government charters contemplate private stockholders' ownership of Fannie Mae and Freddie Mac. *Id.* ¶ 31. Until the imposition of the conservatorships (as discussed below), the Companies' businesses were self-sustaining, consistently profitable, and funded exclusively with private capital raised through the issuance of both common stock and several series of preferred stock, including the stock that Plaintiffs and the other members of the Classes purchased. *Id.* ¶ 3. The Companies' securities were considered safe investments. *Id.* ¶ 31. Moreover, the Companies regularly declared and paid dividends on their common and preferred stock. *Id.* Despite the imposition of the

conservatorships in 2008, the Companies continue to have private stockholders. *Id.* The conservatorships did not alter those stockholders' ownership interests. *Id.*

Federal law authorizes each of the Companies to designate "the law of the jurisdiction in which [its] principal office . . . is located, [or] . . . [the] Delaware General Corporation Law" for purposes of its corporate governance practices and procedures. 12 C.F.R. § 1710.10.[3] Fannie Mae has elected Delaware law to apply pursuant to Section 1.05 of its bylaws (Ex. A), which provides, in pertinent part, that "the corporation has elected to follow the applicable corporate governance practices and procedures of the Delaware General Corporation Law." Compl. ¶ 32. Freddie Mac has elected Virginia law to apply pursuant to Section 11.3 of its bylaws (Ex. B), which provides, in pertinent part, that "the Corporation shall follow the corporate governance practices and procedures of the law of the Commonwealth of Virginia, including without limitation the Virginia Stock Corporation Act as the same may be amended from time to time." Compl. ¶ 32.

B. Despite Being "Adequately Capitalized" And "Safe And Sound," FHFA Places The Companies Into Conservatorship

Beginning in 2006, the global economy experienced a severe recession and the national economy suffered housing market and mortgage crises. *Id.* ¶ 33. Despite this turmoil, the Companies remained "adequately capitalized" and "safe and sound" according to high-ranking government officials. *Id.*; *see also id.* ¶ 4. Indeed, Fannie Mae's and Freddie Mac's assets exceeded their liabilities by ***$50 billion*** as of July 2008. *Id.* ¶ 35. Thus, when Congress enacted the Housing and Economic Recovery Act of 2008 ("HERA") in July 2008, it did so to provide

[3] On November 19, 2015, FHFA promulgated new regulations applicable to the Companies that concern the state laws that govern their internal affairs. *See* 12 C.F.R. § 1239.3 (effective Dec. 21, 2015). These new regulations do not have retroactive effect, and Defendants do not rely on them here. At any rate, they likewise authorize the Companies to select the DGCL or the law of their principal place of business for their corporate governance.

the mortgage and financial markets with added confidence, not because the Companies were insolvent or operating unsafely. *Id.* ¶¶ 4, 34.

HERA created FHFA to replace the Office of Federal Housing Oversight ("OFHEO") as the Companies' regulator and authorized FHFA to appoint itself as conservator or receiver of the Companies in certain specified circumstances. *Id.* ¶ 4. In addition, HERA granted Treasury limited, temporary authority to purchase securities from the Companies. *Id.* ¶ 34. HERA left in place the federal charters of the Companies and did not implicitly or explicitly repeal or modify the provisions of their bylaws specifying that Delaware and Virginia law govern the Companies' internal affairs. *Id.* ¶ 4. Congress did not authorize Treasury to nationalize the Companies, for in exercising its authority HERA expressly required Treasury to consider "the need to maintain [Fannie Mae's and Freddie Mac's] status as . . . private shareholder-owned compan[ies]" and their "plan for the orderly resumption of private market funding or capital market access," 12 U.S.C. §§ 1455(l)(1)(C), 1719(g)(1)(C); *see also* Compl. ¶¶ 34-35.

On September 6, 2008, five weeks after HERA was signed into law, FHFA placed the Companies under conservatorship and appointed itself as conservator. Compl. ¶ 4. FHFA claimed at the time that the conservatorships would be terminated once the Companies had been restored to a safe and solvent condition. *Id.* ¶ 35. FHFA publicly emphasized that the purpose of the conservatorships was, as clearly prescribed by HERA, to rehabilitate Fannie Mae and Freddie Mac, return them to a safe and sound financial condition, and then release them from conservatorship. *See id.*; Statement of James B. Lockhart, Director, FHFA, at 5–6 (Sept. 7, 2008) (Ex. C). Thus, FHFA only would "act as the conservator to operate [the Companies] until they are stabilized." Ex. C at 6. FHFA described its powers as conservator to be those specified in HERA, explaining that "[t]he purpose of appointing the Conservator is to preserve and

conserve the Compan[ies'] assets and property and to put the Compan[ies] in a sound and solvent condition." FHFA FACT SHEET, QUESTIONS AND ANSWERS ON CONSERVATORSHIP at 2 (Sept. 7, 2008) (Ex. D). FHFA repeatedly emphasized that, as required by HERA, Fannie Mae and Freddie Mac would be maintained as "private shareholder-owned compan[ies]" during conservatorship, *see* 12 U.S.C. §§ 1455(l)(1)(C)(v), 1719(g)(1)(C)(v), and that their common and preferred stockholders would retain an economic interest in the Companies. *See* Compl. ¶ 35 ("the common and all preferred stocks [of the Companies] will continue to remain outstanding"); Ex. D at 3 (during the conservatorship, the Companies' stockholders "will continue to retain all rights in the stock's financial worth"). Finally, FHFA publicly vowed, in keeping with the requirements of HERA, that the conservatorships would be *temporary*. *See* Compl. ¶ 35; Ex. D at 2 ("Upon the Director's determination that the Conservator's plan to restore the [Companies] to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship.").[4]

The day after the conservatorships were imposed, FHFA, acting as conservator for the Companies, and Treasury entered into two virtually identical senior preferred stock purchase agreements (the "PSPAs"),[5] pursuant to which each of Fannie Mae and Freddie Mac created and issued a new series of preferred stock, the "Senior Preferred Stock." *Id.* ¶ 36. The Senior Preferred Stock was created pursuant to two virtually identical Senior Preferred Stock Certificates of Designation (one each for Fannie Mae and Freddie Mac) (the "Certificates of Designation") that set forth the rights, powers and preferences of the Senior Preferred Stock. *Id.*

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[4] A press release issued by FHFA the day after placing the Companies into conservatorship stated that, "as the conservator, FHFA will assume the power of the Board and management." Compl. ¶ 4. As conservator, FHFA has ultimate responsibility for, and control of, the affairs of Fannie Mae and Freddie Mac so long as the conservatorships continue. *Id.*

[5] The PSPAs and their amendments are attached hereto as Exhibits E through L.

Treasury purchased 1 million shares of each Company's Senior Preferred Stock in exchange for a funding commitment that allowed each Company to draw up to $100 billion from Treasury (this cap was later increased in size by two subsequent amendments to the PSPAs, first to $200 billion each and then to an amount established by a formula that may be greater (but not less) than $200 billion each). *Id.* The 1 million shares of each Company's Senior Preferred Stock have an aggregate liquidation preference equal to $1 billion ($1,000 per share) plus the sum of all additional amounts drawn by each Company on Treasury's funding commitment. *Id.* ¶ 36. The Senior Preferred Stock of each of the Companies ranks senior to all other classes and series of stock and initially entitled Treasury to receive a cumulative cash dividend of 10% of the outstanding liquidation preference (12% if the dividend were paid in kind). *Id.* ¶ 8. Absent the express consent of Treasury and FHFA, the Companies generally cannot redeem the Senior Preferred Stock. *Id.* ¶ 36. Through the PSPAs, Fannie Mae and Freddie Mac each provided Treasury with warrants to purchase 79.9% of its common stock,[6] and entered into covenants barring each Company from, among other things, making any changes to its capital structure, paying any dividends (other than to Treasury), or seeking to terminate FHFA's conservatorship without Treasury's approval (so long as the Senior Preferred Stock remained outstanding). *Id.*

Soon after the commencement of the conservatorships, FHFA, as conservator, took two steps that required each Company to draw billions of dollars on Treasury's funding commitment. *Id.* ¶ 12. First, FHFA declared that the Companies had suffered substantial non-cash accounting losses, including write-downs of the value of their tax assets and loss reserves. *Id.*; *see also id.* ¶ 38. By 2012, it became clear that these projected losses had been overestimated by ***more than***

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[6] Thus, the very structure of the government's investment in the Companies underscores that the publicly owned common and preferred stock remained outstanding and had value, because these warrants gave Treasury an economic upside when the Companies returned to profitability.

$100 billion and the associated accounting reserves would eventually have to be reversed. *Id.* ¶ 38. Second, FHFA elected to have the Companies pay Treasury discretionary dividends on the Senior Preferred Stock in cash (rather than in kind), resulting in the Companies needing additional incremental capital to fund the cash dividend payments, which they obtained from Treasury pursuant to the funding commitment. *Id.* ¶ 12.

C. The Companies Return To Profitability, But FHFA And Treasury Seize All Of Their Net Worth In Perpetuity Through The Net Worth Sweep

In early August 2012, due largely to rising housing prices and reductions in credit losses, the Companies reported significant income for the second quarter 2012, and neither required a draw from Treasury under the PSPAs. Compl. ¶ 39; *see also* FHFA, Office of Inspector General, Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements at 11 (Mar. 20, 2013) (Ex. M). In the first two quarters of 2012, the Companies posted profits totaling more than $11 billion, more than enough to pay a 10% dividend. Compl. ¶ 39.[7] The return of Fannie Mae and Freddie Mac to profitability in 2012 led to a substantial increase in the trading prices of the Companies' preferred stock. *Id.* ¶ 40.

With the Companies' return to profitability, their stockholders reasonably believed that the Companies would soon be healthy enough to exit conservatorship, as was consistent with the purpose of the conservatorships and as FHFA had vowed when the conservatorships were established. *Id.* ¶ 41. Treasury and FHFA, however, soon dashed those reasonable expectations. *Id.* ¶ 42. Indeed, unbeknownst to the public, the government had long been committed "to

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[7] *See also* Press Release, Fannie Mae, Second Quarter 2012 Results (Aug. 8, 2012); Press Release, Freddie Mac, Second Quarter 2012 Results (Aug. 7, 2012). For the full year 2012, Fannie Mae earned $17.2 billion in profits and Freddie Mac earned $11 billion in profits. Compl. ¶ 39. The Companies became even more profitable in 2013 ($84 billion and $51.6 billion, respectively) and remained profitable in 2014 ($14.2 billion and $9.4 billion, respectively). *Id.*

ensur[ing] existing common equity holders [would] not have access to any positive earnings from the [Companies] in the future." Action Memorandum for Secretary Geithner (Dec. 20, 2010) (Ex. N). FHFA, at the direction of Treasury, executed a plan that would give Treasury, and no other stockholders of the Companies, the benefit of this new profitability in the form of cash payments, all without ever reducing the amount of Treasury's liquidation preference. Compl. ¶ 15; *see also id.* ¶¶ 42-49. The government called the plan the "Net Worth Sweep." *Id.* ¶ 15.

In August 2012, just days after Fannie Mae and Freddie Mac announced their earnings for the second quarter, FHFA entered into a third amendment of each of the Amended and Restated Senior Preferred Stock Purchase Agreements (the "Third Amendment") and agreed to amend the Certificates of Designation setting forth the terms of the Fannie Mae and Freddie Mac Senior Preferred Stock. *Id.* These amendments changed the preferred dividend on Treasury's Senior Preferred Stock from one payable at a 10% cash (and 12% in-kind) rate to a perpetual quarterly "dividend" equal to the entire positive net worth of each of Fannie Mae and Freddie Mac. *Id.*; *see also id.* ¶¶ 42-43. The Companies and their other stockholders received no consideration in exchange for FHFA's acquiescence to the Net Worth Sweep. *Id.* ¶¶ 15, 42.

The Net Worth Sweep circumvented the rules of priority under the charters of each Company and implemented the government's self-dealing expropriation of the remaining value of the private investors' stock. *Id.* ¶ 16. Treasury and FHFA have both acknowledged that, under this unprecedented structure, ***Treasury will receive—in perpetuity—any and all profits that Fannie Mae and Freddie Mac earn***. *Id.* Thus, it will be impossible for either Company to ever have a positive net worth, to ever pay a dividend on other classes or series of stock, or to ever emerge from conservatorship. *Id.*

Specifically, the Third Amendment to the PSPAs and the corresponding Amended and Restated Certificates of Designation (Exs. O and P) provide, in pertinent part, that, as holder of the Senior Preferred Stock, Treasury shall be entitled to receive "cumulative cash dividends in an amount equal to the then-current Dividend Amount." *Id.* ¶ 43.

The "Dividend Amount" is defined as follows:

> For each Dividend Period from January 1, 2013, through and including December 31, 2017, the "Dividend Amount" for a Dividend Period means the amount, if any, by which the Net Worth Amount at the end of the immediately preceding fiscal quarter, less the Applicable Capital Reserve Amount, exceeds zero. ***For each Dividend Period from January 1, 2018, the "Dividend Amount" for a Dividend Period means the amount, if any, by which the Net Worth Amount at the end of the immediately preceding fiscal quarter exceeds zero.*** In each case, "Net Worth Amount" means (i) the total assets of the Company (such assets excluding the Commitment and any unfunded amounts thereof) as reflected on the balance sheet of the Company as of the applicable date set forth in this Certificate, prepared in accordance with GAAP, less (ii) the total liabilities of the Company (such liabilities excluding any obligation in respect of any capital stock of the Company, including this Certificate), as reflected on the balance sheet of the Company as of the applicable date set forth in this Certificate, prepared in accordance with GAAP. "Applicable Capital Reserve Amount" means, as of any date of determination, for each Dividend Period from January 1, 2013, through and including December 31, 2013, $3,000,000,000; and for each Dividend Period occurring within each 12-month period thereafter, $3,000,000,000 reduced by an equal amount for each such 12-month period through and including December 31, 2017, so that for each Dividend Period from January 1, 2018, the Applicable Capital Reserve Amount shall be zero. For the avoidance of doubt, if the calculation of the Dividend Amount for a Dividend Period does not exceed zero, then no Dividend Amount shall accrue or be payable for such Dividend Period.

Id. (emphasis added). Thus, pursuant to the Net Worth Sweep, from January 1, 2013 through December 31, 2017, each Company pays to Treasury, in the form of a purported "dividend," that particular Company's "Net Worth Amount" (*i.e.*, total assets less total liabilities) less the

"Applicable Capital Reserve Amount" (which starts at $3 billion and decreases to $0 by January 1, 2018). *Id.* ¶ 44. Beginning January 1, 2018 and continuing in perpetuity, the Net Worth Amount will be paid out each quarter to Treasury without any capital reserve whatsoever. *Id.*

The Net Worth Sweep "dividends" are cumulative. *Id.* ¶ 45. If the Net Worth Amount is positive and the board of directors does not declare a "dividend" on the Senior Preferred Stock, then the "dividend" accumulates. Under the Certificates of Designation, no dividends may be paid on any other classes or series of stock unless and until full cumulative "dividends" (*i.e.*, the full Net Worth Sweep amount) are paid on the Senior Preferred Stock. *Id.* Because the entire net worth of each Company is payable in perpetuity to the Senior Preferred Stock, no dividends can ever be paid on other classes or series of stock. *Id.*

The Net Worth Sweep has already resulted in historic payments to Treasury. Following their announced December 2015 "dividends" pursuant to the Net Worth Sweep, Fannie Mae and Freddie Mac will have paid a total of ***$144.8 billion*** and ***$96.5 billion*** to Treasury, respectively. *Id*. ¶ 17; Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities at 3 (Dec. 31, 2015) (Ex. Q). Further, the President of the United States' proposed fiscal year 2014 budget estimated that Fannie Mae and Freddie Mac will together pay ***$238.5 billion*** in dividends to Treasury over the next ten years, far outstripping the government's investments. Compl. ¶ 46. Under the PSPAs, even these substantial payments do not reduce the Companies' obligation to Treasury, because these payments cannot be used to offset prior Treasury draws. *Id.* ¶ 48. Accordingly, Treasury still maintains a liquidation preference of $117.1 billion with respect to Fannie Mae and $72.3 billion with respect to Freddie Mac. *Id.*

ARGUMENT

A. Legal Standards

"A motion to dismiss under Rule 12(b)(1) for lack of subject matter jurisdiction can take two forms: it can attack the complaint on its face (facial attack), or it can attack the existence of subject matter jurisdiction in fact (factual attack)." *Blair v. Wal-Mart Stores Inc.*, 2004 WL 2283560, at *1 (D. Del. Sept. 30, 2004). Here, Defendants wage a facial attack upon this Court's jurisdiction. *See* Treasury Br. 9. "When reviewing a facial attack the court must consider the allegations of the complaint as true, making all reasonable inferences in the plaintiff's favor." *Blair*, 2004 WL 2283560, at *1.

A complaint "attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations" to survive a motion to dismiss. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 545 (2007). Rather, a complaint must simply "contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (internal quotation marks omitted). A claim is facially plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* A court must assume the truth of all well-pleaded allegations, view them in the light most favorable to the plaintiff, and draw all reasonable inferences in the plaintiff's favor. *See Maio v. Aetna, Inc.*, 221 F.3d 472, 482-85 (3d Cir. 2000).[8]

B. Plaintiffs Have Stated Claims Under Delaware And Virginia Law

This is a case about Delaware and Virginia corporate law, the law that Fannie Mae and Freddie Mac chose to apply to their corporate governance, as mandated by their enabling federal

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[8] "In this regard, a court may consider the pleadings, public record, orders, exhibits attached to the complaint, and documents incorporated into the complaint by reference." *In re Fisker Auto. Holdings, Inc. S'holder Litig.*, 2015 WL 6039690, at *8 (D. Del. Oct. 15, 2015) (citing *Oshiver v. Levin, Fishbein, Sedran & Berman*, 38 F.3d 1380, 1384-85 n.2 (3d Cir. 1994)).

legislation. When purchasing their stock, the Companies' stockholders relied on the rights and protections afforded them by these states' corporate laws. As explained below, Plaintiffs have stated claims upon which relief can be granted under Delaware and Virginia law.

1. Neither HERA Nor The Certificates Of Designation Preempt Delaware And Virginia Corporate Law

Treasury's and FHFA's primary argument in support of their Rule 12(b)(6) motions is that "[f]ederal law, and the stock certificates themselves, take precedence over any conflicting provision of state law." Treasury Br. 22; *see also* FHFA Br. 26-28. That argument is meritless.

There are two types of preemption: field preemption and conflict preemption.[9] Neither type applies here. Field preemption cannot apply because federal law authorizes, and indeed directs, the Companies to select state law to govern their internal corporate affairs. *See* 12 C.F.R. § 1710.10. The Certificates of Designation governing Treasury's Senior Preferred Stock in the Companies likewise designate that Delaware and Virginia law "shall serve as the federal rule of decision" with respect thereto. Exs. O, P § 10(e). As such, it would not be reasonable to infer that there is "no room for the States to supplement" the federal law that governs the Companies.[10]

Nor does conflict preemption apply, because it would not be impossible for FHFA and Treasury to comply with both HERA and Delaware and Virginia law, and because Delaware and

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[9] *See In re Hechinger Inv. Co. of Delaware,* 274 B.R. 71, 96 (D. Del. 2002) (citing *Orson, Inc. v. Miramax Film Corp.*, 189 F.3d 377, 381-82 (3d Cir. 1999)).

[10] *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *see also Arizona v. Inter Tribal Council of Ariz., Inc.*, 133 S. Ct. 2247, 2271 (2013); *Gade v. Nat'l Solid Wastes Mgmt. Ass'n*, 505 U.S. 88, 98 (1992).

Virginia law do not stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress in implementing the statute.[11]

Neither Treasury nor FHFA identifies a specific, purported conflict between HERA and Delaware or Virginia corporate law. While Treasury conclusorily asserts that the imposition of state law fiduciary duties on it would "be inconsistent with [its] obligation under HERA to act in the best interests of the public and the taxpayers," Treasury Br. 23, there is nothing in HERA to suggest that Treasury's purported public mandate is at all inconsistent with state law fiduciary duties. HERA nowhere authorizes or requires Treasury or FHFA to take action that would violate the Delaware and Virginia corporate law principles applicable to the Companies. Rather, HERA left in place the Companies' charters and bylaws, including the provisions specifying that Delaware and Virginia law apply to their respective corporate governance, stating that a conservator succeeds to the "rights, titles, powers, and privileges of the regulated entity" as they existed prior to the conservatorship, limited and defined by the applicable state corporate laws. 12 U.S.C. § 4617(b)(2)(A)(i). Thus, the authority granted by Congress to Treasury and FHFA pursuant to HERA must be exercised in compliance with those states' corporate laws.

It is implausible that Congress intended to authorize FHFA and Treasury to engage in the statutory violations and wanton self-dealing at issue here, essentially looting the Companies and leaving both insolvent or dangerously close to insolvency every quarter. On the contrary, HERA charged FHFA with rehabilitating Fannie Mae and Freddie Mac by taking action to put the Companies in a sound and solvent condition while preserving and conserving their assets, *see*

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[11] *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990) (Conflict preemption occurs when state law "actually conflicts with federal law," such that it is "impossible" to comply with both state and federal requirements, or "where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.") (internal quotation marks and citations omitted); *see also Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) (conflict preemption is applied cautiously, only where it is the "clear and manifest purpose of Congress").

12 U.S.C. § 4617(b)(2)(D)—authority which is fully consistent with a corporate board of directors' statutory and fiduciary obligations under Delaware and Virginia law.[12] And, consistent with the fiduciary duties imposed on controlling stockholders under those states' corporate laws,[13] HERA's grant of temporary authority to Treasury to invest in the Companies' stock expressly requires Treasury to take into consideration the economic rights of the Companies' private stockholders, including the Companies' plans "for the orderly resumption of private market funding or capital market access" and the "need to maintain the [Companies'] status as [ ] private shareholder-owned compan[ies]." 12 U.S.C. §§ 1455(l)(1)(C), 1719(g)(1)(C). Thus, the application of Delaware and Virginia fiduciary duty law to FHFA and Treasury is fully consistent with their obligations under HERA.

When the OFHEO (the Companies' former regulator) promulgated the corporate governance regulation applicable to the Companies (*i.e.,* 12 C.F.R. § 1710.10), it emphasized

[12] *See Prod. Res. Grp., LLC v. NCT Grp., Inc.*, 863 A.2d 772, 791 (Del. Ch. 2004) ("The directors [of an insolvent firm] continue to have the task of attempting to maximize the economic value of the firm. That much of their job does not change."); *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991) (explaining that the directors of a corporation operating in the vicinity of insolvency owe a duty to the corporate enterprise to "exercise judgment in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity"); *see also Marshall v. Fredericksburg Lumber Co.*, 173 S.E. 553, 558 (Va. 1934) (holding that directors of an insolvent corporation were "obligated as directors to conserve the assets of the corporation . . . .").

[13] *See In re Maxxam, Inc.*, 659 A.2d 760, 771 (Del. Ch. 1995) ("A shareholder that owns a majority interest in a corporation, or exercises actual control over its business affairs, occupies the status of a fiduciary to the corporation and its minority shareholders."); *Thorpe v. CERBCO, INC.*, 1993 WL 443406, at *7 (Del. Ch. Oct. 29, 1993) (explaining that controlling shareholders are not allowed to use their control to exploit the minority); *Brown v. Scott County Tobacco Warehouses*, 1983 WL 489237, at *3 (Va. Cir. Ct. Feb. 22, 1983) ("A director is a fiduciary. So is a dominant or controlling stockholder . . . . Their dealings with the corporation are subjected to rigorous scrutiny."); *Parsch v. Massey*, 2009 WL 7416040, at *9 (Va. Cir. Ct. Nov. 5, 2009) ("Any disposition of the corporation or its assets [by a controlling stockholder] to deprive the minority holders of their just share of it or to gain for themselves at the expense of the holder of the minority stock is a breach of their duties and of trust.").

that the "regulation neither supplants nor displaces traditional standards of corporate governance as commonly defined by State laws regarding the relationships of corporate board members and management to shareholders and other stakeholders," but instead "explicitly clarifies the applicability of such standards to the Enterprises." Office of Federal Housing Enterprise Oversight, *Corporate Governance*, 67 Fed. Reg. 38,361, 38,363 (Final Rule, June 4, 2002).[14] As the OFHEO further clarified, the regulation contemplated not that federal law would negate existing state law fiduciary duties but rather that it might impose ***additional*** requirements on the Companies. *See id.* at 38,367 ("election of a State law . . . is directed, in line with the need to protect shareholders and promote corporate purposes; adherence to Federal standards for safe and sound operations pursuant to a separate and distinct regulatory regime are set forth as well"). In short, 12 C.F.R. § 1710.10 was intended to ensure that the "companies and their boards" would "operate with an eye toward both Federal and State law and regulation." *Id.*[15] Nothing in

[14] *See also id.* at 38,364 (regulation intended to provide "certainty to shareholders and other stakeholders as to the body of corporate law applicable to each Enterprise"); *id.* at 38,368 ("The body of law and legal precedents thereunder elected by the Enterprises pursuant to § 1710.10, to the extent not inconsistent with applicable Federal rules, set forth standards of conduct of board members with respect to shareholders."); *cf. id.* at 38,367 (related regulatory provision "not intended to affect the potential exposure of board members to shareholder actions under applicable standards of State law"); *id.* at 38,366 ("the concept of conflict of interest is a fundamental concept widely understood under traditional precepts of corporate law").

[15] Contrary to FHFA's contentions, *see* FHFA Br. 27 n.18, the Companies' bylaws confirm that the fiduciary duties of those who operate them are not preempted. FHFA invokes Section 1.05 of Fannie Mae's bylaws and Section 11.3 of Freddie Mac's bylaws. But those provisions simply implement 12 C.F.R. § 1710.10. And other provisions of the Companies' bylaws make clear that the fiduciary duties of those who operate them are not preempted. *See* Ex. A § 6.02(a)(i) (Fannie will not indemnify officers and directors for "any breach of such person's duty of loyalty to the corporation or its stockholders"); *id.* § 4.18 (bylaw limiting directors' liability "does not affect the availability of equitable remedies for breach of fiduciary duties"); Ex. B § 8.1(a) (Freddie will not indemnify officers, directors and other fiduciaries for their willful misconduct, improper receipt of personal benefits, or knowing violation of criminal law); *id.* § 8.5 (bylaw limiting officers' and directors' monetary liability in proceedings brought by Freddie or on behalf of Freddie's stockholders does not apply if such a person "engaged in willful misconduct, a

HERA suggests that it was intended to replace or modify this federal regulation or the corporate governance principles applicable to the Companies.[16]

Treasury's and FHFA's related argument that the Certificates of Designation governing Treasury's Senior Preferred Stock take precedence over Delaware and Virginia corporation law has it exactly backwards. A provision in a certificate of designations setting forth the rights, powers, and preferences of a corporation's preferred stock cannot override Delaware or Virginia corporation law, no matter what the provision purports to do.[17] A certificate of designations is part of the corporation's certificate of incorporation, 8 *Del. C.* §§ 104, 151(g); VSCA §§ 13.1-603, 13.1-639, and is the instrument that sets forth the rights, powers, and preferences of a series of preferred stock created by a board of directors. A certificate of designations, as part of the corporate charter, cannot conflict with the applicable corporate law of the governing jurisdiction. 8 *Del. C.* § 102(b)(1) (certificate of incorporation may contain other provisions "not contrary to the laws of this State"); § 102(a)(4) (the powers, preferences, and rights of preferred stock must be "permitted by § 151 of [the DGCL]"); VSCA §§ 13.1-619(B)(3), 13.1-638. The government cites no authority in HERA or elsewhere for the proposition that provisions in a certificate of designations—which itself is a creature of state law—may override applicable state law. Indeed, there is nothing more central to the internal governance of a corporation than the rights, powers,

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transaction from which the director or officer derived an improper personal benefit, or a knowing violation of criminal law").

[16] Further confirming this conclusion is the fact that, in a December 19, 2008 Form 8-K, Fannie Mae acknowledged that it would be managed during conservatorship "in accordance with the applicable designated duties and with the authorities as set forth in . . . Delaware law (for corporate governance purposes) . . . ." Fannie Mae Form 8-K (Dec. 19, 2008).

[17] FHFA's and Treasury's repeated characterization of the Companies' Certificates of Designation as "stock certificates" is inaccurate and misleading. *See* Treasury Br. 23-24; FHFA Br. 26-27. Stock certificates are certificates evidencing an individual stockholder's ownership of shares of stock. 8 *Del. C.* § 158; VSCA § 13.1-647.

and preferences of its capital stock, which would not exist but for applicable state law authorizing its creation and issuance. Moreover, the Senior Preferred Stock certificates of designation themselves acknowledge the applicability of state corporate law by designating that Delaware and Virginia law "shall serve as the federal rule of decision" with respect thereto. Exs. O, P § 10(e).[18] Because, as explained below, the Net Worth Sweep conflicts with state corporate law, those provisions are void and unenforceable.[19]

2. The Net Worth Sweep Is Void And Unenforceable

The Net Worth Sweep is void and unenforceable because preferred stock of a Delaware or Virginia corporation cannot be given a cumulative dividend right equal to the entire net worth of the corporation in perpetuity, to the absolute, permanent exclusion of dividends to other stockholders.

Treasury and FHFA together devote barely two pages and two makeweight arguments in defense of the central claim in this litigation—that the Net Worth Sweep violates Delaware and Virginia law. FHFA first argues that "[t]he DGCL and VSCA are broad, enabling statutes that permit corporations to issue preferred stock with contractually-defined dividend rights." FHFA Br. 28. FHFA and Treasury also contend that variable dividends are permissible under those

[18] Section 10(e) also states "… except where such law is inconsistent with the Company's enabling legislation, its public purposes or any provision of this Certificate." The government's self-serving attempt to avoid the operation of state law is ineffectual. As explained below, a certificate of designation is a creature of state law and, therefore, cannot "opt out" of applicable state law. Nothing in HERA purports to permit FHFA to opt out of applicable state law, whether by merely saying it is so or otherwise, and, in any event, Delaware and Virginia corporate law as applied to the Net Worth Sweep are entirely consistent with HERA and its public purpose of preserving and conserving entities in conservatorship.

[19] *See, e.g., Shintom Co., Ltd. v. Audiovox Corp.,* 888 A.2d 225, 228 (Del. 2005) ("Preferred shares that do not comport with the statutory requirements of the Delaware General Corporation law are void."); *Kaplan v. Block*, 31 S.E.2d 893, 896-97 (Va. 1944) (holding that provisions in corporation's charter and bylaws that divested the board of directors of its authority to manage the company were invalid under Virginia law).

corporation statutes. FHFA Br. 29-30; Treasury Br. 27-28. While the DGCL and VSCA are enabling statutes that allow significant contractual flexibility, FHFA and Treasury ignore the fact that DGCL §§ 102(a)(4) and 151(c), and Va. Code § 13.1-638, which relate to dividend rights of preferred stock, necessarily circumscribe the flexibility afforded by the respective statutes.

Under Delaware law, preferred stock cannot be given a cumulative dividend right equal to all of the corporation's net worth in perpetuity. Section 151 of the DGCL allows preferred stockholders to receive dividends "***at such rates***, on such conditions and at such times as shall be stated in the certificate of incorporation or in the [board] resolution . . . ." 8 *Del. C.* § 151(c) (emphasis added). Such dividends must be "payable ***in preference to, or in . . . relation to***, the dividends payable on" other classes or series of stock. *Id.* (emphasis added).

Because the Net Worth Sweep diverts, ***forever***, all of the net worth of Fannie Mae to Treasury, to the exclusion of any dividends ever being paid on junior stock, it neither is paid at a "rate" nor is it payable "in preference to" or "in relation to" the dividends payable to other classes or series. The Net Worth Sweep is not paid at a "rate" because Treasury's participation in corporate earnings growth is unlimited, absolute, and perpetual.[20]

The Net Worth Sweep is not payable "in preference to" or "in relation to" the dividends payable to other classes or series of stock because it is payable to the absolute, permanent exclusion of dividends to other stockholders. A preferred stock dividend payable "in preference to" a junior stock dividend would entitle preferred stockholders to priority with respect to the

[20] *See* 11 *Fletcher Cyclopedia of the Law of Corporations* § 5283 (perm. ed.) ("In contrast to common shares, preferred shares do not provide an unlimited claim on the corporation's residual earnings[.]"); *id.* ("[Preferred] shares generally give the holder a claim to a ***fixed*** dividend that must be satisfied before any dividend is paid on the common shares.") (emphasis added); Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 Del. J. Corp. L. 27, 38 (1996) ("[P]referred shareholders have a strikingly different relation to a corporation than do common shareholders.").

receipt of dividends—*i.e.,* "to receive a dividend ***before*** the company pays dividends to holders of common shares." *Black's Law Dictionary*, p. 514 (8th ed. 1999) (emphasis added). That is, "in preference to" means that dividends cannot be paid on junior securities until full cumulative dividends are paid on the senior security. *See id.*, p. 1456 ("cumulative preferred stock"). A preferred stock dividend payable "in relation to" a junior stock dividend contemplates "participating" preferred stock—for example, where the dividend on the preferred stock is tied to any dividend on the common stock and where no dividends can be paid on the common stock unless dividends are also paid on the preferred stock in an amount related to those paid on the common stock (*e.g.*, in the same per share amount or some multiple of the per share dividend on the common stock). The Net Worth Sweep is neither "in preference to" nor "in relation to" dividends payable on other classes or series of the Companies' stock. Section 151(c) permits corporations to establish a dividend "preference" that operates as a priority, and/or to afford a dividend participation right to preferred stock "in relation to" the dividend paid on common stock, but it does not permit corporations to establish dividend provisions that operate as a singularity—without regard for or relation to the interests of other classes or series of stock and forever precluding all other stockholders from the potential to receive dividends.[21] Accordingly, the Net Worth Sweep is invalid under Section 151(c) and is void *ab initio* and unenforceable.

Likewise, the Net Worth Sweep violates Virginia corporate law. The VSCA provides that a corporation may authorize "one or more classes or series of shares that . . . ***have preference over*** any other class or series of shares with respect to distributions [such as

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[21] Once the Net Worth Sweep is paid each quarter, there necessarily will be no assets remaining in the Company that would ever be available for the payment of dividends on any other classes or series of stock regardless of how valuable the Company may become in the future. Section 151(c), however, expressly contemplates that, after payment of preferential dividends on senior preferred stock, "a dividend on the remaining class or classes or series of stock may then be paid out of the remaining assets of the corporation available for dividends . . . ." 8 *Del. C.* § 151(c).

dividends].” Va. Code § 13.1-638 (emphasis added). Virginia law does not permit corporations to enter into unconditional agreements to pay dividends without regard to the corporation’s financial condition. *See* 11 *Fletcher Cyclopedia of the Law of Corporations* § 5332 (perm. ed.) (citing *Drewry, Hughes Co. v. Throckmorton*, 92 S.E. 818 (Va. 1917)). Nor does it permit corporations to establish dividend provisions that operate to preclude all other classes of stockholders from the potential to receive dividends in perpetuity. The Virginia Supreme Court has recognized that the “common understanding” of preferred stock is that the holders thereof are entitled to “limited dividends” ***without*** the opportunity for “unlimited gain,” which belongs to the common stockholders. *Johnson v. Johnson & Briggs, Inc.*, 122 S.E. 100, 103 (Va. 1924).

Virginia courts have further recognized that a preferred dividend right is, by definition, ***in preference to*** the dividend right of other classes or series of shares. In *Kain v. Angle*, the Virginia Supreme Court characterized preferred stock as entitling the holders “to receive dividends from the earnings of the company ***before the common stock can receive a dividend*** from such earnings.” 69 S.E. 355, 357 (Va. 1910) (emphasis added). The Court explained that the preference to dividends is “nothing more than that which is paid to one class of shareholders ***in priority to that to be paid to another class***.” *Id.* (emphasis added) (internal quotation marks omitted) (quoting Cook on Stock & Stockholders (3d ed.) § 267). *See also Drewry, Hughes Co.*, 92 S.E. at 819 (emphasis added) (construing the character and privileges of a preferred dividend to be “***definitely fixed***” and constituting “***a preferred charge over***” and “***in preference to***” the common stock). Thus, the Net Worth Sweep is also invalid and void under Virginia law.[22]

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[22] The Net Worth Sweep goes so far as to impermissibly direct the payment of dividends out of the Companies’ capital reserves. The Net Worth Sweep “Dividend Amount” comprises the entire net worth of the Companies—*i.e.*, total assets less total liabilities. The Companies thus will not maintain any capital account at all in violation of Delaware and Virginia law. *See* 8 *Del. C.* § 170; *Klang v. Smith’s Food & Drug Ctrs., Inc.*, 702 A.2d 150, 153 (Del. 1997)

Accordingly, Counts I and II of Plaintiffs' Complaint state claims upon which relief can be granted under Delaware and Virginia law.

3. The Complaint States Claims Against FHFA and Treasury For Breaches Of Fiduciary Duty

Even if Defendants were correct in their assertion that the Net Worth Sweep is permissible under the DGCL and VSCA as a statutory matter (which they are not), it is a well-settled corporate law principle that "inequitable action does not become permissible simply because it is legally possible."[23] Other than Treasury's specious argument that it is not a controlling stockholder and therefore not a fiduciary of the Companies and their other stockholders (which is addressed immediately below), neither FHFA nor Treasury make any effort to contend that Counts VII-X of the Complaint (which allege that FHFA and Treasury breached their fiduciary duties under Delaware and Virginia law) do not adequately state claims for relief under Rule 12(b)(6).

(Under Section 170 of the DGCL, dividends may only be paid out of "surplus," defined by Section 154 to mean "the excess of net assets over the par value of the corporation's issued stock," or out of net profits); *Quadrant Structured Prods. Co. v. Vertin*, 102 A.3d 155, 200-01 (Del. Ch. 2014) ("Section 170(a) requires that dividends be paid (i) out of surplus or (ii) '[i]n case there shall be no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.'"); VSCA § 13.1-653(C) (barring distributions if the effect of the distribution is corporate inability to pay "debts as they become due in the usual course of business," or if "total assets would be less than the sum of its total liabilities plus . . . the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution"); *Dawyot v. Catawba Capital Mgmt., Inc.*, 82 Va. Cir. 521 (2011) (Under Section 13.1-653, "a corporation cannot make distributions to shareholders if such distributions would prevent a corporation from being able pay its debts as they become due of if its total assets would be less than its total liabilities.").

[23] *See Black v. Hollinger Int'l Inc.,* 872 A.2d 559, 564 (Del. 2005); *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971); *Stickley v. Stickley*, 1997 WL 33622770, at *20 (Va. Cir. Ct. July 22, 1997); *Brown v. Scott Cty. Tobacco Warehouse, Inc.*, 1983 WL 489237, at *3 (Va. Cir. Ct. Feb. 22, 1983).

Contrary to its contentions, Treasury does owe fiduciary duties to the Companies and to their other stockholders because it is the controlling stockholder of both Companies as a result of (1) its ownership of senior preferred stock and warrants to purchase 79.9% of the Companies' common stock, (2) its provision of funds to the Companies, and (3) its "actual control" over FHFA and the business and affairs of the Companies.

Under Delaware law, "[a] shareholder will be considered 'controlling' if it either (1) owns a majority interest in the company or (2) exercises 'actual control' over the board of directors during the course of a particular transaction." *Zimmerman v. Crothall*, 2012 WL 707238, at *11 (Del. Ch. Mar. 5, 2012) (footnotes omitted). "'Actual control' under the second test will be found where a shareholder, or shareholder group, wields such formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control." *Id.* (internal quotation marks and footnotes omitted). Virginia law is in accord with these standards.[24] Treasury is a controlling stockholder under both tests.

First, Treasury is a *de facto* majority stockholder of the Companies by virtue of its senior preferred stock and warrants to purchase 79.9% of the Companies' common stock because Treasury, at its will, can exercise its warrants and become majority stockholder at any time.[25]

[24] *See, e.g., Parsch v. Massey*, 2009 WL 7416040, at *9 (Va. Cir. Ct. Nov. 5, 2009) (finding that plaintiffs had a reasonable basis for alleging that a 16% stockholder was a controlling stockholder because he had significant power over the corporation and used that influence to dictate the terms of a self-interested transaction).

[25] *See, e.g., Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 781 (Del. Ch. 2004) ("In short, it is fairly inferable that Salkind, at her will, can assume practical control over NCT by either exercising her foreclosure rights in default or by converting and becoming a controlling shareholder. In essence, PRG fairly alleges that Salkind is NCT's de facto controlling shareholder and that her interests are being inequitably favored over PRG's and other creditor's interests by a complicit board."); *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 535 (Del. Ch. 2003) (considering stock options in concluding that stockholder was controller).

Second, Treasury has actual control over the Companies pursuant to the PSPAs. Treasury's provision of funds to the Companies during the financial crisis—and its power to cease providing such funds in the event the Companies were not managed to Treasury's liking—granted it substantial influence over their management. Moreover, the terms of the PSPAs (originally and as amended) give Treasury numerous rights that entitle it to exercise pervasive control over the management and affairs of the Companies. By way of example, without the prior written consent of Treasury, neither Company can:

- Declare or pay any dividend (preferred or otherwise) or make any other distribution with respect to any Company equity securities (other than with respect to the senior preferred stock or warrant);

- Redeem, purchase, retire or otherwise acquire any Company equity securities (other than the senior preferred stock or warrant);

- Sell or issue any Company equity securities (other than the senior preferred stock, the warrant and the common stock issuable upon exercise of the warrant and other than as required by the terms of any binding agreement in effect on the date of the senior preferred stock purchase agreement);

- Terminate the conservatorship (other than in connection with a receivership);

- Sell, transfer, lease or otherwise dispose of any assets, other than dispositions for fair market value, subject to limited exceptions;

- Incur additional indebtedness or issue any subordinated debt;

- Enter into a reorganization, recapitalization, merger, acquisition or similar event; or

- Enter into any new compensation arrangements or increase amounts or benefits payable under existing compensation arrangements for any executive officers (as defined by SEC rules) without the consent of the Director of FHFA, in consultation with the Secretary of the Treasury.[26]

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[26] Fannie Mae, 2008 Annual Report (Form 10-K), at 28-29 (Feb. 26, 2009); Freddie Mac, 2008 Annual Report (Form 10-K), at 25-26 (March 11, 2009); *see also* Fannie Mae, 2014 Annual Report (Form 10-K), at 28 (Feb. 20, 2015); Freddie Mac, 2014 Annual Report (Form 10-K), at 23 (Feb. 19, 2015).

In fact, the Companies' SEC filings explicitly state that Treasury's consent rights under the PSPAs "***significantly restrict [the Companies'] business activities*** and require the prior written consent of Treasury before [the Companies] can take certain actions. These covenants prohibit [the Companies] from taking a number of actions[.]"[27] Stockholders with far less control than Treasury possesses over the Companies have been found to be controllers under Delaware and Virginia law.[28] There is no reason to reach a different conclusion here.

Perhaps the strongest evidence that Treasury exercised actual control over FHFA with respect to the Net Worth Sweep is the Net Worth Sweep itself, which benefits Treasury exclusively to the detriment of the Companies and all other stockholders. The Net Worth Sweep transfers to Treasury, in perpetuity, every penny that the Companies earn while leaving the principal of the Companies' obligation to Treasury untouched; it was entered into at the precise moment when the Companies were returning to profitability; and it provides the Companies with no relief from their obligation to pay cash dividends that they did not already enjoy. Only a

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[27] Fannie Mae, 2014 Annual Report (Form 10-K), at 28 (Feb. 20, 2015) (emphasis added); *see also* Freddie Mac, 2014 Annual Report (Form 10-K), at 23 (Feb. 19, 2015).

[28] *See, e.g., Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110 (Del. 1994) (upholding lower court's finding that 43.3% minority stockholder dominated corporation and, therefore, owed fiduciary duties as a controlling stockholder); *Hamilton Partners, L.P. v. Highland Capital Mgmt., L.P.*, 2014 WL 1813340, at *13-14 (Del Ch. May 7, 2014) (finding it reasonably conceivable that stockholder, who held 48% of the company's stock and 82% of its debt, was controlling stockholder); *In re Loral Space & Commc'ns Inc.*, 2008 WL 4293781, at *21 (Del. Ch. Sept. 19, 2008) (concluding that a minority stockholder was controller because, among other reasons, it possessed practical power over the corporation and that power "shaped the process for considering and approving the [interested transaction]"); *In re Cysive*, 836 A.2d at 551-53 (finding that an individual stockholder, who with his family members, held close to 40% of the corporation's voting power through stock and options and who had two representatives on a five-member board was a controlling stockholder); *Parsch,* 2009 WL 7416040, at *14 (finding there was reasonable basis to believe that a 16% stockholder, who was neither a manager nor a director of the corporation, was nonetheless a controlling stockholder).

conservator that was so dominated that it lacked the will or power to exercise its independent judgment would agree to forfeit so much for no additional consideration. Compl. ¶¶ 158, 166.

Accordingly, the Complaint adequately pleads that Treasury is the Companies' controlling stockholder and owes fiduciary duties to them and their stockholders.

C. Plaintiffs' Claims Against Treasury Are Not Barred By Sovereign Immunity

Plaintiffs' claims against Treasury fall squarely within the waiver of sovereign immunity set forth in the Administrative Procedure Act ("APA"):

> [a]n action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be denied on the ground that it is against the United States . . . .

5 U.S.C. § 702.[29] "[T]he waiver of sovereign immunity contained in § 702 is not limited to suits brought under the APA." *Treasury of New Jersey v. U.S. Dep't of Treasury*, 684 F.3d 382, 399 (3rd Cir. 2012). Rather, it "eliminate[s] the defense of sovereign immunity in *any* action in a federal court seeking relief other than money damages and stating a claim based on the assertion of unlawful official action by an agency or by an officer or employee of that agency." *Id.* at 400. Treasury argues that this sweeping waiver of sovereign immunity does not apply to state law claims and does not permit the relief Plaintiffs seek here.[30] Both arguments lack merit.

Treasury's argument that the APA waiver is limited to federal law claims is foreclosed by controlling precedent. Indeed, in *Treasurer of New Jersey*, the Third Circuit squarely rejected the precise argument Treasury makes here:

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[29] Because FHFA has not invoked sovereign immunity, that doctrine would not bar compensatory damages or any of the other relief Plaintiffs seek against FHFA.

[30] Treasury also argues that the APA waiver of sovereign immunity is unavailable here because (it claims) 12 U.S.C. § 4617(f) bars the relief Plaintiffs' seek. Treasury Br. 10–11. But as demonstrated below, section 4617(f) does not bar the relief Plaintiffs' seek.

> The Government contends that the [APA] waiver of sovereign immunity should be limited to actions brought under federal law rather than state law as the States have done here to the extent that they seek relief under their unclaimed property acts. Though in view of the circumstance that most cases against the Government are under federal law so that Congress probably was focused on that law when it adopted the 1976 amendments to the APA, we see no support for the distinction that the Government makes between federal and state law in either the text or the history of section 702.

684 F.3d at 400 n.19. The state-law character of Plaintiffs' claims is thus irrelevant to the broad APA waiver of sovereign immunity.

Nor does the limitation of the APA waiver to "relief other than money damages" foreclose the relief Plaintiffs seek. This language does not bar all forms of monetary relief. As the Supreme Court has explained, "Congress employed this language to distinguish between specific relief and compensatory, or substitute, relief." *Dep't of the Army v. Blue Fox, Inc.*, 525 U.S. 255, 261 (1999). As used in Section 702, "[t]he term 'money damages' . . . refers to a sum of money used as compensatory relief. Damages are given to the plaintiff to substitute for a suffered loss, whereas specific remedies are not substitute remedies at all, but attempt to give the plaintiff the very thing to which he was entitled." *Id.* at 262 (internal quotation marks omitted). Accordingly, "[t]he fact that a judicial remedy may require one party to pay money to another is not a sufficient reason to characterize the relief as 'money damages.'" *Bowen v. Massachusetts*, 487 U.S. 879, 893 (1988); *see also Treasurer of New Jersey*, 684 F.3d at 400 n.20.

While Section 702 may not permit this Court to require Treasury to pay compensatory damages to Plaintiffs, it certainly permits the Court to require Treasury to return to Fannie and Freddie the unlawful "dividends" extracted pursuant to the Net Worth Sweep. *Compare* Compl., Prayer for Relief (C), (I), *with Bowen*, 487 U.S. at 895-96 ("describing an action to compel an official to repay money improperly recouped as in essence, specific relief") (quotation marks and

citation omitted).[31] Nor would it bar other injunctive and declaratory relief against Treasury, *see*, *e.g*., Compl. Prayer for Relief (C), (D), (H), including "further relief" that is "just and proper," *id.,* Prayer for Relief (L), such as an injunction requiring that the unlawful "dividends" paid to Treasury be deducted from the value of Treasury's outstanding liquidation preference.[32]

D. Plaintiffs' Claims Are Not Barred By HERA

Defendants contend that HERA's limitation on judicial review, 12 U.S.C. § 4617(f), prohibits all claims for equitable relief that in any way touch on the Net Worth Sweep. It does not. Courts embrace a "strong presumption that Congress intends judicial review of administrative action," *Bowen v. Michigan Acad. of Family Physicians*, 476 U.S. 667, 670 (1986), and the Court should only conclude that judicial review of administrative action is

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[31] *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002), does not hold otherwise. That case did not address the meaning of Section 702, but rather a provision of ERISA limiting judicial redress to "equitable relief" (as opposed to legal relief). *Id*. at 209–10. Indeed, the Court in *Great-West* expressly distinguished its prior holding in *Bowen v. Massachusetts* "that the provision of the Administrative Procedure Act that precludes actions 'seeking money damages' against federal agencies, 5 U.S.C. § 702, does not bar a State from seeking specific relief to obtain money" from a federal agency on the ground that the interpretation of Section 702 "did not turn on distinctions between 'equitable actions and other actions . . . but rather [on] what Congress meant by 'other than money damages' in the Administrative Procedure Act." *Great-West*, 534 U.S. at 212 (internal quotation marks omitted).

[32] In two confusing footnotes, Treasury argues that "[t]he APA's waiver of sovereign immunity does not . . . confer jurisdiction over claims premised solely on state law, like plaintiffs' claims here," Treasury Br. 11, n.6, and that none of the statutes on which Plaintiffs rely for jurisdiction "create[s] a federal cause of action against Treasury," *id.* at 12, n.7. These footnotes appear to be intended solely to support Treasury's mistaken argument that Section 702's waiver of sovereign immunity does not apply to state law claims such as those asserted by Plaintiffs here. In all events, Plaintiffs do not rely on the APA as a basis for subject matter jurisdiction—which they have more than adequately alleged. *See* Compl. ¶ 22. For example, the sue-and-be-sued provisions in Fannie Mae's and Freddie Mac's charters provide subject matter jurisdiction for the claims against FHFA as conservator, *see Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust ex rel. Fed. Nat. Mortg. Ass'n v. Raines*, 534 F.3d 779, 784-85 (D.C. Cir. 2008); 12 U.S.C. § 4617(b)(2)(A), and the claims against Treasury are so related to the claims against FHFA as to form part of the same case or controversy, *see* 28 U.S.C. § 1367. Nor need Plaintiffs identify a *federal* cause of action to assert *state* law claims such as those at issue here.

unavailable "if presented with clear and convincing evidence" that this was Congress' intent. *Reno v. Catholic Soc. Servs. Inc.*, 509 U.S. 43, 63–64 (1993) (quotation marks omitted). Plaintiffs' claims establish that FHFA contravened and exceeded its authority under HERA in implementing the Net Worth Sweep, and Section 4617(f) poses no barrier to equitable relief that simply enforces HERA's limits on FHFA's authority. Nor does Section 4617(f) preclude Plaintiffs' claims against Treasury, for insisting that Treasury honor its own legal obligations does not restrain or affect FHFA's exercise of its conservatorship powers.[33]

1. Section 4617(f) Does Not Bar Plaintiffs' Claims for Equitable Relief Against FHFA.

a. Section 4617(f) Does Not Insulate Conduct That Exceeds or Contravenes FHFA's Authority Under HERA.

Section 4617(f) applies only to actions that would "restrain or affect *the exercise of powers or functions of [FHFA] as conservator or receiver*." (emphasis added). This statute "is inapplicable when FHFA acts beyond the scope of its conservator power."[34] Indeed, even the district court opinion in *Perry Capital*, upon which Defendants repeatedly rely, acknowledged that Section 4617(f) does not bar injunctive relief if FHFA " 'has acted or proposes to act beyond, or contrary to, its statutorily prescribed, constitutionally permitted, powers or functions.' "[35]

These interpretations mirror judicial treatment of Section 1821(j)—the virtually identical provision of the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") on

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[33] By its terms, Section 4617(f) only applies to claims for equitable relief, *see* 12 U.S.C. § 4617(f), and Defendants do not contend otherwise. Thus, even if section 4617(f) did bar Plaintiffs' claims for equitable relief, it would have no effect on Plaintiffs' claims for damages.

[34] *Cnty. of Sonoma v. FHFA*, 710 F.3d 987, 992 (9th Cir. 2013); *see also Leon Cnty. v. FHFA*, 700 F.3d 1273, 1278 (11th Cir. 2012); *Town of Babylon v. FHFA*, 699 F.3d 221, 228 (2d Cir. 2012).

[35] 70 F. Supp. 3d at 220 (quoting *National Trust for Historic Pres. in United States v. FDIC*, 21 F.3d 469, 472 (D.C. Cir. 1994)); *accord Cnty. of Sonoma*, 710 F.3d at 992.

which Section 4617(f) was modeled—as illustrated by *Perry Capital*'s quotation from *National Trust for Historic Preservation*, a leading case interpreting Section 1821(j). *Sharpe v. FDIC*, 126 F.3d 1147 (9th Cir. 1997), is illustrative. In that case, the Ninth Circuit concluded that "the FDIC did not act within its statutorily granted powers" when it breached a contract and therefore held that Section 1821(j) did not bar equitable relief relating to that breach. *Id.* at 1155; *see also Bank of Manhattan, NA v. FDIC*, 778 F.3d 1133, 1136–37 (9th Cir. 2015) (same).[36]

"FHFA cannot evade judicial scrutiny by merely labeling its actions with a conservator stamp."[37] The Court "must consider all relevant factors pertaining to the [Net Worth Sweep] to determine whether it was [implemented] pursuant to the FHFA's powers as conservator," including "its subject matter, its purpose, [and] its outcome." *Leon Cnty*, 700 F.3d at 1278.

The Third Circuit's precedents are consistent with this analysis. To be sure, Defendants invoke language from *Gross v. Bell Sav. Bank PaSA*, 974 F.2d 403 (3d Cir. 1992), stating, in the course of addressing Section 1821(j)'s application to the Resolution Trust Corporation ("RTC") acting as conservator or receiver pursuant to FIRREA, that "federal courts have the ability to restrain the RTC where the Corporation is acting clearly outside its statutory powers." *Id.* at 407. But *Gross* cannot reasonably be understood to suggest that the RTC—and, by analogy, the FHFA—may exceed its authority so long as its conduct is not *too obviously* unlawful. After all,

[36] Defendants invoke the D.C. Circuit's statement in *Freeman v. FDIC*, 56 F.3d 1394 (D.C. Cir. 1995), that Section 1821(j) "effect[s] a sweeping ouster of courts' power to grant equitable remedies." *Id.* at 1399. The court stated this, however, in the course of holding that Section 1821(j) applies not merely to injunctions but also to the remedies of rescission and declaratory relief. *See id.* The fact that the set of *remedies* that Section 1821(j) forecloses is "sweeping" does not mean that a conservator may violate or exceed its statutory authority with impunity.

[37] *Leon Cnty.*, 700 F.3d at 1278; *see also County of Sonoma*, 710 F.3d at 994 ("FHFA cannot evade judicial review . . . simply by invoking its authority as conservator."); *Chemical Futures & Options, Inc. v. RTC*, 832 F. Supp. 1188, 1192–93 (N.D. Ill. 1993) ("[S]ection 1821(j) does not elevate the FDIC to the position of a sacred cow which may graze upon the rights of others at will, unchecked by the courts.").

FHFA either violated HERA when it executed the Net Worth Sweep, or it did not. Conduct that violates HERA is clearly beyond the scope of FHFA's powers and functions under HERA. Indeed, the Supreme Court has squarely rejected the notion that any meaningful distinction can be drawn between an agency acting unlawfully and an agency acting beyond the scope of its powers, explaining that agencies' "power to act and how they are to act is authoritatively prescribed by Congress, so that when they act improperly, no less than when they act beyond their jurisdiction, what they do is ultra vires." *City of Arlington v. FCC*, 133 S. Ct. 1863, 1869 (2013). Any suggestion that a federal court may not enjoin FHFA from violating the very statute from which it derives its authority cannot be reconciled with *City of Arlington*.[38] Thus, before the Court can determine whether Section 4617(f) has any applicability to the claims in this lawsuit, it must first determine whether the Net Worth Sweep was within FHFA's authority as conservator. *See, e.g.*, *County of Sonoma*, 710 F.3d at 994 ("Analysis of any challenged action is necessary to determine whether the action falls within the broad, but not infinite, conservator authority."). Any other reading of Section 4617(f) would render meaningless the enumerated and carefully circumscribed list of conservatorship powers that appears in 12 U.S.C. § 4617(b).[39]

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[38] The Third Circuit's decision in *Rosa v. RTC*, 938 F.2d 383 (3rd Cir. 1991), addressed allegations that the RTC violated another federal statute (ERISA) rather than FIRREA. *See id.* at 397. And *Hindes v. FDIC*, 137 F.3d 148 (1998), discussed more fully below, addressed the limited circumstances in which Section 1821(j) applies to parties other than the federal conservator or receiver. Both decisions are fully consistent with the understanding of Section 4617(f) set forth in the text.

[39] Defendants invoke isolated language from *Ward v. RTC*, 996 F.2d 99 (5th Cir. 1993), and a handful of similar cases suggesting that Section 1821(j) applies even when the conservator or receiver acts unlawfully. *See* Treasury Br. 16; FHFA Br. 16-17, n.11. For example, in *Ward*, the court purported to distinguish "between the exercise of a function or power that is clearly outside the statutory authority of the [conservator or receiver] on the one hand, and improperly or even unlawfully exercising a function or power that is clearly authorized by statute on the other." 996 F.2d at 103. *Ward* and other, similar cases are best understood to mean only that Section 1821(j) applies even when a conservator or receiver violates some law *other* than FIRREA.

b. The Net Worth Sweep Exceeds and Contravenes FHFA's Authority Under HERA.

In addition to enumerating specific powers that FHFA may exercise as conservator or receiver, HERA provides that when FHFA assumes control of Fannie or Freddie in either capacity, it "immediately succeed[s] to . . . all rights, titles, powers, and privileges *of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity* . . . ," may "take over the assets of and operate the regulated entity *with all the powers of the shareholders, the directors, and the officers of the regulated entity* and conduct all business of the regulated entity," and may "perform all functions of the regulated entity *in the name of the regulated entity* which are consistent with the appointment as conservator or receiver." 12 U.S.C. §4617(b)(2)(A), (B) (emphases added). As conservator, then, FHFA "steps into the shoes" of Fannie and Freddie, "obtaining the rights [of those entities] that existed prior to [conservatorship]." *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 86 (1994). "Essentially, the powers of the directors, officers, and shareholders of the entity in conservatorship are transferred to the conservator . . . ." *Leon County*, 700 F.3d at 1278-79; *accord Massachusetts v. FHFA*, 54 F. Supp. 3d at 100; *County of Sonoma*, 710 F.3d at 993.

Given the terms of the general authority that HERA transfers from Fannie and Freddie to FHFA, then, it follows that FHFA may not take actions as conservator that Fannie and Freddie could not themselves have taken—actions including paying illegal preferred dividends, breaching contracts, and violating fiduciary duties—unless those actions are specifically authorized by other provisions of the statute. As the Ninth Circuit explained in rejecting an assertion of authority in the closely analogous context of FIRREA, while "[i]t is true that some provision in the extensive framework of FIRREA might, in theory, afford the FDIC as receiver greater powers than those possessed by a failed financial institution," to "permit the FDIC to

succeed to powers greater than those held by the insolvent bank" in the absence of such a provision would be "an implausible result when FIRREA provides that the FDIC, as receiver, 'shall . . . succeed to . . . all rights, titles, powers, and privileges of the insured depository institution.'"[40] It follows that when FHFA is exercising the "rights, titles, powers, and privileges" of Fannie and Freddie and its officers and directors, it must comply with the same corporate charters, bylaws, state laws, and other rules that governed these entities' officers and directors prior to the conservatorship. Indeed, in the analogous context of FIRREA, the Third Circuit has held that the FDIC as receiver must comply with corporate bylaws, including provisions relating to the indemnification of employees' legal expenses. *Ridder v. City Fed Fin. Corp.*, 47 F.3d 85, 86–87 (3d Cir. 1995); *see also Fleischer v. FDIC*, 70 F. Supp. 2d 1238, 1241–43 (D. Kan. 1999) (same).[41]

Fannie Mae's and Freddie Mac's bylaws incorporate, and require these entities to comply with, Delaware and Virginia corporation law, respectively. *See supra* Part B.1.[42] The Net Worth

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[40] *Bank of Manhattan*, 778 F.3d at 1136 (quoting 12 U.S.C. § 1821(d)(2)(A)) (quotation marks omitted); *see also O'Melveny & Myers*, 512 U.S. at 86-87 ("It is hard to avoid the conclusion that § 1821(d)(2)(A)(i) places the FDIC in the shoes of the insolvent S&L, to work out its claims under state law, except where some provision in the extensive framework of FIRREA provides otherwise."); *Sharpe*, 126 F.3d at 1156 (similar).

[41] Article 8 of Fannie's bylaws provides that "[n]othing in these Bylaws shall be deemed to affect the regulatory or conservatorship powers of the Federal Housing Finance Agency under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Title XIII, P.L. 102-550, as amended by the Federal Housing Finance Regulatory Reform Act of 2008, P.L. 110-289." Ex. A, Corporate Governance Practices & Procedures, Art. 8, available at www.fanniemae.com/resources/file/aboutus/pdf/bylaws.pdf. While this bylaw presumably applies when FHFA exercises specific statutory powers as a conservator other than those general powers derived from Fannie, it cannot reasonably be read to suggest that FHFA may exercise the powers of Fannie's officers and directors without regard to the limitations and rules that define those powers. In all events, Freddie does not have a similar provision in its bylaws.

[42] *See Ridder*, 47 F.3d at 86–87; *Fleischer*, 70 F. Supp. 2d at 1242–43; *cf. Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Raines*, 534 F.3d 779, 783 n.1 (D.C. Cir. 2008).

Sweep is flatly inconsistent with controlling principles of Delaware and Virginia corporation law. *See supra* Part B.2. In implementing the Net Worth Sweep, FHFA thus did not exercise rights of Fannie and Freddie "that existed prior to [conservatorship]." *O'Melveny & Myers*, 512 U.S. at 86. Rather, it purported to exercise "powers greater than those held by" Fannie and Freddie. *Bank of Manhattan*, 778 F.3d at 1136. It thus exceeded and violated its statutory authority under Section 4617(b)(2) of HERA.

FHFA exceeded and violated this authority for another reason as well. It is a well-settled principle of Delaware law "that the DGCL, the certification of incorporation, and the bylaws together constitute a multi-party contract among the directors, officers, and stockholders of the corporation."[43] Under Virginia law, as well, "the VSCA [Virginia Stock Corporation Act] is deemed a part of the contract between a corporation and its shareholders,"[44] and "[c]orporate bylaws when not in contravention of any statute have all of the force of contracts as between the corporation and its members and as between the members themselves."[45]

HERA provides a specific mechanism though which FHFA, as conservator, may repudiate Fannie Mae's and Freddie Mac's contractual obligations. *See* 12 U.S.C. § 4617(d). FHFA may exercise this mechanism only "within a reasonable period following [its] appointment" as conservator, *id.* § 4617(d)(2), and it is liable for "actual direct compensatory damages" arising from the repudiation, *id.* § 4617(d)(3)(A)(i); *see also* 12 CFR § 1237.5 (defining "a reasonable period . . . as a period of 18 months following the appointment of a conservator or receiver"). FHFA lacks authority under HERA to breach Fannie Mae's and

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[43] *Allen v. El Paso Pipeline GP Co.*, LLC, 90 A.3d 1097, 1107 (Del. Ch. 2014); *see also, e.g., Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 940 (Del. Ch. 2013).

[44] *Firestone v. Wiley*, 485 F. Supp. 2d 694, 705 (E.D. Va. 2007).

[45] *Lee v. Virginia Education Association, Inc.*, 2 Va. Cir. 319, 1969 WL 101681, at *1 (1969).

Freddie Mac's contractual obligations without following this statutory mechanism. As the Ninth Circuit explained in the analogous context of FIRREA, "the FDIC can escape the obligations of contracts . . . only through the prescribed mechanism. Section 1821(e) allows the FDIC to disaffirm or repudiate any contract it deems burdensome and pay only compensatory damages. FIRREA does not permit the FDIC to breach contracts at will." *Sharpe,* 126 F.3d at 1155; *see also Bank of Manhattan*, 778 F.3d at 1135 (same). FHFA did not comply with the requirements of Section 4617(d) for repudiating Fannie Mae's and Freddie Mac's contractual obligations to their shareholders to comply with their bylaws and with governing principles of state corporation law. In implementing the Net Worth Sweep in violation of these contractual obligations, FHFA thus "did not act within its statutorily granted powers," and its actions "cannot be considered a statutorily authorized function" under HERA. *Sharpe*, 126 F.3d at 1155. Accordingly, Section 4617(f) does not bar "equitable claims related to [FHFA's] contractual breaches." *Bank of Manhattan*, 778 F.3d at 1135.[46]

As the foregoing discussion makes clear, Plaintiffs do not seek to "avoid" Section 4617(f) "by alleging that the Conservator did a bad job or acted based on an improper motive." FHFA Br. 16. Nor do Plaintiffs seek to "evade" this statute "by arguing that FHFA violated some other law." *Id*. at 17. Rather, Plaintiffs' contend that FHFA contravened and exceeded its statutory authority under HERA itself both by purporting to exercise powers that exceeded those it inherited from Fannie and Freddie pursuant to this statute and also by breaching these entities' contractual obligations to their shareholders without following the statutory requirements prescribed by HERA for repudiating such obligations. Accordingly, the various cases invoked by

[46] Section 4617(f) similarly does not bar equitable relief relating to Counts III–VI, which assert that FHFA's implementation of the Net Worth Sweep constituted breaches of contract and the implied covenant of good faith and fair dealing.

FHFA holding that Section 4617(f) (or its FIRREA analog) bars equitable relief where Plaintiffs argue only that a conservator did not properly exercise otherwise-legitimate powers, violated provisions of other law, or acted with a bad motive are wholly inapposite here.

c. FHFA's Asserted Statutory Authorizations for the Net Worth Sweep All Lack Merit.

FHFA attempts to justify the Net Worth Sweep as an exercise of its statutory power to operate Fannie and Freddie and conduct their business, FHFA Br. 13–15, and of its power to transfer or sell any asset of the enterprises, *id*. at 15–16. FHFA also relies on what it describes as its power to act in the manner it determines is in the best interests of the enterprises or FHFA. *Id*. at 13–15.[47] None of these statutory authorities confers upon FHFA the power effectively to nationalize the Companies by transferring all of their net worth and future earnings to Treasury.

FHFA's reliance on this statutory authority fails for another reason as well. When FHFA acts as conservator, HERA imposes an additional limitation on FHFA's power "to carry on the business" of Fannie and Freddie, directly linking this power with FHFA's duty to "preserve and conserve [their] assets and property."[48] Far from preserving and conserving Fannie's and Freddie's assets, the Net Worth Sweep does the precise opposite, transferring all of these entities' net worth to the government.

Nor can the Net Worth Sweep be sustained as an exercise of FHFA's authority under

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[47] FHFA also invokes what it describes as its authority to "enter into contracts on behalf of the enterprises." FHFA Br. 13. But FHFA does not cite the statutory provision to which it appears to be alluding. That provision provides only that FHFA may "provide by contract for assistance *in fulfilling any function, activity, action, or duty of the Agency as conservator or receiver*." 12 U.S.C. § 4617(b)(2)(B)(v) (emphasis added). This provision does not confer upon FHFA an unqualified power to enter into whatever contracts it chooses, but only the incidental power to enter into contracts that further FHFA's *other* powers and duties as conservator or receiver.

[48] 12 U.S.C. § 4617(b)(2)(D) ("The Agency may, as conservator, take such actions as may be . . . appropriate to carry on the business of the regulated entity *and preserve and conserve the assets and property of the regulated entity*.") (emphasis added).

HERA to "transfer or sell any asset" of Fannie or Freddie "without any approval, assignment, or consent." 12 U.S.C. § 4617(b)(2)(G)).[49]

First, Section 4617(b)(2)(G) specifies that FHFA may only transfer assets "*as conservator or receiver*," (emphasis added), and FHFA was not acting in either capacity when it transferred the entirety of the Fannie Mae's and Freddie Mac's residual economic value from private investors to another government agency in exchange for virtually nothing. To the contrary, when FHFA transfers Fannie Mae's or Freddie Mac's assets, HERA specifically requires it to "maximize[ ] the net present value return" the company receives, *id.* § 4617(b)(11)(E)(i), something that the Net Worth Sweep plainly did not do. Moreover, in the conservatorship context, HERA instructs FHFA to take actions necessary and appropriate to "put [Fannie and Freddie] in a sound and solvent condition" and to "preserve and conserve [their] assets and property." *Id.* § 4617(b)(2)(D). As FHFA has acknowledged, these statutes require it to use its powers to "rehabilitate" the Companies for eventual return to normal business operations. 76 Fed. Reg. at 35,730. The Net Worth Sweep has the purpose and effect of preventing the Companies from ever rebuilding capital so that they could return to private control, and FHFA as conservator lacks the authority to "transfer assets" to *prevent*, rather than to *promote*, rehabilitation of the Companies.

Second, FHFA's contention that the law "does not provide any limitation" on its

[49] This provision governing FHFA's power to dispose of Fannie's and Freddie's assets must be read in conjunction with Section 4617(b)(2)(B)(i), which provides that as conservator, FHFA may "take over the assets of . . . the regulated entity *with all the powers of the shareholders, the directors, and the officers of the regulated entity* . . . ." (emphasis added). It follows that FHFA may exercise no greater control over Fannie's and Freddie's assets than could have Fannie and Freddie themselves before the conservatorship. These Companies could not have disposed of their entire net worth in violation of their bylaws and their contractual obligations to comply with Delaware and Virginia corporate law, and Section 4617(b)(2)(G) cannot reasonably be understood to authorize FHFA to do what Fannie and Freddie could not.

authority to transfer the Companies' assets, FHFA Br. 15, would allow it to completely ignore HERA's detailed procedures and order of priorities for the distribution of assets during liquidation, *see* 12 U.S.C. § 4617(b)(3)–(9), (c). Under FHFA's reading of HERA's transfer provision, for example, during a liquidation the agency would be free to transfer the Companies' assets to subordinated debtholders before paying general creditors, in direct contravention of 12 U.S.C. § 4617(c)(1)(B). The Supreme Court rejected a construction of language in FIRREA's predecessor that would have made nonsense out of other provisions of the same Act, and FHFA's reading of HERA's transfer provision should similarly be rejected.[50] Interpreting the transfer provision in a way that would allow FHFA to eviscerate HERA's order of priorities during receivership is particularly untenable since this reading of the statute would raise grave constitutional concerns by permitting the agency to take private property without paying just compensation. *See United States v. Security Indus. Bank*, 459 U.S. 70, 78–82 (1982) (construing statute narrowly to avoid takings difficulty).

FHFA attempts to prop up its reading of the transfer provision by citing various cases in which courts ruled that FIRREA barred plaintiffs from suing receivers to enjoin specific transfers of assets. FHFA Br. 15–16 & n.10 (citing, *inter alia, Gosnell v. FDIC*, 1991 WL 533637, at *6 (W.D.N.Y. Feb. 4, 1991)). But these cases all involved routine transfers of discrete assets. None of these cases involved self-dealing and waste on the scale alleged here, let alone held or suggested that a federal conservator or receiver may transfer its ward's entire net worth to another entity, effectively nullifying HERA's specific distribution requirements as well as the statutory requirements that a conservator take actions to place its ward "in a sound and solvent condition" and "preserve and conserve [its] assets and property." 12 U.S.C. § 4617(b)(2)(D).

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[50] *See Coit Independence Joint Venture v. Fed. Sav. & Loan Ins. Corp.*, 489 U.S. 561, 573–74 (1989); *King v. Burwell*, 135 S. Ct. 2480, 2495 (2015).

Nor do FHFA's cases suggest that conduct such as that at issue here would escape review. *See, e.g.*, *Gosnell*, 1991 WL 533637, at *6 (observing that receiver is not "wholly above the law" and that "truly ultra vires or arbitrary and capricious acts on its part may be enjoined").

Finally, the Net Worth Sweep cannot be sustained as an exercise of the FHFA's "[i]ncidental power[ ]" to "take *any action authorized by this section*, which the Agency determines is in the best interests of the regulated entity or the Agency." 12 U.S.C. § 4617(b)(2)(J) (emphasis added). As the italicized language makes clear, the incidental power to take actions that FHFA determines are in the best interests of FHFA or Fannie and Freddie is limited to actions otherwise authorized by HERA.

d. The District Court's Decision in *Perry Capital* Does Not Support Defendants' Argument That Section 4617(f) Bars Plaintiffs' Claims.

Defendants repeatedly trumpet the court's decision in *Perry Capital*—an appeal of which is currently pending in the D.C. Circuit—which rejected a challenge to the Net Worth Sweep. But the *Perry Capital* court did not have occasion to consider the argument that, as conservator, FHFA contravened and exceeded its authority under HERA by agreeing to the Net Worth Sweep in violation of state law governance principles. *See supra* Part D.1.b. Nor did the court in *Perry Capital* consider the argument that even during conservatorship the Companies are contractually bound to comply with their bylaws and with provisions of Delaware and Virginia corporation law governing their relationship with stockholders, and that it is well-settled that FHFA may be enjoined from breaching the Companies' contracts during conservatorship. *See supra id*. The plaintiffs in *Perry Capital* did not press these arguments, and Defendants are simply mistaken when they suggest that *Perry Capital* disposes of them.

In all events, the *Perry Capital* decision is hopelessly flawed. The *Perry Capital* court

held that FHFA had acted within its statutory authority simply because "both GSEs continue to operate, and have now regained profitability." 70 F. Supp. 3d at 227. But HERA places clear limits on a conservator's authority that have nothing to do with profitability. As conservator, FHFA is obliged to put the Companies "in a sound and solvent condition" and to manage their affairs so as to "preserve and conserve [their] assets and property," 12 U.S.C. § 4617(b)(2)(D). Transferring all of Fannie's and Freddie's net worth, in perpetuity, to Treasury and leaving those companies just one bad quarter away from insolvency simply cannot be reconciled with FHFA's statutory duties and authority as a conservator.[51]

2. Section 4617(f) Does Not Bar Plaintiffs' Claims for Equitable Relief Against Treasury.

Though HERA includes no provision limiting judicial review of claims against Treasury, Treasury nevertheless argues that Section 4617(f) bars judicial review of its conduct relating to the Net Worth Sweep because the relief Plaintiffs request against Treasury would "affect" FHFA's power to enter into the Net Worth Sweep. Treasury Br. 17. This case underscores the troubling sweep of Treasury's argument, which would empower FHFA to use contracts to immunize third parties—including other federal agencies—from their own, independent legal obligations. On Treasury's view, FHFA could effectively suspend any law simply by entering into a contract obliging a third party to violate it.

Section 4617(f) does not require any such absurd result. As the Supreme Court has explained in an analogous context, the word "affect" reaches only "collateral attacks attempting to restrain the receiver from carrying out its basic functions." *Coit*, 489 U.S. at 575. Relieving

[51] *Continental Western Insurance Company v. FHFA*, 83 F. Supp. 3d 828 (S.D. Iowa 2015), stated in passing *dicta* that it agreed with the *Perry Capital* court's conclusion that FHFA acted within its statutory authority in implementing the Net Worth Sweep. *See* 83 F. Supp. 3d at 840 n.6. The court's *dicta* adds nothing to the flawed analysis of *Perry Capital*.

Treasury from its contractual and common law duties as the Companies' dominant shareholder is not among those basic functions, and the word "affect" in Section 4617(f) cannot be used to bootstrap that or any other power onto the carefully circumscribed list of conservatorship powers found elsewhere in HERA. *See id.* at 574.

Treasury cites several cases in which courts refused to enjoin third parties on the ground that doing so would have indirectly affected a federal conservator's or receiver's exercise of its powers. Treasury Br. 17 & n.11. But in each of these cases, the plaintiffs were at bottom challenging the conduct or attempting to enforce the legal obligations of the *federal conservator or receiver or its ward*, not the conduct or legal obligations of an independent third party. *Hindes v. FDIC*, 137 F.3d 148, 160–61 (3d Cir. 1998), is illustrative. In that case, the plaintiffs sought to belatedly challenge the appointment of the FDIC as receiver for Meritor Savings Bank by suing both the FDIC in its corporate capacity and Pennsylvania's Secretary of Banking, who had appointed FDIC receiver. In an alternative holding that it cautioned "should not be overread," the Third Circuit said that the plaintiffs could not obtain a declaration of invalidity and rescission of a finding, made by FDIC in its corporate capacity, that "Meritor was operating in an unsafe and unsound condition," thus triggering the receivership, since such relief "would throw into question every act of FDIC-Receiver." *Id.* at 159, 161. Nor could plaintiffs obtain "rescission of the Secretary's appointment of a receiver, because it would wholly prevent the FDIC from continuing as receiver." *Id.* at 168. In other words, the *Hindes* plaintiffs effectively were challenging the very appointment of the receiver and the continuing validity of the receivership. Accordingly, the court did not have occasion to decide the question presented here—whether a federal conservator's contract with an independent third party can relieve the third party of its own distinct legal obligations that it did not inherit from the conservator or its

ward. Treasury's other cases similarly fail to address this question.[52]

In contrast to the claims at issue in *Hindes* and Treasury's other cases, Plaintiffs' claims against Treasury allege that Treasury's *own* conduct was unlawful. Other courts have concluded that FIRREA's analogous provision did not apply under similar circumstances, and this Court should likewise hold that Section 4617(f) is inapplicable.[53]

3. HERA Does Not Bar Stockholders From Prosecuting Claims During The Conservatorships.

Treasury contends that Plaintiffs' claims are "purely derivative" in nature and that, as such, they are barred under HERA. Treasury Br. 19. Treasury is mistaken on both fronts. Plaintiffs' claims are not "purely derivative" under the standard established in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1037 (Del. 2004), and, even if they were, HERA does not bar derivative claims where, as here, FHFA has a manifest conflict of interest.

a. Plaintiffs Have Stated Direct Claims For Relief

Under *Tooley*, "whether a stockholder's claim is derivative or direct" turns on two questions: "(1) who suffered the alleged harm (the corporation or the suing stockholders,

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[52] *See Telematics Int'l, Inc. v. NEMLC Leasing Corp.*, 967 F.2d 703, 707 (1st Cir. 1992) (plaintiff's claim turned on validity of debt held by bank subsequently placed in receivership, not the independent legal obligations of third party that contracted with receiver); *Kuriakose v. Fed. Home Loan Mortg. Co.*, 674 F. Supp. 2d 483, 493–94 (S.D.N.Y. 2009) (plaintiff's claim concerned Freddie's contractual obligations during conservatorship); *In re Fed. Home Loan Mortg. Corp. Deriv. Litig.*, 643 F. Supp. 2d 790, 799 (E.D. Va. 2009) (suggesting that it would impermissibly "affect" conservator's exercise of powers to forbid FHFA to represent Fannie Mae in shareholder derivative suit in which FHFA did not have conflict of interest).

[53] *See Stommel v. LNV Corp.*, 2014 WL 1340676, at *5 (D. Utah Apr. 4, 2014) (Section 1821(j) did not preclude claims against third party that "focus[ed] on [the third party's] actions not the actions of the FDIC."); *LNV Corp. v. Outsource Serv. Mgmt., LLC*, 2014 WL 834977, at *4 (D. Minn. Mar. 4, 2014) ("OSM seeks to recover from LNV, and such relief simply would not 'restrain or affect' the FDIC[ ] in any way.").

individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)." 845 A.2d at 1033.

In analyzing the first question, a court considers "whether the stockholder has demonstrated that he or she has suffered an injury that is not dependent on an injury to the corporation"—that is, whether the plaintiff has "demonstrated that he or she can prevail without showing an injury to the corporation." *Id.* at 1036.[54] Plaintiffs' claims satisfy the first prong of *Tooley* because they and the Companies' other private stockholders have suffered an injury distinct from that suffered by the Companies.

As an initial matter, there can be no dispute that Counts III-VI of the Complaint, which assert claims for breach of contract and breach of the implied covenant of good faith and fair dealing, state direct claims for breach of the certificates of designation governing Plaintiffs' and the Classes' preferred stock in the Companies.[55] "[A] party to a commercial contract may sue to enforce its contractual rights directly, without proceeding by way of a derivative action," and "*Tooley* and its progeny do not, and were never intended to, subject commercial contract actions to a derivative suit requirement." *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.,* 118 A.3d 175, 179, 182 (Del. 2015). Significantly, the plaintiff in *NAF Holdings* sought "compensation for the diminution in value of its stock" caused by the alleged breach of contract. *Id.* at 180.[56]

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[54] This analysis does not imply that a stockholder must show that the action that harmed his or her own interests did not also harm the corporation—to the contrary, some wrongs harm *both* the corporation and its stockholders directly and can be challenged through *either* derivative or direct actions. *See, e.g., Gatz v. Ponsoldt,* 925 A.2d 1265, 1278 (Del. 2007); *Gentile v. Rossette,* 906 A.2d 91, 99 (Del. 2006). Rather, it means only that the stockholder must be able to prove his own injury *without regard to* whether the corporation was also harmed.

[55] *See, e.g., MCG Capital Corp. v. Maginn*, 2010 WL 1782271, at *7 (Del. Ch. May 5, 2010) (holding that preferred stockholders' breach of contract claims stated *direct* claims for relief).

[56] While Delaware law is well developed on this issue, Virginia law is not. *See, e.g., Remora Invs., LLC v. Orr,* 673 S.E.2d 845, 848 (Va. 2009) (discussing, but ultimately not deciding

Counts I, II, VII and VIII similarly state direct claims for relief because Plaintiffs and other stockholders of the Companies have suffered a distinct injury caused by the expropriation of all of the net worth of the Companies to Treasury, the Companies' controlling stockholder, pursuant to the Net Worth Sweep. As the Delaware Court of Chancery recently explained:

> When one group of [stockholders] suffers an injury of $[X] million so that [a different stockholder] can receive a net benefit of $[X] million, it seems to me that the [first group of stockholders] have suffered a separate and distinct loss.
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> * * *
>
> [T]he expropriation principle actually applies to insider transfers generally, regardless of whether the nature of the consideration received by the insider is cash, stock, or other corporate property. Whenever the value of the transfer to the insider exceeds the share of the loss that the insider suffers through its stock ownership, the insider transfer expropriates value from the unaffiliated investors. This effect happens precisely because the insider receives benefits to the exclusion of the other investors, resulting in a distinct injury to the other investors and a corresponding benefit to the insider.

In re: El Paso Pipeline Partners, L.P. Deriv. Litig., 2015 WL 7758609, at *27-28 (Del. Ch. Dec. 2, 2015).

The Delaware Supreme Court has recognized this principle, labeling it "cash-value dilution." *In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 330 (Del. 1993). In *Tri-Star*, the Court held that an unfair asset transfer by the corporation to its controlling stockholder caused direct injury to the minority stockholders, explaining that the transfer affected the controller and the minority stockholders differently because, while shares of all holders suffered value diminution, "[a]ny diminution in the . . . value of [the controller's shares] . . . was totally offset

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"whether to adopt the analysis employed by the Delaware Supreme Court in *Tooley*"). In the absence of settled law of their own, Plaintiffs respectfully submit (and Defendants appear to agree) that Virginia courts would follow the principles and analysis set forth by Delaware courts. *See, e.g., U.S. Inspect Inc. v. McGreevy,* 2000 WL 33232337, at *4 (Va. Cir. Ct. Nov. 27, 2000) (looking to Delaware law for guidance in the absence of Virginia Supreme Court precedent).

by the windfall profits . . . [the controller] accumulated." *Id.* The minority stockholders only suffered the injury, without any offsetting benefit. Thus, "the practical effect" of the transaction was "to increase the value of the controlling stockholder's interest at the sole expense of the minority." *Id.* The Court found this type of injury to be "quite different" from a case involving waste or mismanagement, where there is no offsetting transfer and the injury truly "diminishes the value of all stockholders' interests equally." *Id.*; *see also id.* at 332 (stating that the controller "suffered no similar loss, but reaped a substantial profit"). Consequently, the Court held that, in light of "the singular economic injury to minority interests alone, the minority have stated a cause of action" that was direct. *Id.* at 332.[57]

The crux of Plaintiffs' claims here is not that there has been "an equal dilution of the economic value . . . of each of [Fannie Mae's and Freddie Mac's] outstanding shares"; rather, it is that the Net Worth Sweep constituted an unlawful "extraction from [Plaintiffs and the Companies' other stockholders], and a redistribution to [Treasury,] the controlling shareholder, of . . . the economic value" of their stock. *Gentile*, 906 A.2d at 100. As such, Plaintiffs and the Companies' other private stockholders, not the Companies themselves, suffered individual harm.

Because Plaintiffs' claims are direct under *Tooley*'s first prong, "[t]he second prong of the analysis should logically follow." *Tooley,* 845 A.2d at 1036. Because the Net Worth Sweep injured ***both*** the Companies and their private stockholders, the remedy can take place at ***either*** an entity level or a stockholder level. *See El Paso*, 2015 WL 7758609, at *31 (an "entity-level remedy is not the only option"); *id*. at *32 ("Just as the answer to the first question was 'both,' the answer to the second question is 'either.'"). Thus, a stockholder-level remedy that redresses

[57] *See also, e.g., Gradient OC Master, Ltd. v. NBC Universal, Inc.,* 930 A.2d 104, 130 (Del. Ch. 2007) ("[W]hen a controlling shareholder extracts financial benefit from the shareholders and procures a financial benefit exclusive to himself, the non-controlling shareholders have a direct claim . . .").

the expropriation of value from Plaintiffs and the other private stockholders of the Companies to Treasury is available in this case. *See id.* at *31.

b. HERA Does Not Strip Plaintiffs Of Their Rights In Their Stock

FHFA and Treasury contend that HERA vested FHFA, as the Companies' conservator, with any "rights, titles, powers, and privileges" that inhered in Plaintiffs' stock and that Plaintiffs accordingly have no rights in that stock left to vindicate. *See* FHFA Br. 18-22 (citing 12 U.S.C. § 4617(b)(2)(A)); Treasury Br. 18-22 (same). This argument is meritless for two independent reasons. First, HERA does not bar Plaintiffs from asserting direct claims that relate to its ownership of stock, and, as noted, many of the claims here are direct. Second, courts repeatedly have recognized an exception to the general rule that shareholders may not bring derivative claims during conservatorship where, as here, the conservator has a manifest conflict of interest.

i. Plaintiffs Have Standing To Prosecute Their Direct Claims Based On Their Ownership Of Stock

HERA provides that FHFA as conservator succeeds to "all rights, titles, powers, and privileges of . . . any stockholder . . . of [Fannie and Freddie] *with respect to [Fannie and Freddie] and the assets of [Fannie and Freddie]*." 12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added). While this language may have implications for the ability of shareholders to bring derivative claims *on behalf of Fannie Mae and Freddie Mac,* it does nothing to divest stockholders of their own, personal economic rights in Fannie Mae and Freddie Mac and, therefore, does nothing to prevent stockholders from bringing direct claims *on behalf of themselves* to protect *their own rights.* This is why, upon imposition of the conservatorship, FHFA correctly insisted that Fannie Mae's and Freddie Mac's stockholders would continue to "have an economic interest in the companies" and would "retain all rights in the stock's financial

worth." Compl. ¶ 35; Ex. D at 3. If Defendants' current litigating position were correct, these repeated public assurances were blatantly false.[58]

Straining to read HERA as transferring all shareholder rights to the conservator also would raise grave constitutional concerns, because even a temporary governmental appropriation of private property is a taking that requires just compensation to the displaced owner.[59] Thus, even if Plaintiffs' interpretation *were not* the most natural reading of HERA—which, in fact, it is—it would still be improper to interpret HERA's language as transferring *all* shareholder rights, including the ability to bring direct claims to protect those rights, to the conservator, because any such interpretation would raise grave constitutional concerns. *See National Fed'n of Indep. Bus. v. Sebelius,* 132 S. Ct. 2566, 2593–94 (2012) (opinion of Roberts, C.J.).

The Seventh Circuit relied on similar reasoning to hold that a materially identical provision of FIRREA—12 U.S.C. § 1821(d)(2)(A)(i)—grants the FDIC rights only to derivative shareholder claims, not direct shareholder claims:

> Section 1821(d)(2)(A)(i) transfers to the FDIC only stockholders' claims "with respect to . . . the assets of the institution"—in other words, those that investors . . . would pursue derivatively on behalf of the failed bank. This is why we have read § 1821(d)(2)(A)(i) as allocating claims between the FDIC and the failed bank's shareholders rather than transferring to the FDIC every investor's claims of every description. Any other reading of § 1821(d)(2)(A)(i) would pose the question whether . . . stockholders would be entitled to compensation for a taking; our reading of the statute . . . avoids the need to tackle that question.

[58] Indeed, by their very nature, the conservatorships were intended to be temporary. Thus, regardless of what rights purportedly passed to FHFA under HERA during the conservatorships, the stockholders of the Companies retained all of their rights in their stock, with such residual rights being restored upon termination of the conservatorships.

[59] *See, e.g., Arkansas Game & Fish Comm'n v. United States,* 133 S. Ct. 511, 515 (2012) ("Ordinarily, . . . if government action would qualify as a taking when permanently continued, temporary actions of the same character may also qualify as a taking.").

Levin v. Miller, 763 F.3d 667, 672 (7th Cir. 2014) (first omission in original).

In *Miller,* the FDIC *agreed* with the Seventh Circuit's interpretation: "our reading of the statute," the court explained, "is *also the FDIC's.*" *Id.* (emphasis added). There is no rational reason for interpreting the provision at issue here differently than the analogous provision of FIRREA, and Treasury and FHFA's disagreement with the FDIC is inexplicable.

As the Seventh Circuit acknowledged, "[*n*]*o* federal court has read [FIRREA]" to transfer direct claims to the FDIC. *Id.* (emphasis added).[60] Thus, the authorities cited by Defendants involve determinations that HERA or FIRREA bar *derivative* claims by shareholders; they do not hold that those statutes bar *direct* shareholder claims.[61]

In sum, there is absolutely no support for straining to interpret HERA's provision that FHFA as conservator succeeds to shareholder rights "with respect to [Fannie and Freddie] and the assets of [Fannie and Freddie]," 12 U.S.C. § 4617(b)(2)(A)(i), to preclude shareholders from raising direct claims asserting their own rights.

ii. Plaintiffs Have Standing To Prosecute Their Derivative Claims Because FHFA Has A Manifest Conflict of Interest

HERA also permits Plaintiffs to bring derivative claims here. While Section 4617(b)(2)(A) generally has been interpreted to bar derivative (but not direct) suits by shareholders during conservatorship or receivership, it does not follow that *all* shareholder

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[60] *See Barnes v. Harris,* 783 F.3d 1185, 1193 (10th Cir. 2015); *In re Beach First Nat'l Bancshares, Inc.,* 702 F.3d 772, 778, 780 (4th Cir. 2012); *Lubin v. Skow,* 382 F. App'x 866, 878 (11th Cir. 2010); *Plaintiffs in All Winstar-Related Cases at the Ct. v. United States,* 44 Fed. Cl. 3, 9–10 (1999).

[61] *See Kellmer v. Raines,* 674 F.3d 848, 850–51 (D.C. Cir. 2012); *Pareto v. FDIC,* 139 F.3d 696, 700 (9th Cir. 1998); *Continental Western,* 83 F. Supp. 3d at 840 n.6; *Perry Capital,* 70 F. Supp. 3d at 230; *Gail C. Sweeney Estate Marital Trust,* 68 F. Supp. 3d at 119, 126 n.13; *Esther Sadowsky Testamentary Trust v. Syron,* 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009); *In re Freddie Mac,* 643 F. Supp. 2d 790, 795 (E.D. Va. 2009). Even the *Perry Capital* court implicitly recognized that HERA *does not* bar direct claims by shareholders. 70 F. Supp. 3d at 229, n.24.

derivative suits are barred without exception, including derivative suits involving a challenge to the actions of the conservator or receiver itself or a closely related federal agency. Indeed, any such interpretation would be highly suspect, for it is well settled that Congress may not exercise its authority to regulate federal jurisdiction "to deprive a party of a right created by the Constitution." *Bartlett v. Bowen,* 816 F.2d 695, 705 (D.C. Cir. 1987); *see also Reich v. Collins,* 513 U.S. 106, 109–10 (1994); *Battaglia v. General Motors Corp.,* 169 F.2d 254, 257 (2d Cir. 1948). In light of this bedrock constitutional principle, HERA cannot reasonably be read to bar shareholders from obtaining meaningful judicial review of claims—including constitutional claims—where FHFA has a manifest conflict of interest that prevents it from adequately safeguarding shareholders' rights. *See, e.g., Webster v. Doe,* 486 U.S. 592, 603 (1988) (interpreting statute to avoid similar constitutional concern); *Bowen,* 476 U.S. at 680 n.12 (same); *Lockerty v. Phillips,* 319 U.S. 182, 188 (1943) (same).[62]

Two federal courts of appeals have squarely addressed this question, both in the context of 12 U.S.C. § 1821(d)(2)(A)(i), FIRREA's analogue to Section 4617(b)(2)(A). And both of those courts held that shareholders may maintain a derivative suit when the conservator or receiver has a manifest conflict of interest. *See First Hartford Corp. Pension Plan & Trust v. United States,* 194 F.3d 1279, 1283 (Fed. Cir. 1999); *Delta Sav. Bank v. United States,* 265 F.3d 1017, 1024 (9th Cir. 2001). And in the context of HERA, even the authorities on which

[62] This constitutional concern is not hypothetical—the government has raised the same subrogation argument in response to takings claims relating to the Net Worth Sweep that are pending in the United States Court of Federal Claims. *See* Defendant's Motion to Dismiss at 21-23, *Fairholme Funds, Inc. v. United States,* No. 13-465C (Fed. Cl. Dec. 9, 2013), Doc. 20.

Defendants principally rely for the most part recognize a "conflict of interest exception" to the general rule urged by Defendants here.[63]

The district court in *Perry Capital,* to be sure, rejected interpreting HERA to allow shareholder derivative suits when a conservator is conflicted, but its reasoning, echoed by Defendants here, is faulty. First, "Professor Frankfurter's timeless advice" to "(1) Read the statute; (2) read the statute; (3) read the statute" does not preclude a conflict-of-interest exception. *Perry Capital,* 70 F. Supp. 3d at 231. The statute does not explicitly address derivative suits by shareholders when the conservator is conflicted, nor does it explicitly address derivative suits by shareholders generally. Resolution of this question thus is a matter of interpretation, not merely reading the statute's text. And particularly noteworthy here is the fact that every appellate court to address this question in the context of FIRREA before HERA was enacted interpreted the relevant language to include a conflict-of-interest exception to the general rule that shareholders may not bring derivative actions. When Congress reenacted substantially the same language in HERA, it can be presumed to have accepted the consistent judicial construction of that language as including a conflict-of-interest exception. *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit,* 547 U.S. 71, 85–86 (2006).

Second, a conflict-of-interest "exception would [not] swallow the rule" against shareholder derivative suits, *Perry Capital,* 70 F. Supp. 3d at 231, as reflected by cases denying shareholders the right to bring derivative claims despite acknowledging a conflict-of-interest exception. Indeed, a conflict-of-interest exception would do nothing to displace a conservator's or receiver's exclusive control over actions relating to corporate mismanagement that resulted in

[63] *See Kellmer,* 674 F.3d at 850; *In re Fed. Nat'l Mortg. Ass'n Sec., Deriv. & ERISA Litig.,* 629 F. Supp. 2d 1, 4 n.5 (D.D.C. 2009); *In re Fed. Home Loan Mortg. Corp. Deriv. Litig.,* 643 F. Supp. 2d 790, 798 (E.D. Va. 2009); *Esther Sadowsky Test. Trust,* 639 F. Supp. 2d at 350.

the imposition of the conservatorship or receivership in the first place, so long as the conservator or receiver was not implicated in the mismanagement, conflicted, or, as in this case, self-dealing.

Third, there is nothing "odd" about concluding that Congress intended shareholders to retain the right to bring derivative claims when the conservator is conflicted while also "grant[ing] immense discretionary power to the conservator . . . and prohibit[ing] courts from interfering with the exercise of such power." *Id.* at 230–31. This right will only come into play when the conservator is alleged to have acted *outside* of the bounds of its power or in cases seeking damages—both situations in which Congress *has not* shielded the conservator's actions from judicial scrutiny. *See* 12 U.S.C. § 4617(f). The "odd" interpretation of HERA would be to strain to read it as shielding the conservator's actions from judicial review in situations not covered by the statute's provision directly addressing that subject.

In this case, Plaintiffs challenge the Net Worth Sweep—an "agreement" between FHFA, the conservator, and the Department of Treasury, a sister federal agency which has acquired a direct and controlling interest in Fannie and Freddie and with which FHFA has obediently coordinated its actions as conservator. FHFA plainly has a "manifest conflict of interest" within the meaning of *First Hartford,* 194 F.3d at 1295, and the numerous other authorities recognizing this common-sense exception, and Plaintiffs, rather than FHFA, are thus the proper parties to seek redress for the injury inflicted by the Net Worth Sweep.[64]

[64] Treasury and FHFA argue that the *Perry Capital* court's holding that no conflict-of-interest exception exists under HERA precludes Plaintiffs' claims. As explained below, issue preclusion does not apply here. Additionally, FHFA briefly suggests that a conflict-of-interest exception is less suited to the conservatorship context than to the receivership context. *See* FHFA Br. 22. But the opposite is true: Unlike the appointment of a receiver, the appointment of a conservator does not "terminate" shareholder claims and relegate them to a statutory claims process. *See* 12 U.S.C. § 4617(b)(2)(K)(i). And without the protections of this statutory claims process, there is an even greater need for a conflict-of-interest exception to protect the interests of shareholders during conservatorship than during receivership

E. Plaintiffs' Contract Claims Are Ripe

Plaintiffs' contract claims (Counts III-VI) are ripe. While Plaintiffs and other preferred stockholders of the Companies have no present right to a dividend or liquidation distribution, the Net Worth Sweep has caused Plaintiffs and other preferred stockholders to suffer present injury. The Net Worth Sweep nullifies entirely each stockholder's contractual rights under the applicable certificates of designation and expropriates the entire net worth of the Companies to the government, thus presently eliminating all economic value of each stockholder's shares.

FHFA's argument to the contrary fundamentally misconstrues the nature of Plaintiffs' contract claims. Plaintiffs are not seeking liquidation payments or dividends. They are seeking equitable relief and damages for the complete elimination of economic value of their shares through the repudiation and nullification of their contractual rights to ever receive dividends and to participate in the liquidation process if the Companies are liquidated. Even if FHFA is correct that whether and how these rights will be *exercised* is contingent, the *existence* of these rights is not. Those rights had economic value before the Net Worth Sweep, and that value was destroyed by the Net Worth Sweep. This injury was complete the moment Defendants implemented the Net Worth Sweep. Even if Defendants are inclined to contest these obvious propositions, Plaintiffs' well-pled allegations must be credited for purposes of the motions to dismiss. *See* Compl. ¶¶ 16, 20, 48-49, 60, 107-152. Third Circuit precedent squarely holds that exactly this sort of injury—the loss of a contingent future interest that precipitates a reduction in its value at present—renders a case ripe for review.[65]

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[65] *Colonial Penn Ins. Co. v. Heckler*, 721 F.2d 431, 434, 439 (3d Cir. 1983) (automobile insurer's claim challenging regulation that made Medicare coverage secondary to insurance coverage was ripe where alleged injury was loss of future profits). *Perry Capital's* speculation that "just as there was a Third Amendment, the Court cannot definitively say there will be no Fourth or Fifth Amendment" that will restore or otherwise affect Plaintiffs' contractual rights is

Further, it is not the case that "Plaintiffs have not and cannot allege that they suffered any present injury or face an imminent or impending injury resulting from the Third Amendment's alleged nullification of their right to receive a liquidation preference or distribution." FHFA Br. 24. To the contrary, Plaintiffs have alleged that Defendants' nullification of their contractual rights has destroyed the value of their stock. *See* Compl. ¶¶ 49, 114-19, 128-32, 139-41, 149-51.

In short, there is nothing "hypothetical or speculative" about Plaintiffs' claims,[66] further factual development would not assist the Court in resolving them,[67] and a judicial decision now would settle the parties' dispute.[68] And, in all events, as even FHFA recognizes, *see* FHFA Br. 25, Plaintiffs' claims are not circumscribed by the effect of the Net Worth Sweep on their liquidation rights; if upheld, the Net Worth Sweep will have extinguished ***all*** of Plaintiffs' rights as a preferred stockholders, not just their liquidation rights.

F. Plaintiffs' Claims Are Not Precluded By *Perry Capital*

Finally, Defendants have failed to demonstrate the identity of both issues and parties that would be required to support the conclusion that the deeply flawed *Perry Capital* decision precludes Plaintiffs' claims here. *See* Treasury Br. 28–29; *see also* FHFA Br. 21.

Issue preclusion only applies where "the identical issue was previously adjudicated," *Howard Hess Dental Labs. Inc. v. Dentsply Int'l, Inc.*, 602 F.3d 237, 247–48 (3d Cir. 2010), and

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legally irrelevant, for the possibility of future agency action does not suffice to foreclose judicial review of definitive agency action. 70 F. Supp. 3d at 235; *see American Petroleum Inst. v. EPA,* 906 F.2d 729, 739–40 (D.C. Cir. 1990).

[66] *See Nebraska Pub. Power Dist. v. MidAmerican Energy Co.,* 234 F.3d 1032, 1038 (8th Cir. 2000); *Cities Serv. Co. v. Dep't of Energy*, 520 F. Supp. 1132, 1138-39 (D. Del. 1981).

[67] *See Pac. Gas & Elec. Co. v. State Energy Res. Conserv. & Dev. Comm'n,* 461 U.S. 190, 203 (1983); *NE Hub Partners, L.P. v. CNG Transmission Corp.,* 239 F.3d 333, 344 (3d. Cir. 2001).

[68] *See Ernst & Young v. Depositors Econ. Prot. Corp.,* 45 F.3d 530, 539–40 (1st Cir. 1995); *Step-Saver Data Sys. v. Wyse Tech.,* 912 F.2d 643, 648 (3d Cir. 1990).

many of the issues presented in this case were not decided in *Perry Capital*. Most notably, Counts I and II of the Complaint allege that the Net Worth Sweep is void and unenforceable under provisions of Fannie's and Freddie's bylaws that require them to follow state law in corporate governance matters. None of the plaintiffs in the *Parry Capital* litigation asserted those claims, and the court in that case had no occasion to rule on their merits or Defendants' arguments that they are foreclosed under HERA. Apparently recognizing this flaw in its argument, Treasury says that Plaintiffs' claims raise "legal issues that are *nearly* identical to those previously adjudicated in *Perry Capital*." Treasury Br. 28 (emphasis added). But issue preclusion bars relitigation of "the same issue" decided by a previous court, *B&B Hardware, Inc. v. Hargis Indus., Inc.*, 135 S. Ct. 1293, 1303 (2015), and the doctrine is no help to Defendants with respect to legal questions that no court has previously considered.

The party against whom issue preclusion is asserted must have had a "full and fair opportunity to litigate" in the earlier action, *Taylor v. Sturgell*, 553 U.S. 880, 892 (2008). Plaintiffs thus are not bound by *Perry Capital*, which involved a distinct group of plaintiffs, none of whom are parties here. Treasury resists this conclusion by citing cases in which courts have reasoned that because the corporation is the true party in interest in every derivative suit brought on its behalf, a judgment against one derivative plaintiff sometimes bars a second derivative plaintiff from relitigating the same issues. Treasury Br. 29. But that doctrine is plainly inapplicable with respect to issues implicated by Plaintiffs' contract, implied covenant of good faith, individual fiduciary duty, and individual statutory claims—none of which are derivative for the reasons explained above. *See supra* Part D.3.; *Guenther v. Pacific Telecom, Inc.*, 123 F.R.D.

341, 347 n.10 (D. Or. 1987) ("The judgment in a derivative suit will not preclude any right of action that an absent shareholder might have in his or her *individual* capacity.").[69]

Furthermore, even if these claims truly were derivative, issue preclusion still should not apply with respect to issues they implicate because Fannie and Freddie were not adequately represented in the earlier litigation. As Defendants' own authorities acknowledge, "[h]owever established the principle that the same party, the corporation, has sued in each derivative action, it is subject to an important caveat: to bind the corporation, the shareholder plaintiff must have adequately represented the interests of the corporation." *In re Sonus Networks, Inc., S'holder Derivative Litig.*, 499 F.3d 47, 64 (1st Cir. 2007).

First, and as explained above, none of the plaintiffs in *Perry Capital* sought to assert the statutory claims Plaintiffs assert here in *any* capacity, much less a derivative one. Those plaintiffs therefore necessarily did not adequately represent the interests of the corporation with respect to issues implicated by those claims.

Second, none of the plaintiffs in *Perry Capital* asserted or sought to prosecute their contract or implied covenant of good faith claims as derivative actions. The plaintiffs in *Perry Capital*—who did not even purport to assert contract or implied covenant of good faith claims on behalf of Fannie and Freddie, let alone make any attempt to satisfy the substantive and procedural requirements for bringing such claims derivatively—certainly cannot be said to have adequately represented the interests of these corporate entities.

[69] Although the *Perry Capital* court did suggest in passing that the contract claims at issue in that case were derivative under Delaware law, *see* 70 F. Supp. 3d at 235 n.39, 239 n.45, the court later expressly acknowledged that these statements were dicta that did not bind the plaintiffs in another case that had been pending before it, who voluntarily dismissed their challenge to the Net Worth Sweep after the *Perry Capital* decision in order to avoid a similar ruling that may have precluded them from challenging the Net Worth Sweep in another court. *See* Exhibit 1, Memorandum & Order at 5–7 & n.3, *Rafter v. Department of Treasury*, No. 1:14-cv-01404-RCL Slip Op. (D.D.C. Jan. 21, 2015), Doc. 20.

Not surprisingly, none of the preclusion cases that Defendants cite holds that a claim that was unsuccessfully prosecuted as a direct claim will preclude a subsequent suit by a different plaintiff. Because the contract and implied covenant of good faith claims in *Perry Capital* were not brought "expressly for the benefit of any and all the stockholders," *Henik ex rel. LaBranche & Co., Inc. v. LaBranche*, 433 F. Supp. 2d 372, 382 (S.D.N.Y. 2006) (quoting *Dana v. Morgan*, 232 F. 85, 91 (2d Cir. 1916)), Plaintiffs cannot be presumed to have been on notice that their rights were at issue in that case and are not bound by its outcome, *see United States v. LTV Corp*., 746 F.2d 51, 53 n.5 (D.C. Cir. 1984).

Even if Plaintiffs' fiduciary duty claims—the only claims in this action that are analogous to claims that were pressed derivatively in *Perry Capital*—and their statutory claims were considered purely derivative (which they are not), the prior judgment in *Perry Capital* is not binding here because the *Perry Capital* court rested its decision on the conclusion that the plaintiffs before it could not legally represent Fannie and Freddie. It is well established that a judgment in a derivative suit "that is not on the merits but that relates to the representative's *capacity* to bring the suit . . . will not bar other stockholders from bringing a derivative action." CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE & PROCEDURE § 1840 (emphasis added) (footnote omitted); *see also Ercklentz v. Inverness Mgmt. Corp.*, 1985 WL 11535, at *2 (Del. Ch. Feb. 22, 1985) (observing that plaintiff's disqualification as a representative should not preclude other stockholders from pursuing the same claims). That rule applies here, for the *Perry Capital* court dismissed the derivative fiduciary duty claims before it on the theory that the plaintiffs lacked standing to sue derivatively because 12 U.S.C. § 4617(b)(2)(A)(i) "transfers shareholders' ability to bring derivative suits . . . to FHFA." 70 F. Supp. 3d at 230. The *Perry Capital* court's conclusion that the plaintiffs in that case lacked

capacity to sue on behalf of the Companies plainly cannot bind the Companies, and by extension Plaintiffs are not precluded from making the same arguments on the Companies' behalf here.

The analysis does not change because Defendants assert the same legal theory that the *Perry Capital* court credited when it ruled that the plaintiffs in that case lacked standing to bring derivative claims. In the class action context, the Supreme Court has held that where a putative class action is dismissed prior to certification, issue preclusion does not bar an absent class member from relitigating the same issues in a subsequent lawsuit. *Smith v. Bayer Corp.*, 131 S. Ct. 2368, 2380–81 (2011); *accord In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 134 F.3d 133, 141 (3d Cir. 1998). That result is dictated by fundamental principles of due process; a plaintiff who is not authorized to represent a class cannot make litigating decisions that bind absent class members. *Id.*; *see also Taylor v. Sturgell*, 553 U.S. 880, 897 (2008). In the same way here, due process forecloses any argument that the Companies are bound by prior litigation in which the court ruled that the plaintiffs lacked the capacity to sue derivatively on the Companies' behalf. In both the class action and shareholder derivative suit contexts, this result "perforce leads to relitigation of many issues," but the Supreme Court has repeatedly declined to address that problem by "binding nonparties to a judgment." *Smith*, 131 S. Ct. at 2381; *see also Taylor*, 553 U.S. at 903–04.

Some courts have said that issue preclusion may bar shareholders suing derivatively from establishing demand futility when different shareholders have already lost on that issue in earlier litigation. In that context, however, there is no question in the initial suit of the *capacity* of the shareholders to represent the corporation and, indeed, that common capacity to represent the corporation undergirds the reasoning of those cases. *See, e.g.*, *In re Sonus Networks*, 499 F.3d at 64 ("if the shareholder *can sue on the corporation's behalf*, it follows that the corporation is

bound by the results of the suit in subsequent litigation, even if different shareholders prosecute the suits") (emphasis added); *Arduini v. Hart*, 774 F.3d 622, 634 (9th Cir. 2014) (same); *Pyott v. Louisiana Mun. Police Employees' Retirement System*, 74 A.3d 612, 617 (Del. 2013) (similar). That reasoning does not apply here, because the *Perry Capital* court held that the plaintiffs before it *lacked the capacity* to sue derivatively. Plaintiffs that were deemed to lack capacity to sue on behalf of a corporation cannot possibly be deemed nevertheless to have adequately represented the corporation's interests such that issue preclusion could apply in subsequent litigation on the corporation's behalf, and due process would forbid any such result.

CONCLUSION

The Court should deny FHFA's and Treasury's motions to dismiss.

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