Oral Argument Not Yet Scheduled

Nos. 14-5243 (L), 14-5254 (con.), 14-5260 (con.), 14-5262 (con.)

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

PERRY CAPITAL LLC, for and on behalf of investment funds for which it acts as investment manager,

Plaintiff-Appellant,

v.

JACOB J. LEW, in his official capacity as the Secretary of the Department of the Treasury, MELVIN L. WATT, in his official capacity as Director of the Federal Housing Finance Agency, UNITED STATES DEPARTMENT OF THE TREASURY, and FEDERAL HOUSING FINANCE AGENCY,

Defendants-Appellees

On Appeal from the United States District Court for the District of Columbia
No. 13-mc-01288 (Royce C. Lamberth, District Judge)

AMICUS CURIAE BRIEF OF CENTER FOR INDIVIDUAL FREEDOM IN SUPPORT OF PLAINTIFF-APPELLANT

Myron T. Steele
POTTER ANDERSON & CORROON LLP
1313 North Market Street, 6th Floor
Wilmington, DE 19801
Tel: (302) 984-6030
Fax: (302) 658-1192

Counsel for Amicus Curiae
Center for Individual Freedom

July 6, 2015

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

(A) **Parties and Amici.** All parties appearing before the district court and in this Court are listed in the Briefs filed by Plaintiffs-Appellants.

(B) **Rulings Under Review.** References to the rulings at issue appear in the Briefs filed by Plaintiffs-Appellants.

(C) **Related Cases.** This case has not previously been before this Court. Related cases are set forth in the Briefs filed by Plaintiffs-Appellants.

CORPORATE DISCLOSURE STATEMENT

Center for Individual Freedom ("CFIF") is a non-profit organization. It does not have any corporate parent. It does not have any stock, and therefore no publicly held company owns 10% or more of the stock of this *amicus curiae*.

STATEMENT REGARDING CONSENT TO FILE AND SEPARATE BRIEFING

All parties have consented to the filing of this brief. CFIF is filing its notice of its intent to participate in this case as *amicus curiae* contemporaneously herewith. Pursuant to Circuit Rule 29(d), CFIF certifies that a separate brief is necessary to address an important issue of Delaware corporate law that underlies this case that the parties did not address in their briefing.[1]

[1] No counsel for a party authored this brief in whole or in part, and no person other than the *amicus curiae* contributed money that was intended to fund the preparation or submission of this brief. *See* Fed. R. App. P. 29(c)(5).

GLOSSARY

APA	Administrative Procedure Act
CFIF	Center for Individual Freedom
DGCL	Delaware General Corporation Law
FHFA	Federal Housing Finance Agency
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
HERA	Housing and Economic Recovery Act of 2008
Treasury	United States Department of the Treasury

STATEMENT OF IDENTITY, INTEREST IN CASE, AND SOURCE OF AUTHORITY TO FILE

CFIF is a non-partisan, non-profit organization with the mission to protect and defend individual freedoms and individual rights guaranteed by the U.S. Constitution. Based in Alexandria, Virginia, CFIF is a non-profit, 501(c)(4) corporation that relies on private financial support from individuals, associations, foundations and corporations.

CFIF seeks to focus public, legislative and judicial attention on the rule of law as embodied in the federal and state constitutions. Those fundamental documents both express and safeguard society's commitment to individual freedom, not only through specific protections such as the Bill of Rights, but also through structural protections that constrain and disperse governmental authority.

The parties' briefing does not address the Delaware corporate law principles that underlie this case and, indeed, are dispositive of it. CFIF seeks to provide the Court with its expertise in this area of the law.

TABLE OF CONTENTS

Page(s)

TABLE OF AUTHORITIES

CASES

Page(s)

STATUTES & REGULATIONS

OTHER AUTHORITIES

INTRODUCTION

Delaware law is the rule of decision for the Federal National Mortgage Association ("Fannie Mae") to the extent not inconsistent with its enabling legislation, public purpose, or charter. Lost in the mix of federal questions raised in this appeal is a Delaware legal issue that the undersigned respectfully submits is dispositive. The "Net Worth Sweep" is unenforceable and void *ab initio* under Section 151 of the Delaware General Corporation Law ("DGCL"). Preferred stock of a Delaware corporation cannot be given a cumulative dividend right equal to all the net worth of the corporation in perpetuity. The Net Worth Sweep is a flatly illegal term for any preferred stock instrument, whether or not held by the federal government.

The invalidity of the Net Worth Sweep under Delaware law informs the federal questions posed by Plaintiffs-Appellants in this appeal:

1. Whether the Federal Housing Finance Agency ("FHFA") exceeded its statutory authority as conservator for Fannie Mae and the Federal Home Loan Mortgage Corporation ("Freddie Mac," and, together with Fannie Mae, the "Companies") under the Housing and Economic Recovery Act of 2008 ("HERA") by assenting to the Net Worth Sweep under which the Companies must transfer all of their net assets to the United States Department of the Treasury ("Treasury") and are prohibited from retaining capital, in service of the goal of eliminating the Companies; and

2. Whether Treasury exceeded its authority under HERA and violated the Administrative Procedure Act ("APA") by entering into the Net Worth Sweep in 2012, when HERA

> expressly permitted Treasury after December 31, 2009, only "to hold [or] exercise any rights received in connection with, or sell, any obligations or securities [it had already] purchased," or by imposing the Net Worth Sweep based on outdated data without adequately examining reasonable alternatives.

If the Net Worth Sweep was illegal under the charter of the Companies, it exceeds FHFA's statutory authority as conservator by definition. Standing in the shoes of the board and the stockholders, FHFA cannot exercise a corporate power that the board and the stockholders could not themselves have exercised. *See* 12 U.S.C. § 4617(b)(2)(B) (granting the conservator the power to "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").

Similarly, if the Net Worth Sweep is an illegal term for preferred stock, the amendment cannot possibly be regarded under Delaware law as Treasury's exercise of a "right received in connection with" preferred stock purchased by Treasury before December 31, 2009. Preferred stockholders cannot have a perpetual claim on all the residual earnings of the Companies to the exclusion of common stockholders under Delaware law.

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). Preferred stock dividends must be made "payable ***in preference***

to, or in . . . relation to, the dividends payable on any other class or classes or of any other series of stock[.]" *Id.* (emphasis added). Section 151 does not permit a provision requiring that a series of preferred stock receive a quarterly dividend equal to the entire net worth of a corporation to the necessary exclusion (in perpetuity) of any dividends ever being paid on junior stock. In fact, Section 151(c) specifically 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 . . . ." *Id.*

Because the Net Worth Sweep diverts, in perpetuity, all of the net worth of the Companies (assets minus liabilities) to Treasury, 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 of stock. The Net Worth Sweep is not paid at a "rate" because Treasury's participation in corporate earnings growth is unlimited, absolute, and perpetual. 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. Once the Net Worth Sweep is paid each quarter, there necessarily will be no assets remaining in the Companies that would ever be available for the payment of dividends on any other classes or series of stock regardless of how valuable the

Companies may become in the future. Accordingly, the Net Worth Sweep is invalid under Section 151(c) of the DGCL and is void *ab initio* and unenforceable.

ARGUMENT

I. The Net Worth Sweep

Fannie Mae is a federally chartered institution.[2] Fannie Mae's bylaws designate that the DGCL controls for purposes of its corporate governance practices and procedures, to the extent not inconsistent with its enabling legislation.[3] Freddie Mac similarly has designated Virginia law.[4]

---

[2] *See* 12 C.F.R. § 1710.10.

[3] Fannie Mae Bylaws, § 1.05.

[4] Freddie Mac Bylaws, § 11.3. The focus of this *amicus* brief is Delaware law as applied to the Net Worth Sweep entered into by Fannie Mae, as Delaware law is not only the rule of decision for Fannie Mae but also has been considered persuasive authority on corporate law matters associated with federal statutes generally. *See, e.g., United Artists Theatre Co. v. Walton*, 315 F.3d 217, 230 & n.13 (3d Cir. 2003) (referring to Delaware corporate law "as a useful analogue" in interpreting Section 328(a) of federal Bankruptcy Code; stating that: "We look to Delaware corporate law as a guide primarily because it offers time-tested insights on how courts should best evaluate an issue similar to the one before us. Additionally, Delaware's law often cues the market.").

The law of the Commonwealth of Virginia, including the Virginia Stock Corporation Act, governs the corporate governance practices and procedures of Freddie Mac. Freddie Mac Bylaws, § 11.3. The Virginia Stock Corporation Act has similar language to the DGCL, stating 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 dividends]." Va. Code § 13.1-638 (emphasis added). Virginia courts have recognized that, as discussed below, a preferred dividend right is, by definition, in preference to the dividend right of another class of shares. *See, e.g., Kain v. Angle*, 111 Va. 415, 69 S.E. 355,

On September 7, 2008, Treasury and FHFA, as conservator for Fannie Mae and Freddie Mac, entered into two near-identical Senior Preferred Stock Purchase Agreements, pursuant to which Treasury purchased 1 million shares of Variable Liquidation Preference Senior Preferred Stock (the "Senior Preferred Stock") from each of Fannie Mae and Freddie Mac.[5]

On September 26, 2008, Treasury and FHFA, as conservator for the Companies, entered into Amended and Restated Senior Preferred Stock Purchase Agreements.[6] Treasury and FHFA, again as conservator for the Companies,

---

357 (1910) ("A preferred dividend is nothing more than that which is paid to one class of shareholders ***in priority to that to be paid to another class***.") (emphasis added) (internal quotation marks omitted) (quoting Cook on Stock & Stockholders (3d Ed.) § 267). Virginia courts also have considered Delaware authority persuasive on questions of corporate law. *See, e.g.*, *U.S. Inspect Inc. v. McGreevy*, 2000 WL 33232337, at *13 (Va. Cir. Ct. Nov. 27, 2000) (finding Delaware Court of Chancery's reasoning persuasive with regard to valuation issue in dissenting shareholder action). Finally, there is no principled basis for treating the Net Worth Sweep as applied to Fannie Mae and Freddie Mac differently.

[5] *See* Certificate of Designation of Terms of Variable Liquidation Preference Senior Preferred Stock, Series 2008-2, dated Sept. 7, 2008 (Fannie Mae); Certificate of Creation, Designation, Powers, Preferences, Rights, Privileges, Qualifications, Limitations, Restrictions, Terms and Conditions of Variable Liquidation Preference Senior Preferred Stock (Par Value $1.00 Per Share), dated Sept. 7, 2008 (Freddie Mac).

[6] *See* Amended and Restated Senior Preferred Stock Purchase Agreement, dated Sept. 26, 2008 (Fannie Mae); Amended and Restated Senior Preferred Stock Purchase Agreement, dated Sept. 26, 2008 (Freddie Mac).

amended the Amended and Restated Senior Preferred Stock Purchase Agreements in May and December 2009.[7]

Then, on August 17, 2012, Treasury and FHFA, again acting as conservator of the Companies, entered into a Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement in respect of Treasury's Senior Preferred Stock in each Company.[8] These amendments, and the corresponding amended and restated Certificates of Designation for the Senior Preferred Stock,[9] purported to confer upon Treasury, as the holder of the Senior Preferred Stock in

[7] *See* Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of May 6, 2009 (Fannie Mae); Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of May 6, 2009 (Freddie Mac); Second Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of December 24, 2009 (Fannie Mae); Second Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of December 24, 2009 (Freddie Mac).

[8] Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of August 17, 2012 (Fannie Mae); Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of August 17, 2012 (Freddie Mac).

[9] Fannie Mae Amended and Restated Certificate of Designation of Terms of Variable Liquidation Preference Senior Preferred Stock, Series 2008-2, dated Aug. 17, 2012; Freddie Mac Amended and Restated Certificate of Creation, Designation, Powers, Preferences, Rights, Privileges, Qualifications, Limitations, Restrictions, Terms and Conditions of Variable Liquidation Preference Senior Preferred Stock (Par Value $1.00 Per Share), dated Aug. 17, 2012. The Companies' Amended and Restated Certificates of Designation shall collectively be referred to as the "Amended and Restated Certificates of Designation."

the Companies, an unprecedented (and impermissible) dividend preference: the right to receive the entire net worth of each Company each quarter in perpetuity.

Specifically, the Third Amendment to each agreement and the corresponding amended and restated Certificates of Designation provide, in pertinent part, as follows:

> . . . For each Dividend Period from January 1, 2013, holders of outstanding shares of Senior Preferred Stock shall be entitled to receive, ratably, when, as and if declared by the Board of Directors, in its sole discretion, out of funds legally available therefor, ***cumulative*** cash dividends in an amount equal to the then-current Dividend Amount.
>
> * * *
>
> 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.[10]

These provisions implement the Net Worth Sweep, by which, from January 1, 2013 through December 31, 2017, the "Net Worth Amount" (total assets less total liabilities, "excluding any obligation in respect of any capital stock")[11] less the "Applicable Capital Reserve Amount" (which starts at $3 billion and decreases to $0 by January 1, 2018) is paid out as a dividend each quarter to Treasury. Beginning January 1, 2018 and continuing in perpetuity, the Net Worth Amount is

[10] Amended and Restated Certificates of Designation, § 2(a), (c) (emphasis added); *see also* Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of August 17, 2012 (Fannie Mae); Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of August 17, 2012 (Freddie Mac).

[11] The language "excluding any obligation in respect of any capital stock" means that any dividend and liquidation obligations with respect to the Companies' capital stock are not considered liabilities.

paid out as a dividend each quarter to Treasury without any capital reserve whatsoever.

Importantly, the dividends are cumulative.[12] If the Net Worth Amount is greater than zero and the board of directors does not declare a dividend on the Senior Preferred Stock, then the dividend cumulates.[13] No dividends may ever be paid on any other stock unless and until full cumulative dividends are paid on the Senior Preferred Stock.[14] Moreover, because the entire net worth of each Company is payable in perpetuity to the Senior Preferred Stock, there necessarily

---

[12] *See* Amended and Restated Certificates of Designation, § 2(a), (d).

[13] *See Weinberg v. Baltimore Brick Co.*, 114 A.2d 812, 817 (Del. 1955) ("We are dealing with preferred dividends expressly made cumulative. As applied to such dividends the natural meaning of earnings includes both current and accumulated earnings. This is necessarily so, because of the very nature of cumulative preferred stock; the current earnings are first to be devoted to its payment, and, if they are insufficient or if the dividend is passed, all future earnings are also charged with the dividend, and must be used to pay before any dividend can be paid on the common stock. This is the characteristic feature of cumulative preferred stock.").

[14] *See* Amended and Restated Certificates of Designation, § 2(d) ("***The Company may not, at any time, declare or pay dividends on***, make distributions with respect to, or redeem, purchase or acquire, or make a liquidation payment with respect to, ***any common stock or other securities ranking junior to the Senior Preferred Stock unless (i) full cumulative dividends on the outstanding Senior Preferred Stock in respect of the then-current Dividend Period and all past Dividend Periods*** (including any unpaid dividends added to the Liquidation Preference pursuant to Section 8) ***have been declared and paid in cash*** (including through any pay down of Liquidation Preference pursuant to Section 3) and (ii) all amounts required to be paid pursuant to Section 4 (without giving effect to any prohibition on such payment under any applicable law) have been paid in cash.") (emphasis added).

will be no remaining assets from which dividends ever could be paid on other classes or series of stock.

II. Preferred Stock Under The Delaware General Corporation Law

Section 151 of the DGCL governs the rights, powers, and preferences that the shares of various classes and series of a corporation's stock may possess. That statutory provision states, in pertinent part:

> Every corporation may issue 1 or more classes of stock . . . which classes . . . may have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the certificate of incorporation or of any amendment thereto, or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation.

8 *Del. C.* § 151(a).

Although Section 151(a) expressly grants corporations the authority to create different classes and series of stock with different rights, powers, and preferences, other provisions of the DGCL—including Section 151(c), which relates to dividend rights of preferred stock—necessarily circumscribe that flexibility.

The DGCL uses the term "preferred stock" "to refer to stock that, ***in relation to other classes of stock***, enjoys certain rights, powers and preferences that are generally associated with specified priorities as to the payment of dividends and

distributions upon any liquidation." R. Franklin Balotti & Jesse A. Finkelstein, *The Delaware Law of Corporations & Business Organizations*, § 5.4 at 5-9 (3rd ed. 2015) (emphasis added); *see also Starring v. Am. Hair & Felt Co.*, 191 A. 887, 891 (Del. Ch. 1937) ("Preferred stock" is "a stock which in relation to other classes enjoys certain defined rights and privileges. These rights and privileges are generally associated with specified dividend and liquidation priorities."), *aff'd*, 2 A.2d 249 (Del. 1937). "Generally, these are rights to receive specified amounts of dividends or distributions upon liquidation ***before dividends or distributions in liquidation may be paid on one or more of the junior classes of stock***." Balotti & Finkelstein, § 5.4 at 5-9 (emphasis added).

The terms and provisions governing preferred stock must be lawful. *Shintom Co., Ltd. v. Audiovox Corp.*, 888 A.2d 225, 228 (Del. 2005); *see also STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1136 (Del. 1991) (explaining that parties creating or changing the rights of stockholders "must scrupulously observe the law"). "Preferred shares that do not comport with the statutory requirements of the Delaware General Corporation Law are void." *Shintom*, 888 A.2d at 228; *see also STAAR Surgical*, 588 A.2d at 1136 (holding that preferred shares were void because invalidly issued); *Triplex Shoe Co. v. Rice & Hutchins, Inc.*, 152 A.2d 342, 366 (Del. 1930) (stating that stock issued without authority is void).

III. The Net Worth Sweep Is Invalid Under Section 151(c)

The Net Worth Sweep crosses the line separating the lawful private ordering of senior preferred stock rights and the unlawful confiscation of the entire economic value of a corporation and its other classes and series of stock. In so doing, it violates Section 151(c) of the Delaware General Corporation Law.

Section 151(c) provides:

> The holders of preferred or special stock of any class or of any series thereof shall be entitled 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 resolution or resolutions providing for the issue of such stock adopted by the board of directors as hereinabove provided, ***payable in preference to, or in such relation to, the dividends payable on any other class or classes or of any other series of stock***, and cumulative or noncumulative as shall be so stated and expressed. When dividends upon the preferred and special stocks, if any, to the extent of the preference to which such stocks are entitled, shall have been paid or declared and set apart for payment, 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*** as elsewhere in this chapter provided.

8 *Del. C.* § 151(c) (emphasis added).

The Net Worth Sweep violates Section 151(c).

First, the Net Worth Sweep is not paid at a "rate" because Treasury's participation in the Companies' earnings growth is unlimited, absolute, and perpetual. The essential difference between dividends on common stock and

dividends on preferred stock is the debt-like rate of return on the preferred stock investment. While preferred stockholders have priority over common stockholders in the receipt of dividends, such dividends are necessarily limited as a preference and do not appreciate in an absolute and unlimited manner with the growth of the corporation. *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[.]").

Indeed, preferred stockholders' interests "are more similar to those of fixed claimants than to those of common [stock]holders," and their rate of return "is capped at a stated dividend level[.]" 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."); *see also* 11 *Fletcher Cyclopedia of the Law of Corporations* § 5283 ("[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); Richard M. Buxbaum, *Preferred Stock—Law and Draftsmanship*, 42 Cal. L. Rev. 243, 245 (1954) (describing preferred stock dividends as being paid at a "set rate of return," "set return" or a "permissive (or

maximum) return").[15] This capped dividend level for preferred stock is expressed as an interest rate, percentage yield, or fixed dollar amount. *See* Buxbaum, 42 Cal. L. Rev. at 245.[16] In fact, prior to the Third Amendment's implementation of the Net Worth Sweep, the Certificates of Designation governing Treasury's Senior Preferred Stock were in accord with this rule, establishing a "Dividend Rate" of 10% (or 12% in the event the Companies elected not to pay in cash).[17]

Section 151(c)'s use of the term "rate" reflects this fundamental principle of corporate finance as well as that term's legal definition, which involves concepts of

[15] *Accord* 26 C.F.R. § 1.305-5(a) ("The term *preferred stock* generally refers to stock which, in relation to other classes of stock outstanding, enjoys certain limited rights and privileges (generally associated with specified dividend and liquidation priorities) but does not participate in corporate growth to any significant extent. The distinguishing feature of *preferred stock* . . . is not its privileged position as such, but that such privileged position is limited, and that such stock does not participate in corporate growth to any significant extent.").

[16] *Accord* Lawrence E. Mitchell, *The Puzzling Paradox of Preferred Stock (And Why We Should Care About It)*, 51 Bus. Law. 443, 451-52 (1996) (to the extent they have priority, preferred stockholders have priority over the common stockholders to receive dividends in a "fixed" amount). As such, the Senior Preferred Stock's claim on all of the residual interest in the Companies gives it a characteristic that is fundamental to common stock.

[17] *See* Certificate of Designation of Terms of Variable Liquidation Preference Senior Preferred Stock, Series 2008-2, dated Sept. 7, 2008 (Fannie Mae); Certificate of Creation, Designation, Powers, Preferences, Rights, Privileges, Qualifications, Limitations, Restrictions, Terms and Conditions of Variable Liquidation Preference Senior Preferred Stock (Par Value $1.00 Per Share), dated Sept. 7, 2008 (Freddie Mac).

proportionality and relativeness.[18] But the Net Worth Sweep lacks either a specific rate of return that would not participate in the Companies' growth or any proportional or relative connection to Treasury's Senior Preferred Stock investment or the Companies' capital structures. Instead, the Net Worth Sweep directs ***all*** of the net worth of the Companies to ***one*** corporate constituency in perpetuity, irrespective of the capital attributable to Treasury's Senior Preferred Stock or other stockholders' significant capital contributions. As such, the Net Worth Sweep is not a "rate" and, accordingly, violates Section 151(c).

Second, as a result of the Net Worth Sweep, dividends on the Senior Preferred Stock are not "payable in preference to, or in . . . relation to, the dividends payable on any other class or classes or of any other series of stock[.]" 8 *Del. C.* § 151(c). Rather, the Net Worth Sweep is payable to the absolute and permanent exclusion of dividends payable on other classes or series of the Companies' stock.

---

[18] Black's Law Dictionary defines "rate" as: "Proportional or relative value; the proportion by which quantity or value is adjusted." *Black's Law Dictionary*, p. 1289 (8th ed. 1999). The Delaware Court of Chancery will look to *Black's Law Dictionary* when undertaking the task of statutory interpretation, and has done so in deciding issues relating to preferred stock. *See SV Inv. Partners, LLC v. ThoughtWorks, Inc.*, 7 A.3d 973, 982 (Del. Ch. 2010) (citing to *Black's Law Dictionary* in construing a charter provision to determine whether the corporation had sufficient "funds legally available" to permit a redemption of preferred stock in accordance with the terms of the charter and Sections 154 and 160 of the Delaware General Corporation Law), *aff'd*, 37 A.3d 205 (Del. 2011).

While there is no question that stockholders, even preferred stockholders, generally have no right to receive dividends at any given time unless and until they are declared by the corporation's board of directors, *see, e.g.*, *Pa. Co. for Insurances on Lives & Granting Annuities v. Cox*, 199 A. 671, 673 (Del. 1938); *Treves v. Menzies*, 142 A.2d 520, 523 (Del. Ch. 1958), stockholders may not be forever precluded from the potential receipt of dividends absent their affirmative agreement in a share contract. *See* 12 *Fletcher Cyclopedia of the Law of Corporations* § 5443 (perm. ed.) (corporation cannot alter dividend rights without consent of stockholders).[19]

The potential to receive dividends is a fundamental incident of stock ownership. Consistent with the enabling nature of the DGCL, Section 151(c) authorizes corporations to pay dividends to holders of preferred stock "in preference to, or in . . . relation to, the dividends payable on any other class or classes or of any other series of stock[.]" 8 *Del. C.* § 151(c).

[19] Because the Net Worth Sweep adversely affects the rights of the junior stockholders without their affirmative consent, it violates Section 242(b)(2) of the DGCL. That statutory provision states, in pertinent part, as follows: "[t]he holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to vote thereon by the certificate of incorporation, if the amendment would . . . alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely. If any proposed amendment would alter or change the powers, preferences, or special rights of 1 or more series of any class so as to affect them adversely, but shall not so affect the entire class, then only the shares of the series so affected by the amendment shall be considered a separate class for the purposes of this paragraph." 8 *Del. C.* § 242(b)(2).

A preferred stock dividend payable "in preference to" a junior stock dividend would entitle preferred stockholders to priority with respect to the 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,[20] 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

[20] *See* Balotti & Finkelstein, § 5.5 at 5-13 ("It is the grant of prior rights as to dividends or distributions upon liquidation, or of both, to a class or series of stock that renders the stock 'preferred.'").

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. By doing so, the Net Worth Sweep violates Section 151(c).

After payment of the Net Worth Sweep each quarter, there are no remaining assets of the Companies available for dividends on any other classes or series of stock. Thus, no dividends can ever be paid to other stockholders because of the Net Worth Sweep. Section 151(c), however, expressly contemplates that, after satisfaction of the dividend preferences on preferred stock, the potential must exist for dividends to be paid on the remaining classes or series of stock out of "the remaining assets of the corporation available for dividends." 8 *Del. C.* § 151(c). While a dividend on remaining classes or series of stock need not be paid after the corporation has paid a dividend to the preferred stockholders, the plain meaning of Section 151(c) contemplates that there must be at least the possibility that there could be remaining assets available for such a dividend on other classes or series of stock after the preference is paid. Because the Net Worth Sweep operates to ensure that there will never be any assets remaining in the Companies available for a dividend to other stockholders, it is not a permissible dividend "preference." Rather, it appropriates all the net worth of the Companies in perpetuity to the Senior Preferred Stock and thereby violates Delaware law.

IV. The Net Worth Sweep Is Void And Unenforceable

Because the Net Worth Sweep violates Section 151(c) of the DGCL, the dividend feature of the Senior Preferred Stock is void and unenforceable. *See, e.g.*, *Shintom*, 888 A.2d at 228 ("Preferred shares that do not comport with the statutory requirements of the Delaware General Corporation law are void."); *Cigna Health & Life Ins. Co. v. Audax Health Solutions, Inc.*, 107 A.3d 1082, 1099 (Del. Ch. 2014) (holding that indemnification obligation that violated 8 *Del. C.* § 251 was void and unenforceable).

Nor can the Net Worth Sweep, under Delaware law, be salvaged retroactively by equitable doctrines, whether upon remand to the District Court or otherwise. In cases involving DGCL statutory violations such as present here, equitable doctrines cannot be used to turn back the clock and validate otherwise void corporate acts. *See, e.g.*, *STAAR Surgical*, 588 A.2d at 1137 (a "court cannot imbue void stock with the attributes of valid shares"); *Waggoner v. Laster*, 581 A.2d 1127, 1137 (Del. 1990) ("Estoppel, however, has no application in cases where the . . . action approved by the directors or stockholders is illegal or void."); *Liebermann v. Frangiosa*, 844 A.2d 992, 1004 (Del. Ch. 2002) ("[Delaware] case law has refused to overlook the statutory invalidity of stock even in situations when that might generate an inequitable result."). Accordingly, under Delaware

law, the statutory invalidity of the Net Worth Sweep cannot be remedied retroactively by equitable doctrines.[21]

CONCLUSION

Preferred stock cannot be given a cumulative dividend right equal to all the net worth of a corporation in perpetuity. For the foregoing reasons, the undersigned respectfully submits that this Court should hold that the Net Worth Sweep is void *ab initio* and unenforceable under the corporate law governing the Companies and, accordingly, reverse the decision of the District Court.

Respectfully submitted,

/s/ Myron T. Steele

Myron T. Steele
POTTER ANDERSON & CORROON LLP
1313 North Market Street, 6th Floor
Wilmington, DE 19801
Tel: (302) 984-6030
Fax: (302) 658-1192

Counsel for Amicus Curiae
Center for Individual Freedom

Dated: July 6, 2015

[21] However, "[g]iven the contractual nature of preferred stock, . . . where one term of preferred stock is unenforceable but the preferred stock is otherwise valid, the preferred stock is not void." David A. Drexler, Lewis S. Black, Jr. & A. Gilchrist Sparks III, *Delaware Corporation Law & Practice*, § 17.01[3] at 17-8 (2014); *see also Hildreth v. Castle Dental Ctrs., Inc.*, 939 A.2d 1281, 1283-84 (Del. 2007) (invalid term in preferred stock agreement did not render preferred shares or contract void). Therefore, while the Net Worth Sweep is void and unenforceable, the remaining terms of Treasury's Senior Preferred Stock may be enforced.

Certificate of Compliance with Rule 32(a)(7)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) because the brief contains 5,363 words, less than half the length permissible for the principal brief, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface and type style requirements of Fed. R. App. P. 32(a)(5) and (6) and D.C. Cir. Rule 32(a)(1) because the brief has been prepared in a proportionally spaced typeface using Microsoft Word 2007 Professional in 14-point Times New Roman.

/s/ Myron T. Steele
Myron T. Steele

ADDENDUM OF STATUTORY AUTHORITIES

Table of Contents

Page

§ 151 Classes and series of stock; redemption; rights.

(a) Every corporation may issue 1 or more classes of stock or 1 or more series of stock within any class thereof, any or all of which classes may be of stock with par value or stock without par value and which classes or series may have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the certificate of incorporation or of any amendment thereto, or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation. Any of the voting powers, designations, preferences, rights and qualifications, limitations or restrictions of any such class or series of stock may be made dependent upon facts ascertainable outside the certificate of incorporation or of any amendment thereto, or outside the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by its certificate of incorporation, provided that the manner in which such facts shall operate upon the voting powers, designations, preferences, rights and qualifications, limitations or restrictions of such class or series of stock is clearly and expressly set forth in the certificate of incorporation or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors. The term "facts," as used in this subsection, includes, but is not limited to, the occurrence of any event, including a determination or action by any person or body, including the corporation. The power to increase or decrease or otherwise adjust the capital stock as provided in this chapter shall apply to all or any such classes of stock.

(b) Any stock of any class or series may be made subject to redemption by the corporation at its option or at the option of the holders of such stock or upon the happening of a specified event; provided however, that immediately following any such redemption the corporation shall have outstanding 1 or more shares of 1 or more classes or series of stock, which share, or shares together, shall have full voting powers. Notwithstanding the limitation stated in the foregoing proviso:

(1) Any stock of a regulated investment company registered under the Investment Company Act of 1940 [15 U.S.C. § 80 a-1 et seq.], as heretofore or hereafter amended, may be made subject to redemption by the corporation at its option or at the option of the holders of such stock.

(2) Any stock of a corporation which holds (directly or indirectly) a license or franchise from a governmental agency to conduct its business or is a member of a national securities exchange, which license, franchise or membership is conditioned upon some or all of the holders of its stock possessing prescribed qualifications, may be made subject to redemption by the corporation to the extent necessary to prevent the loss of such license, franchise or membership or to reinstate it.

Any stock which may be made redeemable under this section may be redeemed for cash, property or rights, including securities of the same or another corporation, at such time or times, price or prices, or rate or rates, and with such adjustments, as shall be stated in the certificate of incorporation or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to subsection (a) of this section.

(c) The holders of preferred or special stock of any class or of any series thereof shall be entitled 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 resolution or resolutions providing for the issue of such stock adopted by the board of directors as hereinabove provided, payable in preference to, or in such relation to, the dividends payable on any other class or classes or of any other series of stock, and cumulative or noncumulative as shall be so stated and expressed. When dividends upon the preferred and special stocks, if any, to the extent of the preference to which such stocks are entitled, shall have been paid or declared and set apart for payment, 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 as elsewhere in this chapter provided.

(d) The holders of the preferred or special stock of any class or of any series thereof shall be entitled to such rights upon the dissolution of, or upon any distribution of the assets of, the corporation as shall be stated in the certificate of incorporation or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors as hereinabove provided.

(e) Any stock of any class or of any series thereof may be made convertible into, or exchangeable for, at the option of either the holder or the corporation or upon the happening of a specified event, shares of any other class or classes or any other series of the same or any other class or classes of stock of the corporation, at such price or prices or at such rate or rates of exchange and with such adjustments as shall be stated in the certificate of incorporation or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors as hereinabove provided.

(f) If any corporation shall be authorized to issue more than 1 class of stock or more than 1 series of any class, the powers, designations, preferences and relative, participating, optional, or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate which the corporation shall issue to represent such class or series of stock, provided that, except as otherwise provided in § 202 of this title, in lieu of the foregoing requirements, there may be set forth on the face or back of the certificate which the corporation shall issue to represent such class or series of stock, a statement that the corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative, participating, optional, or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights. Within a reasonable time after the issuance or transfer of uncertificated stock, the corporation shall send to the registered owner thereof a written notice containing the information required to be set forth or stated on certificates pursuant to this section or § 156, § 202(a) or § 218(a) of this title or with respect to this section a statement that the corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights. Except as otherwise expressly provided by law, the rights and obligations of the holders of uncertificated stock and the rights and obligations of the holders of certificates representing stock of the same class and series shall be identical.

(g) When any corporation desires to issue any shares of stock of any class or of any series of any class of which the powers, designations, preferences and relative, participating, optional or other rights, if any, or the qualifications, limitations or restrictions thereof, if any, shall not have been set forth in the certificate of incorporation or in any amendment thereto but shall be provided for in a resolution or resolutions adopted by the board of directors pursuant to authority expressly vested in it by the certificate of incorporation or any amendment thereto, a certificate of designations setting forth a copy of such resolution or resolutions and the number of shares of stock of such class or series as to which the resolution or resolutions apply shall be executed, acknowledged, filed and shall become effective, in accordance with § 103 of this title. Unless otherwise provided in any such resolution or resolutions, the number of shares of stock of any such series to which such resolution or resolutions apply may be increased (but not above the total number of authorized shares of the class) or

decreased (but not below the number of shares thereof then outstanding) by a certificate likewise executed, acknowledged and filed setting forth a statement that a specified increase or decrease therein had been authorized and directed by a resolution or resolutions likewise adopted by the board of directors. In case the number of such shares shall be decreased the number of shares so specified in the certificate shall resume the status which they had prior to the adoption of the first resolution or resolutions. When no shares of any such class or series are outstanding, either because none were issued or because no issued shares of any such class or series remain outstanding, a certificate setting forth a resolution or resolutions adopted by the board of directors that none of the authorized shares of such class or series are outstanding, and that none will be issued subject to the certificate of designations previously filed with respect to such class or series, may be executed, acknowledged and filed in accordance with § 103 of this title and, when such certificate becomes effective, it shall have the effect of eliminating from the certificate of incorporation all matters set forth in the certificate of designations with respect to such class or series of stock. Unless otherwise provided in the certificate of incorporation, if no shares of stock have been issued of a class or series of stock established by a resolution of the board of directors, the voting powers, designations, preferences and relative, participating, optional or other rights, if any, or the qualifications, limitations or restrictions thereof, may be amended by a resolution or resolutions adopted by the board of directors. A certificate which:

(1) States that no shares of the class or series have been issued;

(2) Sets forth a copy of the resolution or resolutions; and

(3) If the designation of the class or series is being changed, indicates the original designation and the new designation,

shall be executed, acknowledged and filed and shall become effective, in accordance with § 103 of this title. When any certificate filed under this subsection becomes effective, it shall have the effect of amending the certificate of incorporation; except that neither the filing of such certificate nor the filing of a restated certificate of incorporation pursuant to § 245 of this title shall prohibit the board of directors from subsequently adopting such resolutions as authorized by this subsection.

§ 242 Amendment of certificate of incorporation after receipt of payment for stock; nonstock corporations.

(a) After a corporation has received payment for any of its capital stock, or after a nonstock corporation has members, it may amend its certificate of incorporation, from time to time, in any and as many respects as may be desired, so long as its certificate of incorporation as amended would contain only such provisions as it would be lawful and proper to insert in an original certificate of incorporation filed at the time of the filing of the amendment; and, if a change in stock or the rights of stockholders, or an exchange, reclassification, subdivision, combination or cancellation of stock or rights of stockholders is to be made, such provisions as may be necessary to effect such change, exchange, reclassification, subdivision, combination or cancellation. In particular, and without limitation upon such general power of amendment, a corporation may amend its certificate of incorporation, from time to time, so as:

(1) To change its corporate name; or

(2) To change, substitute, enlarge or diminish the nature of its business or its corporate powers and purposes; or

(3) To increase or decrease its authorized capital stock or to reclassify the same, by changing the number, par value, designations, preferences, or relative, participating, optional, or other special rights of the shares, or the qualifications, limitations or restrictions of such rights, or by changing shares with par value into shares without par value, or shares without par value into shares with par value either with or without increasing or decreasing the number of shares, or by subdividing or combining the outstanding shares of any class or series of a class of shares into a greater or lesser number of outstanding shares; or

(4) To cancel or otherwise affect the right of the holders of the shares of any class to receive dividends which have accrued but have not been declared; or

(5) To create new classes of stock having rights and preferences either prior and superior or subordinate and inferior to the stock of any class then authorized, whether issued or unissued; or

(6) To change the period of its duration; or

(7) To delete:

a. Such provisions of the original certificate of incorporation which named the incorporator or incorporators, the initial board of directors and the original subscribers for shares; and

b. Such provisions contained in any amendment to the certificate of incorporation as were necessary to effect a change, exchange, reclassification, subdivision, combination or cancellation of stock, if such change, exchange, reclassification, subdivision, combination or cancellation has become effective.

Any or all such changes or alterations may be effected by 1 certificate of amendment.

(b) Every amendment authorized by subsection (a) of this section shall be made and effected in the following manner:

(1) If the corporation has capital stock, its board of directors shall adopt a resolution setting forth the amendment proposed, declaring its advisability, and either calling a special meeting of the stockholders entitled to vote in respect thereof for the consideration of such amendment or directing that the amendment proposed be considered at the next annual meeting of the stockholders; provided, however, that unless otherwise expressly required by the certificate of incorporation, no meeting or vote of stockholders shall be required to adopt an amendment that effects only changes described in paragraph (a)(1) or (7) of this section. Such special or annual meeting shall be called and held upon notice in accordance with § 222 of this title. The notice shall set forth such amendment in full or a brief summary of the changes to be effected thereby unless such notice constitutes a notice of internet availability of proxy materials under the rules promulgated under the Securities Exchange Act of 1934 [15 U.S.C. § 78a et seq.]. At the meeting a vote of the stockholders entitled to vote thereon shall be taken for and against any proposed amendment that requires adoption by stockholders. If no vote of stockholders is required to effect such amendment, or if a majority of the outstanding stock entitled to vote thereon, and a majority of the outstanding stock of each class entitled to vote thereon as a class has been voted in favor of the amendment, a certificate setting forth the amendment and certifying that such amendment has been duly adopted in accordance with this section shall be executed, acknowledged and filed and shall become effective in accordance with § 103 of this title.

(2) The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to vote thereon by the certificate of incorporation, if the amendment would increase or decrease the aggregate number of authorized shares of such class, increase or decrease the par value of the shares of such class, or alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely. If any proposed amendment would alter or change the powers, preferences, or special rights of 1 or more series of any class so as to affect

them adversely, but shall not so affect the entire class, then only the shares of the series so affected by the amendment shall be considered a separate class for the purposes of this paragraph. The number of authorized shares of any such class or classes of stock may be increased or decreased (but not below the number of shares thereof then outstanding) by the affirmative vote of the holders of a majority of the stock of the corporation entitled to vote irrespective of this subsection, if so provided in the original certificate of incorporation, in any amendment thereto which created such class or classes of stock or which was adopted prior to the issuance of any shares of such class or classes of stock, or in any amendment thereto which was authorized by a resolution or resolutions adopted by the affirmative vote of the holders of a majority of such class or classes of stock.

(3) If the corporation is a nonstock corporation, then the governing body thereof shall adopt a resolution setting forth the amendment proposed and declaring its advisability. If a majority of all the members of the governing body shall vote in favor of such amendment, a certificate thereof shall be executed, acknowledged and filed and shall become effective in accordance with § 103 of this title. The certificate of incorporation of any nonstock corporation may contain a provision requiring any amendment thereto to be approved by a specified number or percentage of the members or of any specified class of members of such corporation in which event such proposed amendment shall be submitted to the members or to any specified class of members of such corporation in the same manner, so far as applicable, as is provided in this section for an amendment to the certificate of incorporation of a stock corporation; and in the event of the adoption thereof by such members, a certificate evidencing such amendment shall be executed, acknowledged and filed and shall become effective in accordance with § 103 of this title.

(4) Whenever the certificate of incorporation shall require for action by the board of directors of a corporation other than a nonstock corporation or by the governing body of a nonstock corporation, by the holders of any class or series of shares or by the members, or by the holders of any other securities having voting power the vote of a greater number or proportion than is required by any section of this title, the provision of the certificate of incorporation requiring such greater vote shall not be altered, amended or repealed except by such greater vote.

(c) The resolution authorizing a proposed amendment to the certificate of incorporation may provide that at any time prior to the effectiveness of the filing of the amendment with the Secretary of State, notwithstanding authorization of the proposed amendment by the stockholders of the corporation or by the

members of a nonstock corporation, the board of directors or governing body may abandon such proposed amendment without further action by the stockholders or members.

CERTIFICATE OF SERVICE

I hereby certify, pursuant to Fed. R. App. P. 25(c) and Cir. R. 25, that on July 6, 2015, the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system, which will send a notification to the attorneys of record in this matter who are registered with the Court's CM/ECF system.

Dated: July 6, 2015

/s/ Myron T. Steele
Myron T. Steele