**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
CEDAR RAPIDS DIVISION**

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| THOMAS SAXTON, IDA SAXTON, BRADLEY PAYNTER,<br><br>Plaintiffs,<br><br>vs.<br><br>THE FEDERAL HOUSING FINANCE AGENCY, *et al.*,<br><br>Defendants. | Civil Action No. 1:15-cv-00047 |

**PLAINTIFFS' RESPONSE TO DEFENDANTS' MOTIONS TO DISMISS**

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## INTRODUCTION

This case concerns the federal government's unprecedented attempt to expropriate the entire economic value of two of the Nation's largest and most profitable corporations, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation ("Fannie" and "Freddie," respectively, and "the Companies," collectively). In August 2012, the Federal Housing Finance Agency ("FHFA"), purportedly acting as the Companies' conservator, entered into an agreement with the Department of the Treasury ("Treasury") that requires the Companies to pay *all* of their existing net worth and future profits to Treasury in perpetuity. Complaint ¶¶ 70, 80 (May 28, 2015), Doc. 1 ("Compl."). The purpose and effect of this "Net Worth Sweep" was to effectively nationalize Fannie and Freddie by transferring to the federal government all of the economic interests held by Fannie's and Freddie's private shareholders and by making it impossible for the Companies to rebuild their capital reserves, exit conservatorship, and return to normal business operations. *Id.* ¶¶ 13–14, 81. The Companies received no meaningful consideration in return. *Id.* ¶ 14.

As Defendants anticipated when they imposed the Net Worth Sweep, their scheme has been tremendously profitable for Treasury. *See, e.g., id.* ¶¶ 15, 67–68. Under the terms of the investments Treasury made in the Companies in 2008, it would have received approximately $52 billion in dividends during 2013, 2014, and the first three quarters of 2015 had the Companies elected to pay cash dividends on those investments (approximately $4.7 billion per quarter). *Id.* ¶¶ 77–78. But under the Net Worth Sweep, Treasury received *almost $184 billion* during that time. This extra $132 billion should have been used to prudently rebuild Fannie's and Freddie's capital reserves, shield them from future downturns in the market, and position them to exit conservatorship; instead, it is being siphoned to the Treasury's coffers while forcing two immensely profitable insurance companies to operate on the edge of insolvency.

Altogether, Fannie and Freddie have paid Treasury over $239 billion—approximately $52 billion *more* than Treasury disbursed. *See* Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities at 3 (Sept. 30, 2015), http://goo.gl/hDDnDr. But due to the terms of the Net Worth Sweep, these payments have not reduced Fannie's and Freddie's outstanding obligation to Treasury by even one dollar, and Fannie and Freddie must continue to pay all of their net worth each quarter to the Treasury *in perpetuity*. In concocting and imposing the Net Worth Sweep, FHFA and Treasury have achieved their objective of preventing Fannie's and Freddie's minority shareholders from *ever* receiving *anything*—no possible economic participation or investment return whatsoever—in the future.

It is inconceivable that the United States Congress would authorize the federal government to expropriate—peremptorily and without any procedural protections whatsoever—the rights of private shareholders to the future profits of publicly traded companies generating billions of dollars of earnings. To be sure, Congress did *not* authorize the conservator—a federal agency—to strip away all of the Companies' capital, to pay all of their future profits to another federal agency, or to engage in self-dealing expropriation of private property. But FHFA and Treasury insist that is precisely what Congress did in enacting the Housing and Economic Recovery Act of 2008 ("HERA"). Indeed, FHFA and Treasury argue that Congress ousted the courts of jurisdiction under *all* circumstances when FHFA is purporting to act as conservator, even to hear Plaintiffs' challenge of an unconscionable act by a *conservator*—a *Net Worth Sweep*—that is (1) without precedent, (2) fraught with manifest conflicts of interest, and (3) extraordinarily beneficial to one dominant shareholder (Treasury) at the expense, and to the extreme detriment, of all minority shareholders. FHFA and Treasury are wrong, and their attempt to evade judicial review should be flatly rejected.

FHFA and Treasury repeatedly emphasize that Section 4617(f) of HERA bars equitable relief that would "restrain or affect the exercise of powers or functions of the [FHFA] as a conservator . . . ." 12 U.S.C. § 4617(f). But this restriction has no application here because it is clear that FHFA blatantly exceeded its conservatorship authority in imposing the Net Worth Sweep. Indeed, Section 4617(f) is not applicable when FHFA engages in the conduct of an "anti-conservator," undertaking actions that are wholly irreconcilable with its duties and obligations as required under HERA. As conservator, FHFA is expressly charged with the statutory duty of "rehabilitating" Fannie and Freddie by, among other things, taking actions to put them "in a sound and solvent condition" and "preserve and conserve [their] assets and property." *Id.* § 4617(a)(2), (b)(2)(D). This rehabilitative purpose is not unique to conservatorships established under HERA, but rather is the fundamental aim of all conservatorships, everywhere. And it stands in marked contrast to the defining purpose of a receivership, which is to wind down the affairs and liquidate the assets of a failed company. Moreover, HERA mandates that FHFA exercise its conservatorship authority independently; the statute expressly forbids FHFA from being "subject to the direction or supervision of any other agency of the United States" when "acting as conservator." *Id.* § 4617(a)(7).

Just as the conservator is obviously prohibited from usurping all of the Companies' net worth and profits in order to purchase a fleet of luxury yachts for FHFA executives, so too is FHFA—as *conservator*—barred from usurping all of the Companies' net worth and future profits in order to gift unlimited sums of money (purportedly in the form of "variable rate dividends") to a single dominant shareholder (its sister agency, the Treasury).

The Net Worth Sweep is wholly irreconcilable with FHFA's statutory mandates—it guarantees that Fannie and Freddie will *not* be rehabilitated, will *not* operate in a sound and solvent condition, and will *not* preserve and conserve their assets. Furthermore, FHFA imposed the Net Worth Sweep on the basis of extraordinary pressure from Treasury. *See* Compl. ¶¶ 17, 82, 98, 104. Indeed, no *independent* conservator would ever agree to sign away all rights to the future profits of the companies under its care in exchange for virtually nothing.

FHFA's own public statements confirm that the Net Worth Sweep exceeded FHFA's statutory authority. For example, FHFA reassured Fannie's and Freddie's private shareholders that they would continue to "have an economic interest in the companies." *Id.* ¶ 39. And as late as 2011, FHFA emphasized that "[a] conservator's goal is to continue the operations of a regulated entity, rehabilitate it and return it to a safe, sound and solvent condition." *Id.* ¶ 38.

But Treasury secretly resolved that Fannie and Freddie would *never* be allowed to return to private control under their current charters and that all of their future profits would be captured entirely by the federal government. Indeed, an internal Treasury document from December 2010 discusses the Administration's "commitment to ensure existing common equity holders will not have access to any positive earnings from the [Companies] in the future." *Id.* ¶ 85.

The Net Worth Sweep implemented this secret and premeditated Administration decision. *Id.* Indeed, Treasury publicly heralded the Net Worth Sweep as ensuring "that every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers." *Id.* ¶ 84. Treasury also praised the Net Worth Sweep for ensuring that Fannie and Freddie "will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." *Id.* FHFA Acting Director DeMarco likewise explained that the Net Worth Sweep "reinforce[d] the notion that the [Companies] will not be building capital as a potential step to regaining their former corporate status." *Id.* ¶ 86. Treasury's and FHFA's own statements thus confirm that the Net Worth Sweep is completely contrary to a conservator's defining purpose: namely, to rehabilitate a company and return it to normal operations.

Treasury, for its part, purported to exercise rights in connection with its status as a shareholder of Fannie and Freddie in entering the Net Worth Sweep, but HERA provided Treasury with only temporary authority to purchase the Companies' securities. That authority expired on December 31, 2009, *see* 12 U.S.C. §§ 1455(*l*)(4), 1719(g)(4), and the "Government Stock" Treasury acquired before that date did not give it the right to all of the Companies' profits in perpetuity. Treasury had no authority to acquire securities in Fannie and Freddie giving it that right in 2012, whether by purchasing new securities or by "amendment" of its existing securities. And no shareholder of a publicly traded company—let alone a company that is operating under federal conservatorship—has ever "amended" existing securities in order to *usurp* all net worth and future profits of such company in perpetuity, without limitation, and without consideration of any other shareholder. The Net Worth Sweep also violates Congress' desire "to maintain the [Companies'] status as . . . private shareholder-owned compan[ies]," a factor that HERA requires Treasury to "take into consideration" when exercising its authority to purchase the Companies' securities. *Id*. §§ 1455(*l*)(1)(C)(v), 1719(g)(1)(C). Section 4617(f) does not bar the Court from requiring Treasury to operate within its statutory authority, as an injunction remedying *Treasury*'s unlawful conduct will not "restrain or affect" *FHFA*'s actions as conservator.

FHFA and Treasury also rely on another provision of HERA, Section 4617(b)(2)(A)(i), 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] . . . ." While this provision may preclude shareholders of a company in conservatorship from bringing certain *derivative* claims on the company's behalf, Plaintiffs are asserting *direct* claims. In any event, Congress surely did not grant FHFA control over the litigation of a lawsuit *against itself and a sister federal agency.*

When evaluating the breadth and applicability of an anti-injunction provision, the Court must draw a clear distinction between (a) enabling a conservator to make efficient decisions that affect the day-to-day operations of a company, and (b) shielding a conservator that undertakes actions at the behest of one dominant shareholder which explicitly *undermine* the express purpose of any conservatorship and the interests of all other shareholders.

Defendants' motions to dismiss rely on *Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208 (D.D.C. 2014), which rejected claims similar to those at issue here and is currently on appeal before the D.C. Circuit. But the district court's reasoning in that case is utterly bankrupt, and this court should repudiate it. For example, essentially ignoring whether FHFA's actions were consistent with its statutory mandates to "preserve and conserve" Fannie's and Freddie's assets while returning them to a "sound and solvent" condition, 12 U.S.C. § 4617(b)(2)(D), *Perry Capital* instead held that the Net Worth Sweep was within FHFA's conservatorship authority because Fannie and Freddie "maintain an operational mortgage finance business and are . . . profitable." *Id*. at 228. But this superficial analysis ignores the central issue, because the key question under HERA is not *whether* Fannie and Freddie are generating profits, but *what they are doing with* those profits. And being forced to pay out all profits in the form of "dividends" to a controlling shareholder plainly does not preserve and conserve assets, and it is the antithesis of safe and sound operations.

*Perry Capital*'s analysis of Treasury's actions is similarly shallow and misguided. Despite acknowledging that, as a matter of substance, "Treasury agreed to a net worth sweep *in exchange for* eliminating the cash dividend equivalent to 10% of the

[Companies'] liquidation preference," *id*. at 224 (emphasis added), the court reasoned that the transaction nevertheless did not transgress the expiration of Treasury's purchase authority because, as a matter of form, Treasury was not "providing an additional funding commitment or receiving new securities from [the Companies]," *id*. The *Perry Capital* court's reasoning eviscerates the statutory limitations Congress has placed on FHFA and Treasury and grants the agencies free rein to raid the coffers of two of the Nation's most profitable companies and to destroy the property rights of the Companies' shareholders in the process. This is not what Congress intended, and this court must not allow it.

Defendants also argue that Plaintiffs' claims are somehow precluded by rulings against different shareholders in different cases challenging the Net Worth Sweep. Even on their own terms, Defendants' preclusion arguments only apply if Plaintiffs' claims, indisputably asserted as *direct* claims, are actually derivative claims. Because Plaintiffs' claims are direct, Defendants' preclusion arguments fail at the outset. And even if Plaintiffs' claims were held to be derivative, preclusion still should not apply in the circumstances of this case, as explained more fully below.

In addition to transgressing the bounds Congress set for it as a conservator, FHFA has violated the common-law rights of Fannie's and Freddie's private shareholders. 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 all contractual relationships. Furthermore, by permitting Treasury to seize all of the firms' residual profits in perpetuity, the Net Worth Sweep effectively transformed Treasury's Government Stock into 100% of the Companies' common stock. By paying dividends on this common stock without first paying dividends to Fannie's and Freddie's private preferred and common shareholders, FHFA has breached these shareholders' contractual rights. As with

Plaintiffs' claims arising under federal law, nothing in HERA bars this Court from granting relief for FHFA's violations of Plaintiffs' common-law rights.

Congress did not authorize FHFA and Treasury to nationalize the Companies, and this Court has both the jurisdiction and the responsibility to redress Defendants' unlawful expropriation of Plaintiffs' investments. The motions to dismiss should be denied.

## STATEMENT OF FACTS

Fannie and Freddie are for-profit, stockholder-owned corporations that operate under Federal charters. Compl. ¶¶ 28–29. Among other things, the Companies insure mortgages originated by private banks and bundle the mortgages into securities that can be sold to investors. *Id*. ¶ 28. Prior to 2007, Fannie and Freddie were consistently profitable. *Id*. ¶ 33. In fact, Fannie had not reported a full-year loss since 1985, and Freddie had never reported a full-year loss since becoming owned by private shareholders in 1989. *Id.*

Both Companies have outstanding privately owned preferred and common stock, on which they regularly declared dividends while under private control. *Id.* The numerous series of privately owned preferred stock in the Companies are in parity with each other with respect to dividend payments and liquidation preference, but they have priority over the Companies' common stock for these purposes. *Id*. ¶ 30. Owners of the common stock are entitled to the residual economic value of the firms. *Id*. Plaintiffs own Fannie and Freddie common stock and Freddie preferred stock. *Id*. ¶¶ 31–32.

In 2008, Congress enacted HERA. *Id.* ¶ 34. HERA created FHFA (which succeeded to the regulatory authority over Fannie and Freddie previously held by the Office of Federal Housing Enterprise Oversight) and authorized FHFA, under certain statutorily prescribed and circumscribed conditions, to place those Companies into conservatorship or receivership. *Id*.

Under HERA, conservatorship and receivership are distinct statuses aimed at distinct ends: the former toward rehabilitation and return to private control, the latter toward liquidation and wind down of operations. In FHFA's words, "[t]he ultimate responsibility of FHFA as receiver is to resolve and liquidate the existing entity. A conservator's goal is to continue the operations of a regulated entity, rehabilitate it and return it to a safe, sound and solvent condition." Conservatorship and Receivership, 76 Fed. Reg. 35,724, 35,730 (June 20, 2011). These distinctions are grounded in the text of HERA. The Act empowers and obligates FHFA as conservator to carry on a company's business, preserve and conserve its assets and property, and return it to sound and solvent condition:

> Powers as conservator
> The Agency may, as conservator, take such action as may be—
> (i) necessary to put the regulated entity in a sound and solvent condition; and
> (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.

12 U.S.C. § 4617(b)(2)(D).

Only as receiver may FHFA liquidate a company and wind down its operations:

> Additional powers as receiver
> In any case in which the Agency is acting as receiver, the Agency shall place the regulated entity in liquidation and proceed to realize upon the assets of the regulated entity in such manner as the Agency deems appropriate . . . .

*Id.* § 4617(b)(2)(E). To facilitate the receivership process, HERA establishes specific claims determination procedures to be followed by FHFA as receiver "in any case involving the liquidation or winding up of the affairs of a closed regulated entity." *Id.* § 4617(b)(3)(B).

In addition to creating FHFA, HERA also gave Treasury *limited*, *temporary* authority to purchase securities from Fannie and Freddie. Congress did *not* authorize Treasury to nationalize the Companies, for in exercising its authority HERA expressly required Treasury, among other things, to consider "the need to maintain [Fannie's and Freddie's] status as . . . private shareholder-owned compan[ies]" and their "plan for the orderly resumption of private market funding or capital market access," *id.* §§ 1455(*l*)(1)(C), 1719(g)(1)(C).

Finally, Treasury's authority to invest in Fannie's and Freddie's securities expired on December 31, 2009. *Id.* §§ 1455(*l*)(4), 1719(g)(4). While Treasury may continue to hold its shares and exercise rights received in connection with them, it is no longer authorized to purchase new or additional securities. Nor is Treasury authorized to drastically change or fundamentally alter the rights and characteristics of its existing securities under the guise of an "amendment." And it is inconceivable that the Net Worth Sweep could be considered a mere "amendment" to the existing Government Stock, let alone an "exercise of rights" associated with such securities. To the contrary, the Net Worth Sweep so fundamentally transformed the nature of Treasury's investment in the Companies that it can only be understood as the disposition of Treasury's existing senior preferred stock and the acquisition of entirely new stock.

HERA was signed into law on July 30, 2008. Five weeks later, on September 6, 2008, FHFA placed Fannie and Freddie into conservatorship. Compl. ¶ 35. In announcing the conservatorships, FHFA Director James Lockhart publicly emphasized that their purpose was, as clearly prescribed by HERA, to rehabilitate Fannie and Freddie, return them to a safe and sound financial condition, and then release them from conservatorship. Conservatorship, he explained, "is a statutory process designed to stabilize a troubled institution with the objective of returning the entities to normal business operations." *Id.* (quoting Statement of James B. Lockhart, Director, FHFA, at 5–6 (Sept. 7, 2008) ("Lockhart Conservatorship Statement")). Thus, FHFA only would "act as the conservator to operate [the Companies] until they are stabilized." *Id.* ¶ 39 (quoting Lockhart Conservatorship Statement 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), http://goo.gl/HvAL17 ("FHFA FACT SHEET").

FHFA and Director Lockhart repeatedly emphasized that, as required by HERA, Fannie and Freddie would be maintained as "private shareholder-owned compan[ies]" during conservatorship, 12 U.S.C. §§ 1455(*l*)(1)(C)(v), 1719(g)(1)(C)(v), and that their common and preferred shareholders would retain an economic interest in the Companies. *See* Compl. ¶ 39 ("the common and all preferred stocks [of the Companies] will continue to remain outstanding" (alteration in original) (quoting Lockhart Conservatorship Statement at 8)); *id.* (during the conservatorship, the Companies' stockholders "will continue to retain all rights in the stock's financial worth" (quoting FHFA FACT SHEET at 3)); *id.* (the Companies' shareholders "are still in place; both the preferred and common shareholders have an economic interest in the companies" and "going forward there may be some value" (quoting *Oversight Hearing To Examine Recent Treasury and FHFA Actions Regarding the Housing GSEs: Hearing Before H. Comm. on Fin. Servs.*, 110th Cong. (Sept. 25, 2008) (Statement of James B. Lockhart, Director, FHFA))).

Finally, FHFA and Director Lockhart publicly vowed, in keeping with the requirements of HERA, that the conservatorships would be *temporary*. *See* Compl. ¶ 39 ("FHFA will act as the conservator to operate [Fannie and Freddie] *until they are stabilized*." (emphasis added) (quoting Lockhart Conservatorship Statement at 6)); *id.* ¶ 40 ("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." (quoting FHFA FACT SHEET at 2)).

As discussed in detail below, by adopting the Net Worth Sweep, FHFA repudiated all of these emphatic public representations and, more importantly, egregiously violated HERA's unambiguous limits on its powers and functions as conservator.

On September 7, 2008, the day after it had taken control of the Companies, FHFA announced that it had entered into materially identical "Preferred Stock Purchase Agreements" ("PSPAs") with Treasury on behalf of each Company. *Id.* ¶¶ 8, 41, 45. Under the PSPAs, Treasury committed to invest up to $100 billion in each Company, if needed. *Id.* ¶ 45. But Treasury did not invest the full $100 billion at once. Rather, the PSPAs provide that FHFA, on behalf of the Companies, may request quarterly draws from Treasury's funding commitment to maintain a positive net worth. *Id*. By default, the most FHFA may request is the amount by which each Company's liabilities exceed its assets pursuant to Generally Accepted Accounting Principles, although it may request and receive more with Treasury's written agreement. *See* Fannie PSPA 1–2, 4, attached as Exhibit A to FHFA MTD (Sept. 4, 2015), Doc. 20-2; Freddie PSPA 1–2, 4, http://goo.gl/WQmLDp.

In return for its funding commitment, Treasury received one million shares of Government Stock in each Company and a warrant to purchase 79.9% of the common stock of each Company at a nominal price. Compl. ¶ 46. 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. These warrants gave Treasury the potential for an economic upside in addition to the dividends on its Government Stock in the event that the conservatorship succeeded and the Companies returned to stable profitability. *Id.* ¶ 51; *see also id.* ¶ 53 ("Conservatorship preserves the status and claims of the preferred and common shareholders." (original alteration omitted) (quoting Action Memorandum for Secretary Paulson (Sept. 7, 2008))).

Treasury's Government Stock in each Company had an initial liquidation preference of $1 billion. *Id.* ¶ 47. This liquidation preference increases dollar-for-dollar with funds drawn from Treasury's funding commitment. *Id.*

The PSPAs entitled Treasury to quarterly dividends on its Government Stock at an annualized rate of 10% if Fannie and Freddie elected to pay the dividends in cash or 12% if the Companies elected to pay them in kind (by adding the amount of the dividend payment to the existing liquidation preference). *See id.* ¶ 48; Fannie Government Stock Certificate 1–2, attached as Exhibit B to FHFA MTD (Sept. 4, 2015), Doc. 20-3; Freddie Government Stock Certificate 1–2, http://goo.gl/IId4fs. If the Companies chose the latter option, commonly known as a "payment-in-kind" or "PIK" option, the dividend rate would remain at 12% until the Companies had paid all dividends in cash by redeeming Government Stock attributable to in-kind dividend payments. Fannie Government Stock Certificate 1–2; Freddie Government Stock Certificate 1–2. In quarters in which the Companies chose the PIK dividend, the size of the remaining amount of Treasury's commitment would be unaffected, and thus the Companies could preserve the commitment simply by electing to pay a 12% dividend in kind whenever they did not generate sufficient cash to pay a 10% cash dividend.

The PSPAs also provided for a quarterly "periodic commitment fee." *See* Fannie PSPA 6; Freddie PSPA 6. The purpose of the fee was to compensate Treasury for the support provided by its ongoing commitment to purchase Government Stock, and it too could be paid in cash or in kind. *Id.* The fee was to be set for five-year periods by mutual agreement of Treasury and the Companies, but Treasury could elect to waive it for up to a year at a time. *Id.* Treasury has elected to waive this fee; it has never received a periodic commitment fee under the PSPAs. Compl. ¶ 50. Moreover, "[b]y the time of the Net Worth Sweep, the 10 percent return on the

Government Stock and the warrants for 79.9 percent of the common stock provided a more than adequate return on the government's stand-by commitment, and thus any additional fee would have been inappropriate." *Id.* ¶ 76.

The PSPAs provide Treasury with dominating control over the Companies, starting with its warrants to purchase 79.9% of the Companies' common stock. In addition, while the Government Stock remains outstanding the PSPAs require the Companies to obtain Treasury's consent before taking actions such as paying dividends on other classes of stock, issuing new stock, transferring certain assets, making certain fundamental changes to their operations, and increasing their indebtedness above a specified amount. *See* Fannie PSPA 8–9; Freddie PSPA 8–9. The PSPAs also require FHFA to obtain Treasury's consent before returning Fannie and Freddie to private control by terminating the conservatorship. Fannie PSPA 8; Freddie PSPA 8.

Treasury and FHFA amended the PSPAs twice before expiration of Treasury's purchase authority. The first amendment increased Treasury's funding commitment to $200 billion per Company. Compl. ¶ 54. The second amendment, entered one week before Treasury's purchase authority expired, replaced the $200 billion commitment amount with a formula that would allow Treasury's commitment to exceed (but not fall below) $200 billion depending upon any deficiencies experienced in 2010, 2011, and 2012 and any surplus existing as of December 31, 2012. *Id*. ¶ 55. Treasury's purchase authority expired on December 31, 2009, and Treasury acknowledged that its "ability to make further changes to the PSPAs . . . [was] constrained." *Id.* ¶ 56 (alterations in original).

From 2008 through the second quarter of 2012, Treasury paid $187 billion to Fannie and Freddie under the PSPAs, *id.* ¶ 58, bringing the liquidation preference of the Government Stock to $189 billion. The net payment was $161 billion, given that $26 billion of the gross amount was used to pay cash dividends to Treasury. *Id.* As explained above, the Companies were under no obligation to make these draws because they could have paid the dividends in kind with additional Government Stock. Indeed, the PSPAs expressly "*exclude* any obligation in respect of . . . [Government] Stock" for purposes of establishing the default maximum draw from Treasury. Fannie PSPA 2 (emphasis added); Freddie PSPA 2 (emphasis added).

The Companies' draws from Treasury's commitment were initiated at FHFA's direction to address temporary fluctuations in their balance sheets created by excessive provisioning for potential future losses based on the government's exceedingly pessimistic views of the Companies' financial prospects, and by write-downs of the value of significant deferred tax assets. Compl. ¶ 58. Deferred tax assets are assets (such as net operating loss carryforwards) that may be utilized to offset future tax liability, but they must be written down to the extent they are not expected to be used. *Id*. ¶ 63. Deferred tax assets are written back up if it is subsequently determined that they are likely to be used. And through loan loss reserves a company books expected loan losses before the losses are actually incurred. *See id*. ¶ 59. Reserves for non-cash losses such as these temporarily decreased Fannie's and Freddie's net worth by hundreds of billions of dollars. *Id*. ¶ 57.

As explained above, at the outset of conservatorship FHFA publicly emphasized that conservatorship was a process aimed at rehabilitating Fannie and Freddie and returning them to normal operations as private, shareholder-owned Companies. Acting Director DeMarco reiterated to Congress in February 2010 that "the only [post-conservatorship option] that FHFA may implement today under existing law is to reconstitute [Fannie and Freddie] under their current charters." *Id.* ¶ 83 (quoting Letter from Edward J. DeMarco, Acting Director, FHFA, to Chairmen and Ranking Members of the S. Comm. on Banking, Hous., & Urban Affairs and the

H. Comm. on Fin. Servs. (Feb. 2, 2010) ("DeMarco Letter to Chairmen and Ranking Members")). FHFA further emphasized in 2011 that the agency "preserves and conserves the assets and property of the Enterprises . . . and facilitates their financial stability and emergence from conservatorship. The conservatorships of Fannie Mae and Freddie Mac allow[ ] FHFA to . . . ensure they . . . are positioned to emerge from conservatorship financially strong . . . ." FHFA, ANNUAL PERFORMANCE PLAN at 16 (Mar. 14, 2011), http://goo.gl/sYGaJ0. And later that year, Acting Director DeMarco informed the Senate that, "[b]y law, the conservatorships are intended to rehabilitate [Fannie and Freddie] as private firms." Letter from Edward J. DeMarco, Acting Director, FHFA, to United States Senators (Nov. 10, 2011) ("Letter from DeMarco to Senators"), http://goo.gl/JIHglN.

At some point, however, the Administration clandestinely decided that Fannie and Freddie should not be rehabilitated and returned to private control but rather nationalized, looted of all profits, and wound down. As early as December 2010, a secret Treasury document articulated the "Administration's commitment to ensure existing common equity holders will not have access to any positive earnings from the [Companies] in the future." Compl. ¶ 85 (quoting Action Memorandum for Secretary Geithner (Dec. 20, 2010)). In February 2011, Treasury and the Department of Housing and Urban Development ("HUD") issued a white paper announcing the Administration's intention to "work with FHFA to determine the best way to responsibly reduce Fannie Mae and Freddie Mac's role in the market and ultimately wind down both institutions." DEP'T OF TREASURY & HUD, REFORMING AMERICA'S HOUSING FINANCE MARKET, A REPORT TO CONGRESS at 12 (Feb. 2011), http://goo.gl/Twym5i. Indeed, Treasury emphasized that "[a]s the market begins to heal" it would "seek opportunities, wherever possible, to accelerate Fannie Mae and Freddie Mac's withdrawal." *Id.* at 13. Treasury reiterated its "commitment to ensuring Fannie Mae and Freddie Mac have sufficient capital to honor any guarantees issued now or in the future and meet any of their debt obligations remains unchanged," but insisted that "under the PSPAs, there is sufficient funding to ensure the orderly and deliberate wind down of Fannie Mae and Freddie Mac." *Id.* at 12. However, Treasury had no authority to effectuate, direct, or otherwise mandate the wind down of these companies.

In February 2012, FHFA followed suit with the publication of a new "strategic plan" for conservatorship "consistent with . . . the housing finance reform framework[ ] set forth in the white paper produced [in 2011] by Treasury and [HUD]." FHFA, A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS: THE NEXT CHAPTER IN A STORY THAT NEEDS AN ENDING at 6 (Feb. 21, 2012), http://goo.gl/JkdbpR. The plan did "not anticipate Fannie Mae and Freddie Mac continuing as they existed before conservatorship," and the "next chapter of conservatorship" would "focus[ ] in earnest on building a secondary mortgage market infrastructure that will live beyond the Enterprises themselves." *Id.* at 20, 21.

Fannie and Freddie, however, threatened these plans by returning to strong and consistent profitability. "Due to rising house prices and reductions in credit losses, in early August 2012 the Companies reported significant income for the second quarter 2012 . . . and neither required a draw from Treasury under the [PSPAs]." Compl. ¶ 60 (omission in original) (quoting FHFA, Office of Inspector General, Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements at 11 (Mar. 20, 2013)). In the first two quarters of 2012 the Companies posted profits totaling more than $11 billion, more than enough to pay a 10% dividend. *Id.* ¶ 59. Based on the Companies' robust financial performance in early 2012, it was apparent that there was still value in the Companies' private shares. Treasury's attempt to drown the Companies by extending a *concrete* "life preserver" had failed.

In response, on August 17, 2012, just days after the Companies announced their positive second quarter results, Treasury and FHFA abruptly changed the PSPAs for a third time, replacing the existing dividend structure of the Government Stock with one that entitles Treasury to *all*—100%—of the Companies' existing net worth and future profits. *See id.* ¶¶ 70–74. On information and belief, FHFA acquiesced to this entirely one-sided Net Worth Sweep at the direction of Treasury. *Id.* ¶ 98. Under the Net Worth Sweep, since January 1, 2013, the Companies have been required to make quarterly dividend payments equal to their entire net worth, minus a $3 billion reserve amount that steadily decreases to $0.00—*zero* dollars—by January 1, 2018. *Id*. ¶¶ 70–74. In light of the fact that the Net Worth Sweep entitles Treasury to all the Companies' profits, it officially suspended payment of periodic commitment fees, which, as explained above, Treasury had never sought in the past. *See* Fannie, Third Amendment to PSPA 5 (Aug. 17, 2012), http://goo.gl/FgCpco; Freddie, Third Amendment to PSPA 5 (Aug. 17, 2012), http://goo.gl/U6Olyc. The effect of the Net Worth Sweep was thus to ensure that despite their profitability, Fannie and Freddie would remain firmly under government control and their existing private shareholders would be deprived of the economic bundle of rights associated with their investments. In short, the Net Worth Sweep nationalized the Companies and expropriated for the Treasury the entire value of all other shareholders' stock in the Companies.

In direct repudiation of FHFA's earlier public representations, Treasury trumpeted the "quarterly sweep of every dollar of profit that each firm earns going forward" as advancing its goal of making "sure that *every dollar of earnings* that Fannie Mae and Freddie Mac generate *will be used to benefit taxpayers*" for their investment in those firms and acting upon the commitment made in the Administration's 2011 White Paper that the GSEs "*will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior* *form*." Compl. ¶ 84 (emphases added) (quoting Press Release, Treasury Department Announces Further Steps To Expedite Wind Down of Fannie Mae and Freddie Mac (Aug. 17, 2012), http://goo.gl/DKxNPs ("Treasury Net Worth Sweep Press Release")). FHFA likewise emphasized that the Net Worth Sweep "ensures all the [Companies'] earnings are used to benefit taxpayers" and reinforces that "the [Companies] will not be building capital as a potential step to regaining their former corporate status." Compl. ¶ 86 (quoting FHFA, 2012 REP. TO CONG. (2013) at 1; *Oversight of FHFA: Evaluating FHFA as Regulator and Conservator: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs* at 3, 113th Cong. (Apr. 18, 2013) (statement of Edward J. DeMarco, Acting Director, FHFA) ("DeMarco Statement Before S. Comm. on Banking, Hous. & Urban Affairs")).[1]

When the Net Worth Sweep was imposed, Fannie and Freddie were entering a period of record profitability. From the beginning of 2012 through the first two quarters of 2015, Fannie and Freddie have generated net income of approximately *$194 billion*. *See* Compl. ¶¶ 15, 62, 64; News Release, *Fannie Mae Reports Net Income of $4.6 Billion and Comprehensive Income of $ 4.4 Billion for Second Quarter 2015* (Aug. 6. 2015), http://goo.gl/d0t6P1; News Release, *Freddie Mac Reports Net Income of $4.2 Billion, Comprehensive Income of $3.9 Billion for Second Quarter 2015* (Aug. 4, 2015), http://goo.gl/Zs6VPj.

These profits reflect in part the reversal of FHFA-mandated accounting decisions that led Fannie and Freddie to incur substantial non-cash accounting losses during the peak of the housing crisis. For example, under the accounting rules it was inevitable that the Companies

[1] Treasury and FHFA claim that the Net Worth Sweep also "end[ed] the circular practice of the Treasury advancing funds to the [Companies] simply to pay dividends back to Treasury." Treasury Net Worth Sweep Press Release; *see also* FHFA Br. 10–11; Treas. Br. 8–10. But, as explained above, the Companies were under no obligation to pay Treasury dividends in *cash* and thus were under no obligation to draw funds from Treasury for that purpose.

would release their deferred tax assets valuation allowances when they returned to profitability, and that is precisely what has happened. Fannie released over $50 billion of the Company's deferred tax assets valuation allowance in the first quarter of 2013, and based on its results that quarter was required by FHFA under the Net Worth Sweep to pay Treasury a "dividend" of *$59.4 billion*. Compl. ¶ 90. Freddie released $26.4 billion of its deferred tax assets valuation allowance in the third quarter of 2013, and it was required to pay Treasury a "dividend" of *$30.4 billion* in the fourth quarter of that year. *Id.* ¶¶ 64, 77; Freddie Mac, Third Quarter Report at 1 (Form 10-Q) (Nov. 7, 2013). In fact, FHFA and Treasury knew (or should have known) that when the Companies returned to profitability the deferred tax assets would be written back up, generating huge windfall profits. *Id.* ¶¶ 67–68. Indeed, a senior executive at one of the Companies discussed release of the deferred tax assets valuation allowance with Treasury shortly *before* the Net Worth Sweep was adopted. *Id.* ¶ 68.

Treasury has now recouped tens of billions of dollars more from the Companies than it disbursed to them. As of the third quarter of 2015, Fannie has returned $142.5 billion on Treasury's $116.1 billion investment and Freddie has returned $96.5 billion on Treasury's $71.3 billion investment. Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities, at 2–3 (Sept. 30, 2015), http://goo.gl/hDDnDr. Yet, according to Treasury, the liquidation preference of the Government Stock (the amount that Treasury claims is still owed) remains undiminished at $189 billion, and the Companies' profits continue to be swept to Treasury with no end in sight.

In sum, FHFA and Treasury have effected a *de facto* nationalization of Fannie and Freddie and have expropriated all value of private shareholders' interests in the Companies, all while purporting to operate under statutory authorities that require FHFA, as conservator, "to put the [Companies] in a sound and solvent condition" and "to carry on the business of the [Companies] and preserve and conserve [their] assets." 12 U.S.C. § 4617(b)(2)(D).

## **STANDARD OF REVIEW**

Treasury and FHFA have moved to dismiss Plaintiffs' Complaint for lack of jurisdiction under Federal Rule of Civil Procedure 12(b)(1) and for failure to state a claim for relief under Rule 12(b)(6). As Defendants acknowledge, "[w]here, as here, a motion to dismiss for lack of jurisdiction is limited to a facial attack on the pleadings, it is subject to the same standard as a motion brought under Rule 12(b)(6)." Mem. in Supp. of Mot. to Dismiss by Defs. FHFA as Conservator for Fannie Mae and Freddie Mac, and FHFA Director Melvin L. Watt at 12 (Sept. 4, 2015), Doc. 20-1 ("FHFA Br.") (citing *Mattes v. ABC Plastics, Inc*., 323 F.3d 695, 698 (8th Cir. 2003)); *accord* Department of the Treasury's Mem. in Supp. of Its Mot. to Dismiss the Compl. at 11, Doc. 19-1 ("Treas. Br."). This Court must therefore accept as true all factual allegations in the Complaint, and " 'dismissal is inappropriate unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.' " *Ulrich v. Pope Cnty.*, 715 F.3d 1054, 1058 (8th Cir. 2013).

## **ARGUMENT**

### **I. Plaintiffs' Claims Are Not Precluded.**

Both FHFA and Treasury argue that Plaintiffs' APA claims and contract claims are precluded by the district court decisions in *Perry Capital*, 70 F. Supp. 3d 208, and *Continental Western Insurance Co. v. FHFA*, 83 F. Supp. 3d 828 (S.D. Iowa 2015). *See* FHFA Br. 13–19; Treas. Br. 22–24, 28–33. While those cases did involve claims similar to the APA claims and contract claims at issue here, Defendants do not dispute that Plaintiffs were not parties to either of those cases. Because Plaintiffs were not parties, the *Perry Capital* and *Continental Western* decisions could potentially have affected Plaintiffs' rights only if the plaintiffs in those cases were somehow in privity with Plaintiffs here. In arguing that such privity exists, Defendants invoke the distinction drawn by corporate law between direct actions—through which shareholders seek redress for injuries to their own interests—and derivative actions, a specialized procedural mechanism through which shareholders may bring suit on behalf of a corporation to seek redress for injuries to the corporation that affect the shareholders only indirectly. Although the claims rejected in the other cases invoked by Defendants were indisputably asserted and prosecuted as direct claims, Defendants maintain that they were actually derivative claims brought on behalf of Fannie and Freddie and that the judgments in those cases thus bind the two companies. And although Plaintiffs in this case likewise seek to assert only direct claims, Defendants maintain that the claims at issue here are in fact derivative claims that belong to Fannie and Freddie and are thus foreclosed by the earlier judgments.

Defendants' preclusion argument fails for the simple reason that Plaintiffs' claims are direct, not derivative. And even if Defendants' characterization of Plaintiffs' claims were correct, issue preclusion should not apply here.

**A. Plaintiffs' Claims Are Direct, Not Derivative.**

In arguing that Plaintiffs' claims are derivative rather than direct, Defendants rely primarily on the test set forth in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), a leading Delaware case elaborating the distinction between these two categories of claims. *See* FHFA Br. 16–17; Treas. Br. 23–24. FHFA (but not Treasury) also argues more broadly that Plaintiffs' claims are per se derivative "because they are based on an alleged injury to the value of their stock." FHFA Br. 14. As demonstrated below, however, wholly apart from *Tooley*, Plaintiffs' claims are direct as a matter of law. Even if the *Tooley* test applies to these claims, moreover, they are still manifestly direct. And FHFA's argument that Plaintiffs' claims are per se derivative is wholly meritless.

### 1. Plaintiffs' Claims Are Direct Regardless of the *Tooley* Test.

In Counts IV and V of the Complaint ("the contract claims"), Plaintiffs allege that FHFA, acting as conservator for Fannie and Freddie, breached Fannie's and Freddie's contractual obligations to Plaintiffs. Any suggestion that such claims belong to Fannie and Freddie, rather than Plaintiffs, is untenable. Had Fannie and Freddie, in the absence of a conservatorship, taken precisely the same actions challenged here, they would be the proper Defendants in a suit challenging their breach of contract. Plainly they could not also be the Plaintiffs to such a suit. Not surprisingly, the Delaware Supreme Court recently made clear that "a party to a commercial contract may sue to enforce its contractual rights directly, without proceeding by way of a derivative action" and that "*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 (Del. 2015); *see also id*. at 182 ("[A] suit by a party to a commercial contract to enforce its own contractual rights is not a derivative action under Delaware law."). 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.[2]

[2] To the extent the issue of whether Plaintiffs' claims are direct or derivative turns on state law, it is governed by the laws of Delaware (for Fannie) and Virginia (for Freddie). *See* 12 C.F.R. § 1710.10(b)(1); Fannie Mae Bylaws, Corporate Governance Practices & Procedures, Art. 1, § 1.05, http://goo.gl/973DZI; Bylaws of the Federal Home Loan Mortgage Corporation, Corporate Governance Practices & Procedures & Governing Law, Art. 11, § 11.3, http://goo.gl/3XIGw9. Defendants do not contend otherwise. *See* FHFA Br. 15 n.7; Treas. Br. 23 n.11. While Delaware law is well-developed on this issue, Virginia law is not. *See, e.g.*, *Remora Investments, LLC v. Orr*, 673 S.E.2d 845, 848 (Va. 2009) (discussing, but ultimately not deciding "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 that the Virginia courts would follow the principles and analysis set forth by the 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).

In Counts I to III ("the APA claims"), Plaintiffs allege that both Defendant agencies violated HERA and that Treasury acted arbitrarily and capriciously. Plaintiffs seek redress pursuant to the Administrative Procedure Act. As the Delaware Supreme Court recently made clear, *Tooley* should not be read as "a general statement requiring all claims, whether based on a tort, contract, or statutory cause of action (e.g., antitrust), to be brought derivatively whenever the corporation of which the plaintiff is a stockholder suffered the alleged harm." *NAF Holdings*, 118 A.3d at 180. And there are good reasons to reject Defendants' arguments that Plaintiffs' APA claims are derivative given the broad language of the APA:

> The zone of interests adequate to sustain judicial review is particularly broad in suits to compel federal agency compliance with law, since Congress itself has pared back traditional prudential limitations by the Administrative Procedure Act, which affords review to any person "adversely affected or aggrieved by [federal] agency action within the meaning of a relevant statute."

*FAIC Sec., Inc. v. United States*, 768 F.2d 353, 357 (D.C. Cir. 1985) (alteration in original) (citation omitted) (quoting 5 U.S.C. § 702). This Court should not lightly read state corporate law to limit Congress's sweeping conferral of standing.

### 2. Plaintiffs' Claims Are Direct Under *Tooley*.

a. While Delaware law permits stockholders to bring derivative suits "on behalf of the corporation for harm done to the corporation," it also provides that "[a] stockholder who is directly injured . . . retain[s] the right to bring *an individual action* for injuries affecting his or her legal rights as a stockholder." *Tooley*, 845 A.2d at 1036 (emphasis added). "[W]hether a stockholder's claim is derivative or direct" turns "*solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)." *Id*. at 1033. In analyzing the first question, the 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. Once this first inquiry is conducted, "[t]he second prong of the analysis should logically follow." *Id*.

This analysis does not imply that a stockholder must show that the action which 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) ("claim could have been brought either as a direct or as a derivative claim"); *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006) (holding that claim "was both derivative and direct"); *see also Tooley*, 845 A.2d at 1036 (distinguishing "individual action for injuries affecting [stockholder's] legal rights as a stockholder" from derivative action seeking redress for "an injury caused to the corporation *alone*") (emphasis added). Rather, it means only that the stockholder must be able to prove his own injury *without regard to* whether the corporation was also harmed.

b. In this case, the harms for which Plaintiffs seek redress—the unlawful transfer of the economic bundle of rights and value of their stock to a dominant shareholder, in violation of HERA and of Fannie's and Freddie's obligations to Plaintiffs—were suffered by Plaintiffs directly. This is indisputably true of the harms for which Plaintiffs' contract claims seek redress, as discussed above. Obviously it is Plaintiffs, not Fannie and Freddie, who were harmed by FHFA's breach of the contractual obligations that Fannie and Freddie owed to Plaintiffs as minority shareholders. *See Allen v. El Paso Pipeline GP Co.*, 90 A.3d 1097, 1111 (Del. Ch. 2014) (noting "the longstanding recognition in *Tooley* and other decisions that investors can sue directly for violations of their contractual rights.").

Plaintiffs also suffered direct harm to their own interests from the violations of HERA for which Plaintiffs' APA claims seek redress. While Plaintiffs believe that the Net Worth Sweep also injured Fannie and Freddie, the injury Plaintiffs suffered "is not dependent on an injury to [either] corporation." *Tooley*, 845 A.2d at 1036; *see also Rossette*, 906 A.2d at 102–03 ("Although the corporation suffered harm (in the form of a diminution of its net worth), the minority shareholders also suffered a harm that was unique to them and independent of any injury to the corporation."). Indeed, even if Defendants' apparent (though facially implausible and, for purposes of the motions to dismiss, irrelevant) suggestion that the Net Worth Sweep somehow benefitted Fannie and Freddie were correct, *see, e.g.*, FHFA Br. 10–11; Treas. Br. 8–10, Plaintiffs were still directly injured because the Net Worth Sweep destroyed the value of their investments through the transfer of Fannie's and Freddie's entire net worth to Treasury. The gravamen of Plaintiffs' Complaint is not that the Net Worth Sweep has diminished Fannie's and Freddie's overall corporate profits and thus harmed all shareholders indirectly, but rather that it has improperly allocated to a single, dominant shareholder whatever profits those corporations do make, harming minority shareholders and destroying the economic interest in the Companies to which Plaintiffs are entitled as holders of stock. It follows that Plaintiffs "can prevail without showing an injury" to Fannie or Freddie, *Tooley*, 845 A.2d at 1036, and thus that Plaintiffs—not Fannie and Freddie—suffered the specific injury complained of here.

Significantly, the Delaware Supreme Court has expressly approved direct stockholder suits to redress the "improper extraction or expropriation, by the controlling shareholder, of economic value and voting power that belonged to the minority stockholders." *Rossette*, 906 A.2d at 102; *see also Gatz*, 925 A.2d at 1278, 1280–81 (allowing direct suit in analogous circumstances raising the same policy concerns as *Rossette*); *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 . . ."). As the Delaware Supreme Court explained, although in such cases the corporation may "suffer[ ] harm (in the form of a diminution of its net worth), the minority shareholders also suffer[ ] a harm that [is] unique to them and independent of any injury to the corporation." *Rossette*, 906 A.2d at 103. Indeed, in the recent AIG litigation, the Government "concede[d] that the *Gatz-Rossette* line of cases recognize the right of a plaintiff to bring a direct claim where a stockholder uses its majority or effective control to dilute minority shares," but argued that these cases did not apply in that case "because the Government was not a stockholder, nor did it have majority or effective control of AIG, when the purported dilution occurred." *Starr Int'l Co. v. United States*, 106 Fed. Cl. 50, 64 (2012) (quotation marks omitted); *see also id*. at 65 (rejecting Government's argument and following *Gatz* and *Rossette* in upholding shareholder's "right to maintain a direct claim"). Here, also, the crux of Plaintiffs' claim is not that there has been "an equal dilution of the economic value . . . of each of [Fannie's and Freddie's] outstanding shares." *Rossette*, 906 A.2d at 100. Rather, it is that the Net Worth Sweep constituted an unlawful "extraction from [Plaintiffs], and a redistribution to [Treasury,] the controlling shareholder, of . . . the economic value" of their stock. *Id*. It is Plaintiffs, not Fannie and Freddie, who have suffered this harm.

c. Given that Plaintiffs' claims easily qualify as direct under the first prong of *Tooley*, "[t]he second prong of the analysis should logically follow." *Tooley*, 845 A.2d at 1036. "[C]ourts have been more prepared to permit the plaintiff to characterize the action as direct when the plaintiff is seeking only injunctive or prospective relief," as is the case with respect to Plaintiffs' APA claims. *Grimes v. Donald*, 673 A.2d 1207, 1213 (Del. 1996), *overruled on other grounds*, *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000); *see also Tooley*, 845 A.2d at 1038 (citing *Grimes* with approval). Thus, even before the Delaware Supreme Court's decision in *Rossette*, the Delaware Court of Chancery held in *Gatz v. Ponsoldt* that a shareholder's claim was direct where the plaintiff asked the court to unwind a transaction entered into by the corporation to the advantage of certain shareholders at the expense of others. 2004 WL 3029868, at *7–*8 (Del. Ch. Nov. 5, 2004); *see also San Antonio Fire & Police Pension Fund v. Bradbury*, 2010 WL 4273171, at *9 (Del. Ch. Oct. 28, 2010); *Grayson v. Imagination Station, Inc.*, 2010 WL 3221951, at *6 (Del. Ch. Aug. 16, 2010). Because Plaintiffs' APA claims seek similar relief, Plaintiffs are entitled to press those claims directly. Plaintiffs' contract claims are likewise direct because they seek damages that would be paid to Plaintiffs, not to Fannie and Freddie. In short, all of Plaintiffs' claims are direct because, however the relief would affect Fannie and Freddie, Plaintiffs would benefit from the requested relief in a way that is unique and independent from the Companies, since the relief would restore the balance of value between Treasury's holding and the other classes of stock, award Plaintiffs damages for breach of contract, or both.

### 3. FHFA's Additional Argument Lacks Merit.

In addition to arguing (erroneously) that Plaintiffs' claims are derivative under *Tooley*, FHFA (but not Treasury) argues that Plaintiffs' claims are necessarily derivative "because they are based on an alleged injury to the value of their stock." FHFA Br. 14. But the authorities FHFA cites in support of this proposition do not address circumstances or claims such as those at issue here, where Plaintiffs' injury does not flow simply from a decrease in the total value of Fannie and Freddie, but rather from the unlawful transfer of the entire value of their stock to another, dominant shareholder. In all events, FHFA's argument that claims seeking redress for injury to the value of a shareholder's stock are necessarily and categorically derivative is contrary to Delaware law. Indeed it has been recently and authoritatively rejected by the Delaware Supreme Court, which, as discussed above, squarely rejected the proposition that Delaware law requires "all claims, whether based on a tort, contract, or statutory cause of action . . . to be brought derivatively whenever the corporation of which the plaintiff is a stockholder suffered the alleged harm." *NAF Holdings*, 118 A.3d at 180.[3] Indeed this recent decision directly repudiated one of the principal cases FHFA cites in support of its categorical argument. *See* FHFA Br. 15 (citing *NAF Holdings, LLC v. Li & Fung (Trading) Ltd*., 2013 WL 489020, at *6 (S.D.N.Y. Feb. 8, 2013)).[4]

For all of these reasons, it is clear that Plaintiffs' claims are direct, not derivative.

### B. Even If Plaintiffs' Claims Were Derivative, Issue Preclusion Should Not Apply.

As discussed above, the decisions in *Perry Capital* and *Continental Western* could potentially have affected Plaintiffs' rights only if both the claims rejected in those cases and the analogous claims asserted here are derivative claims that belong to Fannie and Freddie rather than the plaintiffs asserting the claims.

It is undisputed that the plaintiffs in *Perry Capital* and *Continental Western* did not assert

[3] Nor is FHFA's categorical argument supported by the Delaware Supreme Court's earlier decision in *Tooley*. To the contrary, the language from *Tooley* that FHFA quotes in support of its argument comes from the court's discussion of an earlier case, the analysis of which the court in *Tooley rejected* as "confusing and inaccurate." *Tooley*, 845 A.2d at 1037.

[4] The Delaware Supreme Court's decision in *NAF Holdings* was issued in response to a certified question from the United States Court of Appeals for the Second Circuit in the course of the appeal from the decision FHFA cites in its motion to dismiss. *See NAF Holdings*, 118 A.3d at 176. The Second Circuit reversed the district court decision on which FHFA relies in light of the Delaware Supreme Court's repudiation of the very proposition for which FHFA cites that decision here. *See NAF Holdings, LLC v. Li & Fung (Trading) Ltd*., 2015 WL 5166302, at *1–*2 (2d Cir. Sept. 4, 2015).

or seek to prosecute either their APA claims or their contract claims as derivative actions.[5] Nor does it appear that they made any attempt to comply with the rigorous procedural or substantive requirements for bringing a derivative action imposed by the Federal Rules of Civil Procedure and Delaware and Virginia law. For example, there is no indication in the record of either *Perry Capital* or *Continental Western* that the plaintiffs either made demands on the Boards of Fannie and Freddie to bring APA or contract claims against FHFA and Treasury or determined that such demands would be futile. *See, e.g.*, *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 366–67 (Del. 2006) (explaining that "the right of a stockholder to prosecute a derivative suit is limited to situations where either the stockholder has demanded the directors pursue a corporate claim and the directors have wrongfully refused to do so, or where demand is excused because the directors are incapable of making an impartial decision regarding whether to institute such litigation"). Certainly, plaintiffs in these cases did not "state with particularity" in their pleadings that they had made either such a demand or such a determination as is required by FED. R. CIV. P. 23.1. Nor did the district court in either case hold that the APA claim was derivative. *See Perry Capital*, 70 F. Supp. 3d at 229 n.24.[6] And while Judge Lamberth did state in passing in *Perry Capital* that he believed the contract claims at issue in that case were derivative under Delaware law, *see id.* at 235 n.39, 239 n.45, these statements cannot be reconciled with the Delaware Supreme Court's subsequent decision in *NAF Holdings*, *see supra* Part I.A.1. In all events, as Judge Lamberth later expressly acknowledged, these statements were dicta that did not bind the plaintiffs in another case that had been pending before him, who voluntarily dismissed

[5] Some of the plaintiffs in *Perry Capital* did assert derivative claims that FHFA and Treasury had breached their *fiduciary duties* to Fannie and Freddie. *See Perry Capital*, 70 F. Supp. 3d at 218–19. But Plaintiffs have not asserted any fiduciary duty claims here.

[6] The court in *Continental Western* did not question the plaintiff's characterization of its APA and contract claims as direct.

their challenge to the Net Worth Sweep after Judge Lamberth issued 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 (D.D.C. Jan. 21, 2015), Doc. 20 ("Rafter Order").

Under these circumstances, even if Plaintiffs' claims in this case truly were derivative, issue preclusion plainly should not apply. First, the suits in *Perry Capital* and *Continental Western* were not avowed derivative actions 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)), and Plaintiffs cannot be presumed to have been on notice that their rights were at issue in those cases, *see United States v. LTV Corp*., 746 F.2d 51, 53 n.5 (D.C. Cir. 1984). Second, 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). The plaintiffs in *Perry Capital* and *Continental Western*—who did not even purport to assert APA and contract claims on behalf of Fannie and Freddie, let alone make any attempt to satisfy the substantive and procedural requirements for doing so—certainly cannot be said to have adequately represented the interests of these corporate entities. Third, it appears that the court in *Perry Capital*—which, unlike the court in *Continental Western*, at least considered the question whether the APA and contract claims were direct or derivative—would not regard its judgment as precluding this claim. *See* Rafter Order. Finally, and at a bare minimum, the unusual posture of this case and the district court proceedings on which Defendants rely surely constitute "special circumstances" that "warrant an exception to the normal rules of preclusion." *Montana v. United States*, 440 U.S. 147, 155 (1979); *see Taylor v. Sturgell*, 553 U.S. 880, 897 (2008) (observing that due process limits application of issue preclusion in absence of "special procedures to protect the nonparties' interests or an understanding by the concerned parties that the first suit was brought in a representative capacity").

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, even if (as did not happen here) the court in the first case holds that the initial claim should have been brought as a derivative action, and even if (as is not the case here) the claims in the second case truly are derivative. Nor are Plaintiffs aware of any cases that would support this remarkable proposition. For all of these reasons, issue preclusion should not apply here.

## II. HERA's Jurisdictional Bar Does Not Prohibit Plaintiffs' Claims.

Treasury and FHFA 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); *Kenney v. Glickman*, 96 F.3d 1118, 1124 (8th Cir. 1996); *see also* 5 U.S.C. § 702 ("A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof."). Indeed, the Court should only conclude that judicial review of administrative action is 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). Here, Section 4617(f)'s instruction that courts not "restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver" is no barrier to claims that the Net Worth Sweep *grossly exceeded* FHFA's "powers" and "functions" under HERA. *See Sharpe v. FDIC*, 126 F.3d 1147, 1155 (9th Cir. 1997) (applying virtually identical provision under the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA"), 12 U.S.C. § 1821(j)).[7] 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.

**A. Section 4617(f) Does Not Bar Plaintiffs' Claims Against FHFA.**

Section 4617(f) does not strip this Court of jurisdiction over claims that FHFA acted in excess of or contrary to its statutory authority as conservator. By entering the Net Worth Sweep, FHFA blatantly transgressed the limits Congress has placed on its authority in a least five ways. First, FHFA as conservator cannot be subject to the direction or supervision of any other government agency, *see* 12 U.S.C. § 4617(a)(7), but FHFA entered the Net Worth Sweep at the direction and under the supervision of Treasury. Second, FHFA failed to act as a "conservator"—and, indeed, acted as an "anti-conservator"—because conservators are not allowed to use the companies under their care as ATM machines. Third, FHFA is required to put Fannie and Freddie in a sound and solvent condition, *see id.* § 4617(b)(2)(D)(i), but the Net Worth Sweep forces the Companies to operate on the edge of insolvency in perpetuity. Fourth,

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[7] By its terms, Section 4617(f) only applies to claims for equitable relief. 12 U.S.C. § 4617(f) ("[N]o court may take any action *to restrain or affect* the exercise of powers or functions of the agency as a conservator or a receiver." (emphasis added)); *see Dittmer Props., LP v. FDIC*, 708 F.3d 1011, 1016 (8th Cir. 2013) (observing that analogous provision of FIRREA "constrain[s] the court's equitable powers"); *Sharpe*, 126 F.3d at 1155 (damages claim "not affected" by FIRREA's jurisdictional bar). Thus, even if the Court agrees with Defendants' virtually unbounded understanding of that provision's restriction on equitable remedies, it should not dismiss Plaintiffs' claims for damages resulting from FHFA's breach of contract and breach of the implied covenant of good faith and fair dealing.

FHFA is required to conserve and preserve Fannie's and Freddie's assets, *id*. § 4617(b)(2)(D)(ii), but the Net Worth Sweep requires the dissipation of assets by forcing the Companies to pay their net worth to Treasury on a quarterly basis. Finally, FHFA is charged with rehabilitating Fannie and Freddie and seeking to return them to private control, *see id*. § 4617(a)(2); 76 Fed. Reg. at 35,727, 35,730, but the Net Worth Sweep makes any such outcome impossible. Each one of these violations independently removes this case from the ambit of Section 4617(f).

**1. This Court Has Jurisdiction To Enjoin FHFA from Exceeding Its Statutory Authority.**

HERA's jurisdictional bar is inapplicable to Plaintiffs' claims that FHFA exceeded its statutory authority. By its terms, Section 4617(f) applies only to actions that would "restrain or affect *the exercise of powers or functions of [FHFA] as conservator or receiver*"; it thus "is inapplicable when FHFA acts beyond the scope of its conservator power." *County of Sonoma v. FHFA*, 710 F.3d 987, 992 (9th Cir. 2013) (emphasis added). Courts uniformly agree on this point. *Id.*; *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); *Suero v. Federal Home Loan Mortg. Corp.*, -- F. Supp. 3d --, 2015 WL 4919999, at *10 (D. Mass. Aug. 18, 2015); *Massachusetts v. FHFA*, 54 F. Supp. 3d 94, 99–100 (D. Mass. 2014), *appeal pending*, No. 14-2348 (1st Cir.); *Gail C. Sweeney Estate Marital Trust v. United States Treasury Dep't*, 68 F. Supp. 3d 116, 125–26 (D.D.C. 2014). 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.'" 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)).[8] These interpretations mirror the uniform judicial treatment of Section 1821(j), the provision on 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). *See also, e.g.*, *Dittmer Props.*, 708 F.3d at 1017; *Sharpe*, 126 F.3d at 1155; *Tri-State Hotels, Inc. v. FDIC*, 79 F.3d 707, 715 (8th Cir. 1996); *Arkansas State Bank Comm'r v. RTC*, 745 F. Supp. 550, 556 n.4 (E.D. Ark.), *rev'd on other grounds*, 911 F.2d 161 (8th Cir. 1990); *cf. Coit Independence Joint Venture v. Federal Sav. & Loan Ins. Corp.*, 489 U.S. 561, 572 (1989). *Sharpe* 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 FIRREA's jurisdictional bar inapplicable. 126 F.3d at 1155; *see also Bank of Manhattan, NA v. FDIC*, 778 F.3d 1133, 1136–37 (9th Cir. 2015). The same analytical framework applies here.

Even Defendants acknowledge that HERA's jurisdictional bar does not apply where FHFA "'is acting *clearly* outside its statutory powers.'" Treas. Br. 13 (quoting *Gross v. Bell Sav. Bank PaSA*, 974 F.2d 403, 407 (3d Cir. 1992) (emphasis added)); *see also* FHFA Br. 26–27. FHFA's *ipse dixit* that the Net Worth Sweep was an exercise of its statutory authority does not affect this analysis: "FHFA cannot evade judicial scrutiny by merely labeling its actions with a conservator stamp." *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

[8] *Perry Capital* erred in holding that FHFA and Treasury acted within the scope of their statutory authorities in adopting the Net Worth Sweep. *See infra* Part II.A.2.d.

upon the rights of others at will, unchecked by the courts.”). As explained in Part II.A.2, *infra*, FHFA clearly exceeded its conservatorship powers, thus satisfying even the artificially high bar to judicial review that Defendants attempt to erect.[9]

In grabbing hold of *Gross*’s “clearly outside” language, Defendants argue, in effect, that courts are powerless to prevent FHFA from engaging in unlawful conduct, so long as FHFA’s conduct is not *too obviously* unlawful. *See* Treas. Br. 13–14; FHFA Br. 25–28. That is not the law. Indeed, the law of this Circuit is clear that the Court must simply “determine whether the challenged action is within” the scope of FHFA’s authority as conservator. *Dittmer*, 708 F.3d at 1017. And the Supreme Court has squarely rejected the notion that a 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). FHFA either violated HERA and therefore exceeded its powers when it executed the Net Worth Sweep, or it did not. 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 . . . conservator authority.”).

FHFA and Treasury also argue that this Court cannot rule on Plaintiffs’ APA claims because Section 4617(f)’s jurisdictional bar applies even if the conservator is “improperly or

[9] Treasury likewise “clearly” exceeded its authority under HERA by continuing to purchase the Companies’ stock after its statutory authority to do so expired on December 31, 2009. *See* 12 U.S.C. §§ 1455(*l*)(4), 1719(g)(4); Compl. ¶¶ 107–15.

even unlawfully exercising" its conservatorship powers. Treas. Br. 13 (quoting *Ward v. RTC*, 996 F.2d 99, 103 (5th Cir. 1993)); *see also id.* at 18; FHFA Br. 21, 27 n.15. But this argument is foreclosed by *City of Arlington*, quoted above. 133 S. Ct. at 1869. In any event, Plaintiffs allege that FHFA acted *outside* of its statutory authority, not that it exercised that authority in an improper manner or that it might make a mistake in the future. *See Bank of America Nat'l Ass'n v. Colonial Bank*, 604 F.3d 1239, 1244 (11th Cir. 2010). And HERA does not prohibit courts from enjoining FHFA if it exceeds its statutory authority as conservator. *See County of Sonoma*, 710 F.3d at 992; *National Trust for Historic Pres. v. FDIC*, 995 F.2d 238, 240 (D.C. Cir. 1993).

*Ward*, at any rate, was nothing like this case. It concerned a plaintiff's attempt to thwart the sale of a single property as part of a larger group sale—an action the court determined was clearly authorized by statute. 996 F.2d at 103–04; *see also id.* at 103 (case involved challenge to "method, terms and conditions" of sale). Here, by contrast, Plaintiffs challenge FHFA's decision to enter the Net Worth Sweep, which effectively nationalizes Fannie and Freddie and ensures that the Companies will never be rehabilitated and returned to private control, an action that both exceeds and directly contravenes the authority granted the FHFA as conservator under HERA, including the authority to sell assets. *See infra* Part II.A.2.

Furthermore, *Ward*'s endorsement of "unlawful" conduct refers to the fact that HERA bars injunctions where the conservator—acting perfectly within its conservatorship authority—happens to violate a separate substantive law, as demonstrated by *Ward*'s citations to *National Trust for Historic Preservation* and *Gross*. *Ward*, 996 F.2d at 103–04. In *National Trust for Historic Preservation*, the court held that FIRREA's analogous jurisdictional bar prohibited a suit requiring the FDIC as receiver to comply with the National Historic Preservation Act. 955 F.2d at 238–39. And in *Gross*, the plaintiffs sought recovery of pension assets on the ground that the RTC had violated ERISA. 974 F.2d at 405. *See also Volges v. RTC*, 32 F.3d 50, 52 (2d Cir. 1994) (plaintiff could not enjoin sale of home in reliance on oral modification to contract). By contrast, Defendants have violated HERA, the statute that gives FHFA its conservatorship powers in the first place—and, in doing so, have necessarily violated the APA as well. *See Sharpe*, 126 F.3d at 1155 (equivalent provision of FIRREA did not prevent court from enjoining FDIC from evading limitations on its authority to repudiate contracts).

But if Defendants are correct in ascribing to *Ward* the view that a federal court is impotent to enjoin a conservator or receiver from violating the very statute from which its authority is derived, then *Ward* is plainly wrong after *City of Arlington*. And the Eighth Circuit has taken a different approach. *Dittmer* holds that this Court's task is to "determine whether the challenged action is within [FHFA]'s power or function," 708 F.3d at 1017, and conduct that violates HERA is plainly beyond the scope of FHFA's powers and functions under HERA. Indeed, any other reading of the statute would render meaningless the carefully circumscribed and enumerated list of conservatorship powers that appears in Section 4617(b).[10] Importantly, the Supreme Court adopted the same interpretation of FIRREA's predecessor, holding that a provision similar to Section 4617(f) was not an obstacle to judicial review where the federal receiver had purported to adjudicate a claim the statute did not authorize it to adjudicate. *Coit*, 489 U.S. at 572–79; *see also* H.R. REP. NO. 101-54, at 130 (1989) (FIRREA's jurisdictional bar

[10] The Eighth Circuit's observation in *Hanson v. FDIC* that an analogous provision of FIRREA "effects a sweeping ouster of courts' power to grant equitable remedies" is not to the contrary. 113 F.3d 866, 871 (8th Cir. 1997) (quoting *Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995)). The fact that the set of *remedies* Section 4617(f) forecloses is "sweeping"—including not only injunctions but also the constructive trust at issue in *Hanson* and the declaratory judgment sought in *Freeman*—does not imply that a conservator's *powers* are likewise "sweeping." To the contrary, the unavailability of most remedies when a conservator is exercising, rather than exceeding or violating, its statutory powers is a reason to construe those powers narrowly.

prevents courts, "to the same extent as the Home Owners' Loan Act does now under existing law, from restraining or affecting the exercise of the powers or functions of the FDIC as conservator or receiver"). To the extent that there is any tension in the caselaw, this Court must follow *City of Arlington*, *Coit*, and *Dittmer*, rather than *Ward*.

#### 2. FHFA Exceeded Its Statutory Authority when It Entered the Net Worth Sweep.

Although the scope of judicial review allowed under Section 4617(f) is sharply contested, the Court need not resolve that dispute to reject Defendants' motions to dismiss. That is because Defendants acknowledge that a court may intervene when FHFA acts "clearly outside" its statutory powers, *see* FHFA Br. 27; Treas. Br. 13, and the facts alleged in Plaintiffs' Complaint, which must be assumed to be true, amply satisfy even that artificially high standard.

The Complaint alleges that by the time of the Net Worth Sweep the Companies "had regained the earnings power to redeem Treasury's Government Stock and exit conservatorship," Compl. ¶ 70, that the Net Worth Sweep "effectively nationalized the Companies and confiscated the existing and potential value of all privately held equity interests" in the Companies, *id.* ¶ 71, and that "[t]he Companies did not receive any meaningful consideration" in return for permanently forfeiting the ability to build capital reserves, *id.* ¶¶ 75, 81.[11] The Complaint also

[11] Suspension of the periodic commitment fee, which under the original terms of the PSPAs was to be set by mutual agreement of the Companies and Treasury at a market rate, was not consideration for the Net Worth Sweep. As the Complaint alleges and this Court must assume for present purposes, dividends on the Government Stock and the warrants to acquire 79.9% of the Companies' common stock already more than compensated Treasury for its remaining commitment in August 2012, and "any additional fee would have been inappropriate." Compl. ¶ 76. In addition, "even if a market-rate fee had been agreed between Treasury and FHFA and imposed pursuant to the PSPA, the Companies had sufficient market power to pass the entire amount of this fee through to their customers . . . without affecting profitability or the value of the Companies' equity securities." *Id.* And relief from the periodic commitment fee is no more adequate consideration for the Companies giving up their entire net worth than relief from property taxes is adequate consideration for the government seizing someone's home.

cites specific instances in which Defendants publicly declared their intention to ensure that "every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers," *id.* ¶ 84; *see also id.* ¶¶ 14, 71, 86, and alleges that on the eve of the Net Worth Sweep a senior executive of one of the Companies discussed with Treasury the writing up of deferred tax assets—an item that would generate tens of billions of dollars of profit. *Id.* ¶ 68. The gravamen of Plaintiffs' Complaint is thus that Defendants placed the Companies in a financial coma, unable to rebuild their capital reserves, in order to harvest all of their sizable future profits for the Treasury. Whatever the precise scope of FHFA's statutory powers as conservator, looting the Companies and expropriating private shareholders' investments is "clearly outside" of it.

#### a. FHFA Exceeded Its Statutory Authority by Agreeing to the Net Worth Sweep at Treasury's Direction.

To ensure that FHFA would exercise its best *independent* judgment in protecting the interests of *all* creditors and shareholders of the Companies, Congress mandated that FHFA as conservator "shall not be subject to the direction or supervision of any other agency of the United States." 12 U.S.C. § 4617(a)(7). Plaintiffs alleged that FHFA violated that provision of HERA by agreeing to the Net Worth Sweep at Treasury's explicit direction. Compl. ¶¶ 16, 82, 104, 124. Defendants respond by seeking to characterize Plaintiffs' allegations as "conclusory," Treas. Br. 18, FHFA Br. 29, by impermissibly controverting those allegations, *see* FHFA Br. 28–29, and by asserting that "FHFA's state of mind in exercising its conservatorship powers is simply irrelevant to the Section 4617(f) inquiry . . . ." Treas. Br. 19. Defendants are wrong on all counts.

Far from conclusory, Plaintiffs' allegations are detailed and specific. The Complaint alleges, in terms, that "FHFA agreed to the Net Worth Sweep only at the insistence and under the direction and supervision of Treasury," Compl. ¶ 82, and that "FHFA was not authorized to subject itself to Treasury's will" in this way, *id.* ¶ 104. And the Complaint further alleges facts supporting these allegations, including that Treasury had exerted significant influence over FHFA from the beginning of the conservatorship, *id.* ¶ 82 and that 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, *id.* ¶ 97, was entered into almost immediately after the Companies announced their return to substantial profitability, *id.* ¶¶ 12, 59–62, 68, was known to the government to result in a substantial financial windfall for the government, *id*. ¶¶ 67–68, and provides the Companies with no relief from their obligation to pay cash dividends that they did not already enjoy, *id.* ¶ 75. FHFA would no doubt have understood all this had it exercised its independent judgment, for it was clear that the recognition of deferred tax assets, the release of loan loss reserves, and monetary recoveries from legal settlements with big banks would all soon make enormous contributions to the Companies' net worth. *Id.* ¶¶ 63–68. And that is to say nothing of the real and very substantial profits the Companies were poised to earn from their core businesses of guaranteeing and securitizing mortgages as the housing market recovered. *Id.* ¶ 60. Only a conservator that has given up the will to exercise its independent judgment could agree to forfeit so much under such circumstances. Further reinforcing the conclusion that Treasury was the driving force behind the Net Worth Sweep, it was entered into against the backdrop of the Administration's previously undisclosed policy decision to exclude Fannie's and Freddie's common equity holders from having access to any of the Companies' positive earnings, and Treasury trumpeted the Net Worth Sweep as making "sure that every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers." *Id*. ¶ 84. These allegations are more than enough to "allow[ ] the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). Plaintiffs need not do more at this stage of the litigation.

To be sure, although FHFA acknowledges that Section 4617(f) bars it "from being *involuntarily* subjected to legally binding directives of other federal agencies . . . ," it seeks to controvert Plaintiffs' allegations, claiming that in acceding to the Net Worth Sweep it "*voluntarily*" negotiated and executed an agreement with Treasury that it determined was in the "best interests of the [Companies] or the [a]gency." FHFA Br. 28–29.[12] But this Court may not accept these self-serving allegations—for purposes of this motion to dismiss, Plaintiffs' well-pleaded allegations must be accepted as true.[13]

Finally, Treasury is wrong when it suggests that FHFA's purpose in agreeing to the Net Worth Sweep is "irrelevant to the Section 4617(f) inquiry." Treas. Br. 19. Surely if FHFA's purpose was, as the Complaint plainly alleges, to expropriate the value of Plaintiffs' shares in the Companies in faithful obedience to the wishes of Treasury, its conduct directly violates Section 4617(a)(7), and cannot be shielded from this Court's review by Section 4617(f). Indeed, courts regularly look to the purpose and function of an act when deciding whether it may be enjoined as beyond the statutory powers of a conservator or receiver. *See Leon Cnty.*, 700 F.3d at 1278 (court tasked with deciding whether FHFA acted outside its conservatorship powers "must consider all relevant factors," including the action's "subject matter, its purpose, [and] its outcome"); *Massachusetts v. FHFA*, 54 F. Supp. 3d at 100 ("[P]urpose, rather than labels, determines

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[12] *Gail C. Sweeney Estate Marital Trust*, which FHFA cites in support of this argument, did not involve a challenge to the Net Worth Sweep and did not consider the facts and circumstances surrounding that transaction.

[13] FHFA relies on the district court's decision in *Perry Capital*, which rejected the argument that FHFA had acted at Treasury's direction on the ground that plaintiffs in that case relied on what the court called "subjective, conclusory allegations" rather than "objective facts." 70 F. Supp. 3d at 226. But Plaintiffs here have no obligation to prove "objective facts" to defeat Defendants' motions to dismiss. And as set forth above, Plaintiffs' detailed and specific allegations are far from conclusory.

whether the FHFA in any given instance is acting . . . as a conservator.”). And here, where the manifest aim of the conservator’s actions is to cannibalize its ward for the benefit of another federal agency, that reality is relevant to whether the conservator should be found to have impermissibly acted at the other agency’s direction (or, for that matter, to have acted in contravention of the core responsibilities of a conservator to preserve and conserve an entity’s assets and seek to restore it to safety and soundness and, ultimately, private control).[14]

**b. The Net Worth Sweep Violated FHFA’s Statutory Duties To Preserve and Conserve the Companies’ Assets and To Place Them in a Sound and Solvent Condition.**

**i. As Conservator, FHFA Is Obligated To Preserve and Conserve Assets with the Aim of Rehabilitating the Companies.**

When Congress enacts a statute using “a well-established term,” courts presume that “Congress intended the term to be construed in accordance with pre-existing . . . interpretations.” *Bragdon v. Abbott*, 524 U.S. 624, 631 (1998). “Conservatorship” is among those “well-established term[s],” familiar to anyone even remotely acquainted with financial regulation. As

[14] FHFA suggests in a footnote that Plaintiffs may not complain of FHFA’s violation of Section 4617(a)(7) because they are not within the “zone of interests” protected by this provision. FHFA Br. 29 n.17. But there can be no doubt that Section 4617(a)(7) is intended to preserve the integrity of conservatorships and receiverships by barring other agencies from interfering with FHFA’s decisions. Nor can there be any doubt that one of the principal purposes of a conservatorship or receivership is to protect the interests of an entity’s creditors and shareholders. Indeed, as conservator, FHFA owes fiduciary duties to Fannie’s and Freddie’s shareholders. *See, e.g.*, 12 U.S.C. § 1831f(d)(3); 12 U.S.C. § 1823(d)(3)(A), (C); *Golden Pac. Bancorp v. FDIC*, 273 F.3d 509, 519 (2d Cir. 2001); *Suess v. FDIC*, 770 F. Supp. 2d 32, 38 (D.D.C. 2011); *Gibralter Fin. Corp. v. Federal Home Loan Bank Bd.*, 1990 WL 394298, at *3 (C.D. Cal. June 15, 1990); *In re Franklin Nat’l Bank Sec. Litig.*, 445 F. Supp. 723, 731, 733–34 (E.D.N.Y.), *supplemented by* 449 F. Supp. 574 (E.D.N.Y. 1978). In all events, it is well-settled that “[t]he zone of interests adequate to sustain judicial review is particularly broad in suits to compel federal agency compliance with law, since Congress itself has pared back traditional prudential limitations by the Administrative Procedure Act, which affords review to any person ‘adversely affected or aggrieved by [federal] agency action within the meaning of a relevant statute.’ ” *FAIC Sec., Inc. v. United States*, 768 F.2d 352, 357 (D.C. Cir. 1985) (quoting 5 U.S.C. § 702 (second alteration in original) (citation omitted)).

the Congressional Research Service has explained, "[a] conservator is appointed to operate the institution, conserve its resources, and restore it to viability." DAVID H. CARPENTER & M. MAUREEN MURPHY, CONG. RESEARCH SERV., RL34657, FINANCIAL INSTITUTION INSOLVENCY: FEDERAL AUTHORITY OVER FANNIE MAE, FREDDIE MAC, AND DEPOSITORY INSTITUTIONS 5 (2008), http://goo.gl/ecEI4H. This authority stands in contrast to that of a "receiver," which "is appointed to liquidate the institution, sell its assets, and pay claims against it to the extent available funds allow." *Id.*

Courts, and regulators, including FHFA itself, have emphasized that a conservator's purpose is to revive a troubled entity. The Eighth Circuit, for example, has explained that "[t]he conservator's mission is to conduct an institution as an ongoing business" while restoring it "to a solvent position," *RTC v. CedarMinn Bldg. Ltd. P'ship*, 956 F.2d 1446, 1453–54 (8th Cir. 1992), and other courts uniformly agree.[15] The FDIC also understands the defining purpose of conservatorship. *See* FDIC, MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 216 (1998), *available for download at* https://goo.gl/qjIjTh ("A conservatorship is designed to operate the institution for a period of time in order to return the institution to a sound and solvent operation."). And commentators explain that a conservatorship's "basic statutory assumption is

[15] *See, e.g.*, *Delaware Cnty. v. FHFA*, 747 F.3d 215, 219 (3d Cir. 2014) ("[A] conservator . . . tries to return the bankrupt party to solvency, rather than liquidating it."); *DeKalb Cnty. v. FHFA*, 741 F.3d 795, 798 (7th Cir. 2013) (same); *Elmco Props., Inc. v. Second Nat'l Fed. Sav. Ass'n*, 94 F.3d 914, 922 (4th Cir. 1996) ("[A] conservator's function is to restore the bank's solvency and preserve its assets."); *James Madison Ltd. by Hecht v. Ludwig*, 82 F.3d 1085, 1090 (D.C. Cir. 1996) ("The principal difference between a conservator and receiver is that a conservator may operate and dispose of a bank as a going concern, while a receiver has the power to liquidate and wind up the affairs of an institution."); *Del E. Webb McQueen Dev. Corp. v. RTC*, 69 F.3d 355, 361 (9th Cir. 1995) (conservatorship is intended to operate entities so that they "might someday be rehabilitated"); *1185 Ave. of the Americas Assocs. v. RTC*, 22 F.3d 494, 497 (2d Cir. 1994) ("A conservator . . . is empowered to take action to restore the thrift to a solvent position and to carry on the business of the institution.") (quotation marks omitted).

that the institution may well return to the transaction of its business." 3 Michael P. Malloy, *Banking Law and Regulation* § 11.3.4.2 (2011); *see also* Donald Resseguie, *Banks & Thrifts: Government Enforcement & Receivership* § 11.01 (2013) ("The intent of conservatorship is to place the insured depository institution in a sound and solvent condition, rather than liquidating the institution as in the case of a receivership.").

Outside the context of litigation challenging the Net Worth Sweep, FHFA has often expressed the same view. When FHFA placed the Companies in conservatorship, it stated that its purpose was to "stabilize" the Companies "with the objective of returning [them] to normal business operations." Compl. ¶ 7; *see also id.* ¶¶ 35, 39–40. And it has often repeated this understanding of its goal as a conservator. *E.g.*, 76 Fed. Reg. at 35,727 (The conservator "has a statutory charge to work to restore a regulated entity . . . to a sound and solvent condition."); Joint Status Report, Attachment A at .pdf 7, *McKinley v. FHFA*, No. 10-1165 (D.D.C. Sept. 16, 2011), Doc. 18-1 ("The goal of a conservator is to return the entity to a sound and solvent condition, carry on the business of the entity and preserve/conserve the entity's assets and property."); Compl. ¶ 83 ("[T]he only [post-conservatorship option] that FHFA may implement today under existing law is to reconstitute [Fannie and Freddie] under their current charters." (quoting DeMarco Letter to Chairmen and Ranking Members at 7)); FHFA, ANNUAL PERFORMANCE PLAN at 16 (FHFA as conservator "preserves and conserves the assets and property of the Enterprises . . . and facilitates their financial stability and emergence from conservatorship."); Letter from DeMarco to Senators at 1 ("By law, the conservatorships are intended to rehabilitate [Fannie and Freddie] as private firms."). An internal Treasury document from 2011 likewise recognized that "the path laid out under HERA" was for Fannie and Freddie to "becom[e] adequately capitalized" and "exit conservatorship as private companies." Compl. ¶ 85.

This defining purpose—rehabilitation and a return to viability as a going concern—informs the scope of a conservator's power. For example, in *CedarMinn* the Eighth Circuit concluded that the RTC was not required to exercise its statutory authority to repudiate contracts immediately upon its appointment as conservator because this would put the conservator "in the untenable position of trying to operate the business as an ongoing concern with one hand, while at the same time calculating the . . . repudiation issue as if it were shutting the business down." *CedarMinn Bldg. Ltd. P'ship*, 956 F.2d at 1454; *see also MBIA Ins. Corp. v. FDIC*, 816 F. Supp. 2d 81, 97 (D.D.C. 2011) (same). The Fifth Circuit explained that "a conservator *only* has the power to take actions necessary to restore a financially troubled institution to solvency" and that it cannot "as a matter of law" take actions reserved to a receiver. *See McAllister v. RTC*, 201 F.3d 570, 579 (5th Cir. 2000) (emphasis added); *see also id.* ("Expenses of liquidation cannot be incurred by a conservator as a matter of law, as liquidation is not a function of the conservator."). Thus, when exercising its powers as conservator, FHFA must always act consistent with the overarching purpose of rehabilitating its charges.

A conservator's "mission . . . to conduct an institution as an ongoing business" contrasts with that of a receiver, "whose interest, by definition, is shutting the business down." *CedarMinn Bldg. Ltd. P'ship*, 956 F.2d at 1454. Unlike conservators, receivers act to "liquidat[e] [an] institution and wind[ ] up its affairs." *See* CARPENTER & MURPHY, *supra*, at 6. During this process of liquidation a receiver gathers and sells the financial institution's assets and distributes the proceeds to creditors and others with claims against the failed entity in accordance with the statutory priority scheme. *See Freeman*, 56 F.3d at 1401 (Receivership "ensure[s] that the assets of a failed institution are distributed fairly and promptly among those with valid claims against the institution."). As this distribution process leaves the receivership entity with no remaining assets, receivership requires a "determination . . . that the institution is not viable." *See* CARPENTER & MURPHY, *supra*, at 6. Indeed, "[p]lacing a bank in receivership acknowledges that restoration is impossible." John W. Head, *Lessons from the Asian Financial Crisis: The Role of the IMF and the United States*, 7 KAN. J.L. & PUB. POL'Y 70, 77 (1998).

The fundamental distinction between a conservator and a receiver was well understood by Congress and by FHFA in promulgating regulations implementing its conservatorship powers. HERA requires FHFA as conservator to "put the [Companies] in a sound and solvent condition" and "carry on the business of the [Companies] and preserve and conserve [their] assets and property." 12 U.S.C. § 4617(b)(2)(D). FHFA's regulations explain that these statutory powers "charge[ ] [FHFA] with rehabilitating the regulated entity." 76 Fed. Reg. at 35,727; *id.* ("[T]he essential function of a conservator is to preserve and conserve the institution's assets . . . ."); *id.* at 35,730 ("A conservator's goal is to continue the operations of a regulated entity, rehabilitate it and return it to a safe, sound and solvent condition."). Indeed, FHFA's regulations generally prohibit distributions of capital such as dividends precisely because they would "deplete the entity's conservatorship assets" and therefore "would be inconsistent with the agency's statutory goals, as they would result in removing capital at a time when the Conservator is charged with rehabilitating the regulated entity." *Id.* at 35,727.

#### ii. The Net Worth Sweep Failed To Preserve and Conserve the Companies' Assets.

The Net Worth Sweep contravenes FHFA's basic obligations under HERA and its own regulations to "preserve and conserve the [Companies'] assets and property," 12 U.S.C. § 4617(b)(2)(D)(ii), and to "put the [Companies] in a sound and solvent condition" with the goal of rehabilitating them, *id.* § 4617(b)(2)(D)(i).

First, the Net Worth Sweep depletes the Companies' capital, a consequence that FHFA has elsewhere determined is "inconsistent with [its] statutory goals." 76 Fed. Reg. at 35,727. Indeed, former Director Lockhart emphasized that, "[a]s the conservator, FHFA's *most important goal* is to preserve the assets of Fannie Mae and Freddie Mac over the conservatorship period. That is our statutory responsibility." *The Present Condition and Future Status of Fannie Mae and Freddie Mac: Hearing Before the H. Comm. on Fin. Servs., Subcomm. of Capital Markets, Ins. & Gov't Sponsored Enters.* 111th Cong. (2009) (written statement of James B. Lockhart, III, Director, FHFA) (emphasis added), http://goo.gl/nVaYYE. Rather than allow the Companies to build up their capital, the Net Worth Sweep siphons off every dollar earned by the Companies into Treasury's coffers, precluding them from strengthening along with the improving housing market. Indeed, Treasury made clear at the time of the Net Worth Sweep that its very purpose was to prevent the Companies from "retain[ing] profits" or "rebuild[ing] capital." Compl. ¶ 84 (quoting Treasury Net Worth Sweep Press Release). This perpetual and complete giveaway to Treasury is certainly more detrimental to the Companies' chances of rehabilitation than other capital distributions that FHFA has prohibited altogether. *See* 12 C.F.R. § 1237.13 (prohibiting payment of securities litigation claims). Indeed, the Net Worth Sweep has the perverse effect of prohibiting Fannie and Freddie from "retain[ing] capital to withstand a sudden, unexpected economic shock . . . ." Press Release, Statement by Kelli Parsons, Senior Vice President and Chief Communications Officer, on Stress Test Results (Apr. 30, 2014), http://goo.gl/g4pSNB. Accordingly, the Net Worth Sweep is antithetical to FHFA's duty to "preserve and conserve the assets and property" of the Companies. 12 U.S.C. § 4617(b)(2)(D)(ii).

The Net Worth Sweep's effect on the Companies' capital retention also violates FHFA's obligation to "put the [Companies] in a sound and solvent condition." *Id.* § 4617(b)(2)(D)(i). At the core of American regulation of financial institutions are capital requirements, with capital defined as the excess of assets over liabilities. Such capital serves as a buffer against the inevitable vicissitudes of the economic cycle that affect all financial institutions. Institutions with sufficient capital are deemed safe, and those without capital are deemed unsound. The Net Worth Sweep condemns the Companies into the ranks of the undercapitalized on a permanent basis. It is difficult to imagine a regulatory action more calculated to undermine the "soundness and solvency" of a financial institution than the Net Worth Sweep.

Second, the Net Worth Sweep guarantees that the Companies will never resume "normal business operations." "Normal" companies recovering from financial distress save their profits to withstand the next downturn. But today the Companies' opportunities to operate as normal, private companies exist in name only because the Net Worth Sweep depletes every dollar of their net worth, depriving them of the "future income flows" that represent a company's "fundamental value." *See Tennessee Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1208 n.2 (D.C. Cir. 1991). Indeed, the Companies themselves have described the Net Worth Sweep as a "risk factor" because it does not allow them to build capital reserves. *See* Fannie Mae 2012 Annual Report at 46–47 (Form 10-K) (Apr. 2, 2013), http://goo.gl/rGVpQq. FHFA has clearly and impermissibly abandoned its conservatorship duty to "rehabilitate" the Companies and has instead converted them into a stealthy government revenue stream, prohibited from "retain[ing] profits" or "rebuild[ing] capital." *See* Compl. ¶ 84; 76 Fed. Reg. at 35,727, 35,730.

Third, the Net Worth Sweep has caused the Companies to incur tens of billions of dollars in additional debt to finance unlawful dividends. Because many of the Companies' assets are valued based on assumptions about future financial performance or marked to market (i.e., valued according to fluctuating market prices), increases in the Companies' net worth are not necessarily associated with corresponding increases in cash on hand. Deferred tax assets, for example, appear on the Companies' balance sheets when management concludes that it is likely that the Companies will eventually be able to use them to offset future tax liability, but the recognition of those assets is an accounting decision that does not generate any cash. The result is that a cash dividend linked solely to net worth may need to be financed through borrowing. Indeed, the Companies incurred substantial additional debt in 2013 in order to pay cash dividends under the Net Worth Sweep. *See* Compl. ¶ 90. Ordering the Companies to pay debt-financed dividends when they are undercapitalized is inimical to FHFA's statutory duties to "preserve and conserve" the Companies' assets, 12 U.S.C. § 4617(b)(2)(D)(ii), and to place them in a "sound and solvent" condition, *id.* § 4617(b)(2)(D)(i). Such forced borrowing for Companies operating under federal conservatorship is absolutely astonishing and financially reckless.

Fourth, the government has openly vowed that, far from rehabilitation, the Net Worth Sweep is aimed specifically at winding down the Companies' operations. At the time of the Net Worth Sweep, Treasury proclaimed that it would "expedite the wind down of Fannie Mae and Freddie Mac" and make "sure that every dollar of earnings that [each firm] generate[s] will be used to benefit taxpayers," such that the Companies "will be wound down and will not be allowed to "retain profits, rebuild capital, and return to the market in their prior form." Compl. ¶ 84 (quoting Treasury Net Worth Sweep Press Release). FHFA similarly told Congress that its goal was to "move the housing industry to a new state, one without Fannie Mae and Freddie Mac." Compl. ¶ 86 (quoting FHFA, 2012 REP. TO CONG. at 13). FHFA's Acting Director tied the Net Worth Sweep to this goal, telling Congress that it "reinforce[d] the notion that the

[Companies] will not be building capital as a potential step to regaining their former corporate status." *Id.* (second alteration in original) (quoting DeMarco Statement Before S. Comm. on Banking, Hous. & Urban Affairs).

These actions—agreeing to pay "every dollar of earnings" to the Treasury, depleting capital, eliminating the possibility of rehabilitation and a return to normal business operations, borrowing money to pay cash dividends on paper profits, and doing so with the intent to slowly wind down the Companies—neither "preserve and conserve" the Companies' assets, 12 U.S.C. § 4617(b)(2)(D)(ii), nor "put the [Companies] in a sound and solvent condition," *id.* § 4617(b)(2)(D)(i). And they are plainly not the actions of a conservator. *See Del E. Webb McQueen Dev. Corp.*, 69 F.3d at 361. These actions instead are those of a *de facto* receiver, determined to "ensure that the assets of [the Companies] are distributed" and the Companies wound down. *See Freeman*, 56 F.3d at 1401. But that liquidation function belongs solely to a receiver, not a conservator. *See* 12 U.S.C. § 4617(b)(2)(E). As conservator, FHFA must "assum[e]" that the Companies "may well return to the transaction of [their] business" outside of governmental control. *See* Malloy, *supra*, § 11.3.4.2. FHFA's actions to the contrary exceeded its authority under HERA and its own regulations and, therefore, violated the APA.

**c. Defendants' Purported Justifications for the Net Worth Sweep Lack Merit.**

i. Defendants argue that even if the Net Worth Sweep was intended as a step toward "winding up" the Companies' affairs, FHFA had authority to take this step. *See* FHFA Br. 29–30; Treas. Br. 16–17. But the argument that a conservator can wind down an entity toward eventual liquidation—contrary to the language of HERA and FHFA's own expressed goal of using the conservatorship to "return[ ] the [Companies] to normal business operations," Compl. ¶ 35 (quoting Lockhart Conservatorship Statement at 5–6)—is simply "untenable," *CedarMinn*

*Bldg. Ltd. P'ship*, 956 F.2d at 1454.

Again, liquidation is exclusively the province of a receiver, as both HERA's text and FHFA's regulations provide, and FHFA's *de facto* liquidation of the Companies under conservatorship ignores the important procedural protections provided during receivership.

HERA lays out a complex procedure for processing claims against the Companies during liquidation that applies only during receivership. 12 U.S.C. § 4617(b)(3)–(9). By prohibiting FHFA from liquidating the Companies while it acts as their conservator, HERA also prohibits FHFA from "winding [them] up" in preparation for liquidation. Indeed, HERA, caselaw, commentators, and even dictionaries all use "liquidation" and "wind up" synonymously. For example, HERA imposes specific requirements on FHFA when it initiates "the *liquidation* or *winding up* of the [Companies'] affairs." *Id.* § 4617(b)(3)(B) (emphasis added). Similarly, caselaw regarding the FDIC's receivership authority underscores this point, holding that the purpose of a receivership is "to expeditiously 'wind up the affairs of failed banks.' " *Freeman*, 56 F.3d at 1401 (quoting *Local 2 v. FDIC*, 962 F.2d 63, 64 (D.C. Cir. 1992)). Treatises explain that receivers "liquidate the institution and wind up its affairs." Resseguie, *supra*, § 11.01. Dictionaries also define "liquidation" and "winding up" as virtually the same. *See* BLACK'S LAW DICTIONARY 1738 (10th ed. 2014) (winding up: "The process of settling accounts and liquidating assets in anticipation of a partnership's or a corporation's dissolution."); OXFORD ENGLISH DICTIONARY ONLINE (Dec. 2013) ("liquidation, n." defined as "[t]he action or process of winding up the affairs of a company"). Because HERA prohibits FHFA as conservator from liquidating the Companies, it also prohibits FHFA as conservator from winding them up.

Defendants argue that HERA—contrary to the traditional limitations of conservatorship authority—empowers conservators to wind down regulated entities because Section 4617(a)(2) states that FHFA may "be appointed *conservator or receiver* for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity." *See* Treas. Br. 4 (emphasis added); FHFA Br. 29–30. Defendants misread the statute. It does not follow that the powers articulated in Section 4617(a)(2) belong to conservators and receivers alike. After all, "the words of a statute must be read in their context." *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000); *see also King v. Burwell*, 135 S. Ct. 2480, 2487 (2015). As explained above, HERA, caselaw, commentators, and dictionaries use "liquidation" and "winding up" as synonyms. And given that liquidating the Companies is beyond FHFA's conservatorship powers, it follows that steps to wind down the Companies are also forbidden to FHFA as conservator. Further, concluding that FHFA as conservator may wind down the Companies generates absurd results: If FHFA as conservator has all three powers listed in Section 4617(a)(2)—"reorganizing, rehabilitating, [and] winding up"—it follows that FHFA as receiver must also have these three powers, including rehabilitation. But that cannot be, as even FHFA explains that as receiver it "shall place the [Companies] in liquidation," leaving no room to rehabilitate them. 12 C.F.R. § 1237.3(b) (quoting 12 U.S.C. § 4617(b)(2)(E)). Section 4617(a)(2) thus is best read as listing the authorities that HERA collectively grants FHFA as conservator and receiver, while the following provisions of the statute specify which authorities FHFA may exercise in a particular capacity. The structure of HERA's various provisions provides further support for this interpretation. *See* 12 U.S.C. § 4617(a) ("Appointment of the Agency as conservator or receiver"); *id*. § 4617(b) ("Powers and duties of the Agency as conservator or receiver"); *id.* § 4617(b)(2)(D) ("Powers as conservator"); *id*. § 4617(b)(2)(E) ("Additional powers as receiver").

If Defendants were correct—and FHFA could wind down the Companies as conservator—it would have license to evade the procedural protections afforded by receivers.

HERA requires FHFA, "as receiver, [to] determine claims in accordance with the requirements of" Section 4617(b). 12 U.S.C. § 4617(b)(3)(A). These rules require FHFA as receiver, "in any case involving the liquidation *or winding up* of the affairs of a closed regulated entity," to "promptly publish a notice to the creditors of the regulated entity to present their claims, together with proof . . . not less than 90 days after the date of publication of such notice," and to provide a mailing to the same effect. *Id.* § 4617(b)(3)(B), (C) (emphasis added). After considering these claims, FHFA may allow or disallow a creditor's claim under its prescribed rules. *Id.* § 4617(b)(5)(B), (C). These rules ensure that receivers "fairly adjudicat[e] claims against failed financial institutions." *Whatley v. RTC*, 32 F.3d 905, 909–10 (5th Cir. 1994) (describing similar procedures for FDIC and RTC). Indeed, several Courts of Appeals have recognized that a receiver's failure to provide statutorily required notice raises "serious due process concerns." *Freeman*, 56 F.3d at 1403 n.2; *see also Greater Slidell Auto Auction, Inc. v. American Bank & Trust Co. of Baton Rouge*, 32 F.3d 939, 942 (5th Cir. 1994) ("Mailing of notice to claimants known to the receiver is constitutionally required."); *Elmco*, 94 F.3d at 922 ("[I]t would violate the Due Process Clause of the Fifth Amendment to allow the RTC to treat Elmco's claim as untimely, hence permanently denied.").

FHFA should not be allowed to circumvent this adjudication process. The Net Worth Sweep transfers all of the Companies' existing net worth and future profits to Treasury, leaving Plaintiffs and other private shareholders with nothing, no matter how valuable or profitable the Companies' assets may become. This result is what would happen if FHFA as receiver had adjudicated, and disallowed, Plaintiffs' claims. *See MBIA Ins. Corp.*, 816 F. Supp. 2d at 87 (describing FDIC receivership notice that the entity's funds "are insufficient to pay claims below the depositor class and that all non-depositor creditor claims have no value"). Yet FHFA provided no notice to Plaintiffs, who have valid claims against the Companies' assets. FHFA's action, if permitted, would deprive Plaintiffs of due process. *See Freeman*, 56 F.3d at 1403 n.2.[16]

ii. Clearly prohibited from winding up the Companies, FHFA further argues that it may accomplish the same end by virtue of its authority under HERA to "'transfer or sell any asset' of the [Companies] 'without any approval, assignment, or consent.'" FHFA Br. 24 (citing 12 U.S.C. § 4617(b)(2)(G)); *see also* Treas. Br. 17. This argument fails.

As an initial matter, FHFA as conservator may engage in a wide array of conduct while it oversees the Companies: For example, it may "collect all obligations and money due" to the Companies, or contract with third parties to "fulfill[ ] any function, activity, action, or duty of the Agency as conservator," or pay valid obligations incurred by the Companies. *See* 12 U.S.C. § 4617(b)(2)(B)(ii), (b)(2)(B)(v), (b)(2)(H). But transferring the entirety of the Companies' residual economic value from private investors to another government agency in exchange for virtually nothing is not among the basic powers of a conservator. To the contrary, when FHFA transfers the Companies' assets, HERA specifically requires it to "maximize[ ] the net present value return" the Companies receive. *Id.* § 4617(b)(11)(E)(i). HERA would raise grave constitutional concerns if it authorized giveaways to the government of the sort at issue here. *See United States v. Security Indus. Bank*, 459 U.S. 70, 78–82 (1982) (construing statute narrowly to avoid takings difficulty).

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[16] Defendants also claim that they are not winding up Fannie and Freddie through the Net Worth Sweep. Treas. Br. 16; *see also* FHFA Br. 30. But this argument is difficult to take seriously given that the avowed purpose and indisputable effect of the Net Worth Sweep is to "expedite the wind down of Fannie Mae and Freddie Mac" and to ensure that these two companies "will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." Compl. ¶ 84 (quoting Treasury Net Worth Sweep Press Release); *see also* Compl. ¶ 86 (quoting Remarks of Edward J. DeMarco, Getting Our House in Order at 6 (Wash., D.C., Oct. 24, 2013) (acknowledging FHFA's plan to "wind[ ] up the affairs of Fannie and Freddie")).

In any event, FHFA does not exercise its power to transfer the Companies' assets in a vacuum, devoid of statutory goals or its own regulatory guidance. Again, the provision on which FHFA relies specifies that the agency may only transfer assets "*as conservator or receiver*," 12 U.S.C. § 4617(b)(2)(G) (emphasis added), and HERA instructs FHFA as conservator to "preserve and conserve" the Companies' assets, which FHFA has explained requires it to use its powers to "rehabilitate" the Companies for eventual return to normal business operations. *Id.* § 4617(b)(2)(D)(ii); 76 Fed. Reg. at 35,730. And in a conservatorship context, FHFA lacks the authority to "transfer assets" to *prevent*, rather than to *promote*, rehabilitation of the Companies.

FHFA attempts to prop up its argument by citing a flotilla of cases in which courts ruled that FIRREA barred plaintiffs from suing receivers to enjoin various transfers of assets. FHFA Br. 24–25 & n.14 (citing *Gosnell v. FDIC*, 1991 WL 533637, at *5–*6 (W.D.N.Y. Feb. 4, 1991); *Waterview Mgmt. Co. v. FDIC*, 105 F.3d 696, 700–02 (D.C. Cir. 1997); *Courtney v. Halleran*, 485 F.3d 942, 949 (7th Cir. 2007); *Volges v. RTC*, 32 F.3d 50, 53 (2d Cir. 1994); *United Liberty Life Ins. Co. v. Ryan*, 985 F.2d 1320, 1328–29 (6th Cir. 1993)). But all of those cases involved *receivership* and thus did not implicate the specific issue here: whether FHFA as conservator may effect an otherwise impermissible wind down of the Companies' affairs by transferring all of their profits in perpetuity to another federal agency. Moreover, the transfers at issue in FHFA's cases were all routine exercises of a receiver's powers; none involved self-dealing or waste on the scale alleged here. Nor do those cases suggest that conduct such as that at issue here would escape review. *See, e.g.*, *Gosnell v. FDIC*, 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").

The Seventh Circuit's decision in *Courtney*, on which Treasury relies, Treas. Br. 17, is far afield. In that case, the FDIC as receiver entered into an agreement with a third party to pursue legal claims against another entity and divide the proceeds of any recovery. The Seventh Circuit held that the receiver's statutory power to settle legal claims, "if it is to mean anything at all," must "operate independently" of any statutory priority distribution scheme. *Courtney*, 485 F.3d at 949. That ruling provides no support for Defendants' argument that a conservator's power to transfer assets is unrestrained by the statutory goals of conservatorship.

The Court should reject FHFA's unbounded understanding of its authority to transfer assets, which runs roughshod over HERA's careful enumeration of a conservator's powers and obligations. *See Coit Independence Joint Venture v. Federal Sav. & Loan Ins. Corp.*, 489 U.S. 561, 573–74 (1989) (interpreting FIRREA's predecessor and concluding that particular provision did not give agency power to adjudicate claim in light of other provisions enumerating its authority); *see also Beck v. PACE Int'l Union*, 551 U.S. 96, 108 (2007) (looking to ERISA's overall structure to interpret specific provision); *Utility Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2440-41 (2014) (same with respect to Clean Air Act).

3. FHFA further claims that the Net Worth Sweep was within its statutory authority to "carry on the business" of Fannie and Freddie, to "operate the [Enterprises]," and to "conduct all business of the [Enterprises]" in the manner the Conservator "determines is in the [Enterprises or FHFA's] best interests." FHFA Br. 22–23 (quoting 12 U.S.C. § 4617(b)(2)(B)(i), (D), (J)(ii)); *see also* FHFA Br. 3.[17] FHFA does not muster any support for this stunning proposition that it

[17] FHFA also invokes in passing what it describes as its authority to "enter into contracts on behalf of the enterprises." FHFA Br. 22, 29 (citing 12 U.S.C. § 4617(b)(2)(B)(v).) But it does not actually quote the statutory provision it cites in support of this power, which 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). As the italicized language makes clear, this provision does not confer upon FHFA an open-

can disregard its conservatorship obligations if it, in its sole discretion, concludes that an action may benefit the Companies, or even itself. That is not the law, and "FHFA cannot evade judicial scrutiny by merely labeling its actions with a conservator stamp." *Leon Cnty. v. FHFA*, 700 F.3d 1273, 1278 (11th Cir. 2012). Indeed, HERA expressly links FHFA's power as conservator to "carry on the business" of Fannie and Freddie with its duty to "preserve and conserve [their] assets and property." 12 U.S.C. § 4617(b)(2)(D) ("The Agency may, as conservator, take such action 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 likewise makes clear that FHFA's "[i]ncidental power[ ]" to take actions that FHFA determines are in the best interests of FHFA or the Companies is limited to actions otherwise "authorized by this section [of HERA]." 12 U.S.C. § 4617 (b)(2)(J); *see also FHFA v. City of Chicago*, 962 F. Supp. 2d 1044, 1057–58 (N.D. Ill. 2013) ("As conservator, FHFA has broad powers to operate Fannie and Freddie and do *what it sees fit to 'preserve and conserve [their] assets.'* ") (emphasis added) (quoting 12 U.S.C. § 4617(c)(2), (b)(2)(D)(ii)). Thus there is no basis for reading a broad, free-floating grant of authority into a provision that provides merely for the exercise of authority incidental to that expressly granted by HERA to FHFA. *Cf. McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 411 (1819) ("[A] great substantive and independent power . . . cannot be implied as

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ended, 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. And as demonstrated above, the Net Worth Sweep does not further any of these powers or duties. In addition, Treasury briefly invokes FHFA's responsibilities as conservator to "put the [GSEs] in a sound and solvent condition" and to "preserve and conserve the assets and property of the [GSEs]." Treas. Br. 15. But as we have demonstrated at length, the Net Worth Sweep does the precise opposite. *See supra* Part II.A.2.b.ii.

incidental to other powers, or used as a means of executing them.”).[18]

#### d. The *Perry Capital* Court Erred in Holding that FHFA Acted Within Its Authorities in Executing the Net Worth Sweep.

Defendants repeatedly trumpet the district 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. While the district court in that case did hold that FHFA acted within its authority in executing the Net Worth Sweep, its reasoning on this point is hopelessly flawed.

First, the district court deliberately blinded itself to the purpose of the Net Worth Sweep, stating that “FHFA’s underlying motives . . . do not matter” and that it would look only “at *what* has happened, not *why* it happened.” *Perry Capital v. Lew*, 70 F. Supp. 3d 208, 226 (D.D.C. 2014). While the court cited language from the district court’s decision in *Leon County*, 816 F. Supp. 2d at 1208, in support of its approach, it disregarded the Eleventh Circuit’s later statement in the same case that in deciding whether FHFA acted within its statutory powers, a court “must

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[18] FHFA briefly suggests that review of its execution and implementation of the Net Worth Sweep is barred by 5 U.S.C. § 701, which exempts agency actions from judicial review under the APA where (1) “statutes preclude judicial review,” *id*. § 701(a)(1), or (2) “agency action is committed to agency discretion by law,” *id*. § 701(a)(2). *See* FHFA Br. 30 n.18. As demonstrated above, 12 U.S.C. § 4617(f) does not bar review of FHFA’s actions where, as here, those actions exceed or contravene its statutory authorities as conservator. Accordingly, Section 701(a)(1) has no application in this case. And as FHFA’s own authorities acknowledge, Section 702(a)(2) “is a very narrow exception” that applies only “in those rare instances where statutes are drawn in such broad terms that in a given case there is no law to apply.” *Heckler v. Chaney*, 470 U.S. 821, 830 (1985) (quotation marks omitted); *North Dakota ex rel. Bd. of Univ. and Sch. Lands v. Yeutter*, 914 F.2d 1031, 1033 (8th Cir. 1990); *see also Bowen v. Michigan Acad. of Family Physicians*, 476 U.S. 667, 670 (1986) (noting “the strong presumption that Congress intends judicial review of administrative action”); *Yeutter*, 914 F.2d at 1033 (same). This case does not present a “rare instance” where “there is no law to apply.” To the contrary, as demonstrated above, *see supra* Part II.A.2.b, HERA, regulations, precedent, and historical practice provide clear limits on a conservator’s authority, and even the most seemingly broad statutory powers invoked by FHFA are tied, both expressly and implicitly, to these limits. *See, e.g.*, 12 U.S.C. § 4617(b)(2)(D) (linking FHFA’s power as conservator to “carry on the business” of Fannie and Freddie to its duty to “preserve and conserve [their] assets and property”); *id*. § 4617(b)(2)(j) (limiting FHFA’s incidental powers to what is “necessary to carry out” the “powers and authorities” expressly granted).

consider *all* relevant factors," including the action's "subject matter, *its purpose*, [and] its outcome," *Leon Cnty.*, 700 F.3d at 1278 (emphasis added).

In blinding itself to FHFA's rationales, the district court went seriously astray. HERA defines FHFA's "powers as conservator" by reference to what is "*necessary* to put the [Companies] in a sound and solvent condition" and "*appropriate* to . . . preserve and conserve the [Companies'] assets." 12 U.S.C. § 4617(b)(2)(D) (emphases added). To determine whether FHFA's actions are "necessary" or "appropriate" to achieve its statutory goals generally requires analysis of whether the agency actually was attempting to further those aims. Indeed, by refusing to consider even FHFA's self-proclaimed intent, the *Perry Capital* court erased a principal distinction between conservators and receivers: While a few statutory powers are reserved to conservators alone or receivers alone, many powers (like transferring assets) are granted to both. *See* 12 U.S.C. § 4617(b)(2)(A)–(C), (G)–(J). When exercising these common powers, conservators distinguish themselves from receivers by their "distinct missions": The conservator must aim to "conserve assets," while the receiver must "shut a business down and sell off its assets." *RTC v. United Trust Fund, Inc.*, 57 F.3d 1025, 1033 (11th Cir. 1995). Had it considered FHFA's intent, the *Perry Capital* court would have found that FHFA adopted the Net Worth Sweep to implement Treasury's goal to "wind down" Fannie and Freddie by ensuring that they would not "retain profits, rebuild capital, and return to market in their prior form." Compl. ¶ 84 (quoting Treasury Net Worth Sweep Press Release). That is clearly inconsistent with FHFA's mission and authorities as a conservator.

Second, 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. Accordingly, the court reasoned, Fannie and Freddie were not in "*de facto* liquidation" and "FHFA ha[d] acted within its broad statutory authority as a conservator." *Id*.

These facts, however, are not dispositive of whether FHFA acted within its authority as conservator. As discussed above, *see supra* Part II.A.2.b.i, HERA, regulations, precedent, and historical practice provide clear limits on a conservator's authority that have nothing to do with *de facto* liquidation or profitability. FHFA's own regulations interpreting HERA are particularly clear on this point: "the Conservator is charged with rehabilitating the regulated entity," 76 Fed. Reg. at 35,727; "the essential function of a conservator is to preserve and conserve the institution's assets," *id*.; and "one of the primary objectives of conservatorship of a regulated entity would be restoring that regulated entity to a sound and solvent condition," *id*.; *see also* 12 U.S.C. § 4617(b)(2)(D) (requiring FHFA as conservator to "put the [Companies] in a sound and solvent condition" and "preserve and conserve [their] assets and property"). As demonstrated at length above, *see supra* Part II.A.2.b.ii, transferring all of Fannie's and Freddie's net worth, in perpetuity, to Treasury—transfers that have already exceeded by tens of billions of dollars the amount borrowed from Treasury in the first place but have not reduced FHFA's debt by even one dollar—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.[19]

### B. Section 4617(f) Does Not Bar Plaintiffs' Claims Against Treasury.

1. 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 with respect to the Net Worth Sweep because a court's setting aside the Net Worth Sweep would

[19] Defendants also repeatedly invoke the district court's decision in *Continental Western Insurance Company v. FHFA*, 83 F. Supp. 3d 828 (S.D. Iowa 2015). That decision rested on preclusion grounds and stated in 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*.

"affect" FHFA's power to enter into it. Treas. Br. 19–21. But Section 4617(f) does not bar suits against FHFA for violating HERA, and by extension Plaintiffs' claims against Treasury for violating HERA may also proceed. As even the *Perry Capital* court recognized, "if FHFA, as a conservator or receiver, signs a contract with another government entity that is acting beyond the scope of its HERA powers, then FHFA is functionally complicit in its counterparty's misconduct, and such unlawful actions may be imputed to FHFA." 70 F. Supp. 3d at 222. Treasury violated HERA when it agreed to the Net Worth Sweep, and the fact that FHFA was complicit in Treasury's actions does not preclude judicial review.

More fundamentally, Treasury errs when it argues that judicial relief that would compel Treasury to abide by its own, independent legal obligations when it contracts with the Companies would "affect" FHFA's exercise of its conservatorship powers within the meaning of Section 4617(f). 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. Immunizing Treasury from liability for violations of its independent obligations under HERA and the APA 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.

Resisting this straightforward interpretation of Section 4617(f), Treasury cites two cases in which courts rejected claims against third parties that if allowed to proceed would have "affected" a federal conservator's or receiver's exercise of its powers or functions. Treas. Br. 19–20. But unlike Plaintiffs' claims against Treasury, these cases concerned efforts to enforce the legal obligations of *a federal receiver or conservator or its charge* by suing a third party. Thus, in *Dittmer Properties, LP v. FDIC*, the plaintiff argued that a debt a third party had acquired from FDIC was void because the failed bank that originally issued the debt could not have enforced it. 708 F.3d 1011, 1015–16 (8th Cir. 2013). The Eighth Circuit held that the courts could no more enjoin the third party from enforcing the debt than they could have enjoined FDIC from doing so prior to the debt's transfer. *Id.* at 1016–20. In so ruling, the Eighth Circuit emphasized that the plaintiff's claim ultimately turned on "the act or omission of a failed banking institution"—not the unrelated legal obligations of the third party that eventually acquired the debt. *Id.* at 1019. Similarly, in *Gail C. Sweeney Estate Marital Trust v. United States Department of Treasury*, 68 F. Supp. 3d 116, 118 (D.D.C. 2014), the plaintiff attempted to sue Treasury derivatively on behalf of Fannie—a step that only FHFA may take absent a manifest conflict of interest. The claims against Treasury in that case were foreclosed by HERA's jurisdictional bar because the plaintiffs were attempting to exercise a specific power that belongs exclusively to FHFA, and nothing in the court's opinion suggests that Section 4617(f) gives FHFA the much broader power that Treasury claims for it here: the power to suspend the law as it applies to the Companies' contractual counterparties.

In contrast to the claims against third parties in *Dittmer* and *Gail C. Sweeney Estate Marital Trust*, Plaintiffs' claims here against Treasury allege that Treasury's *own* conduct was unlawful and do not depend on the legal obligations of FHFA or the Companies. Other courts have concluded that FIRREA's analogous jurisdictional bar was inapplicable under similar circumstances, and this Court should likewise hold Section 4617(f) inapplicable. *See Stommel v. LNV Corp.*, 2014 WL 1340676, at *5 (D. Utah Apr. 4, 2014) (FIRREA's jurisdictional bar 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) ("At bottom, OSM seeks to recover from LNV, and such relief simply would not 'restrain or affect' the FDIC[ ] in any way.").

2. Treasury is also wrong when it argues that the Net Worth Sweep was an exercise of its supposed "right to amend" the securities it already owned in the Companies and was therefore permissible even though its authority "to purchase any obligations and other securities issued by the [Companies]" had expired on December 31, 2009. 12 U.S.C. § 1719(g)(1)(A), (g)(4)[20]; *see* Treas. Br. 20–21. After that date, HERA limited Treasury's authority to "hold[ing], exercis[ing] any rights received in connection with, or sell[ing]" the Companies' securities, 12 U.S.C. § 1719(g)(2)(D), and, as Treasury acknowledged, its "ability to make further changes to the PSPAs . . . [was] constrained," Compl. ¶ 56. The Net Worth Sweep was not the exercise of a purported "right to amend" but rather was an impermissible "purchase" of new securities.

As an initial matter, Treasury's purported "right to amend" is not a "right" that it can "exercise" within the meaning of Section 1719(g)(2)(D). A "right" to act means "[a] legal, equitable, or moral entitlement to do something." OED Online (right, n.). Similarly, "exercise"—in the context of contracts—means "[t]o implement the terms of; to execute," as in to "exercise the option to buy the commodities." BLACK'S LAW DICTIONARY 693 (10th ed. 2014). A party has a contractual "right" when it "can initiate legal proceedings that will result in coercing" the other party to act. 1 E. Allen Farnsworth, *Farnsworth on Contracts* § 3.4, at 205 n.3 (3d ed. 2004). Definitionally, a contractual "right" is an entitlement to certain performance from the counter-party, and it is "exercised" through unilateral action that does not require negotiation or mutual assent. By contrast, an arrangement that depends on "mutual consent" is not a right at all. *See United States v. Petty Motor Co.*, 327 U.S. 372, 380 n.9 (1946) (an agreement that depends on

[20] For the sake of convenience, we generally refer to the statutory provisions governing Treasury's authority to purchase Fannie's stock. The same analysis applies to the parallel provisions governing Treasury's authority to purchase Freddie's stock. *See* 12 U.S.C. § 1455(*l*).

the parties' subsequent "mutual consent" "does not add to their rights"). Because Treasury could not unilaterally require FHFA to agree to the Net Worth Sweep, Treasury's decision to adopt the Net Worth Sweep was not an "exercise" of a "right."

Rather than an amendment to existing securities, the Net Worth Sweep constituted the "purchase" of new securities after Treasury's purchasing authority had expired on December 31, 2009. 12 U.S.C. § 1719(g)(1)(A), (g)(4). The Oxford English Dictionary defines "purchase" as "[t]o acquire in exchange for payment in money or an equivalent; to buy," OED Online (purchase, v.), the Uniform Commercial Code defines that term as "any other voluntary transaction creating an interest in property," U.C.C. § 1-201(b)(29), and Black's Law Dictionary defines "purchaser" to mean "one who obtains property for money or *other valuable consideration*," BLACK'S LAW DICTIONARY, *supra*, 1430 (emphasis added). The Net Worth Sweep clearly meets these definitions of "purchase." Purchases are not confined to cash. *See SEC v. National Sec., Inc.*, 393 U.S. 453, 467 (1969). The Companies sold Treasury a new obligation—to hand over their net worth each quarter—by canceling the Companies' fixed-dividend obligations. Indeed, this is precisely how FHFA describes the transaction: "By executing the Third Amendment, the Conservator agreed to . . . waiv[e] the Enterprises' annual fixed dividend and periodic commitment fee obligations *in exchange for* the payment of a variable dividend based on net worth." FHFA Br. 23 (emphasis added). This 2012 transfer of obligations was clearly a "purchase"—albeit an exceedingly one-sided one—that Treasury was unauthorized to make.

Echoing the *Perry Capital* court, Treasury nevertheless argues that the Net Worth Sweep transaction was not a purchase because Treasury did not increase its funding commitment. Treas. Br. 20–21. But if Treasury were deemed to have a "right to amend" its securities, there would be no basis for distinguishing amendments that increase Treasury's funding commitment versus those that do not, because HERA grants Treasury the authority to "exercise any rights received in connection with" purchases of Fannie's and Freddie's stock "at any time." 12 U.S.C. § 1719(g)(2)(A). This underscores why HERA must not be interpreted to grant Treasury a right to amend its securities, because any such right would make the expiration of Treasury's purchase authority wholly illusory.

Furthermore, the existence of a funding commitment is not determinative of whether there is a purchase under Section 1719(g). Treasury could have purchased securities with no funding commitment at all. The touchstone of a purchase is an exchange of value. Here, Treasury acquired the Companies' existing net worth and future profits in exchange for cancellation of its right to a fixed dividend and commitment fee. The transfer of a fixed dividend obligation worth $19 billion per year in exchange for the Companies' net worth and future earnings (a deal that has netted Treasury over $130 billion to date) most certainly constitutes a new investment in the Companies—Treasury now essentially owns 100% of the Companies' equity value. Treasury's decision to exchange its fixed dividend for the Companies' equity value was thus a "purchase" prohibited by HERA.

The securities laws and Treasury's own IRS regulations recognize that "amendments" such as the Net Worth Sweep that fundamentally change a security's nature create an entirely new security and that this transformation constitutes a purchase. Section 10(b) of the Securities Exchange Act of 1934 prohibits fraud "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b). When deciding whether plaintiffs have either purchased or sold securities, courts ask whether there is "such significant change in the nature of the investment or in the investment risks as to amount to a new investment." *Gelles v. TDA Indus., Inc.*, 44 F.3d 102, 104

(2d Cir. 1994). This analysis requires assessing the "economic reality of [a] transaction," *Keys v. Wolfe*, 709 F.2d 413, 417 (5th Cir. 1983), including the investment's altered risk profile, *see 7547 Corp. v. Parker & Parsley Dev. Partners, LP*, 38 F.3d 211, 229 (5th Cir. 1994) (plaintiff exchanged "units in a financially solvent limited partnership" for stock in a financially unstable corporation). Holders of a fundamentally changed security are considered purchasers of new securities. *National Sec., Inc.*, 393 U.S. at 467.

Treasury's taxation regulations similarly recognize that a major change to a security is a purchase. Normally, the IRS taxes assets when sold. To prevent tax evasion, IRS regulations provide that "a significant modification of a debt instrument . . . results in an exchange of the original debt instrument for a modified instrument." 26 C.F.R. § 1.1001-3(b). A modification is "significant" if it alters the security's annual yield by "¼ of one percent" or "5 percent of the annual yield of the unmodified instrument," or if it converts debt into equity. *Id*. § 1.1001-3(e)(1), (2)(ii), (5)(i). In addition, and most notably, the IRS has held that an amendment changing the value of preferred stock to "equal the net worth of [a] corporation" "constitutes, in substance, . . . new preferred stock." Rev. Rul. 56-564, 1956-2 C.B. 216, 1956 WL 10781.

The Net Worth Sweep's change to the Government Stock's fixed dividend gave Treasury a new security. Under the "economic reality of the transaction," *Keys*, 709 F.2d at 417, the Net Worth Sweep generated more than $110 billion in additional dividends during 2013 alone. And Treasury's annual yield soared from 10% of the liquidation preference to almost 70% of the preference—many multiples of the IRS's threshold (i.e., $130 billion in 2013 dividends vs. $189 billion in liquidation preference).

The Net Worth Sweep also fundamentally transformed Treasury's fixed-dividend preferred stock effectively into unlimited-upside common stock. *Cf.* 26 C.F.R. § 1.1001-

3(e)(5)(i) (exchange where "modification . . . results in an instrument or property right that is not debt"). Preferred shares "generally give the holder a claim to a fixed dividend that must be satisfied before any dividend is paid on common shares. . . . In contrast to common shares, preferred shares do not provide an unlimited claim on the corporation's residual earnings." 11 *Fletcher Cyclopedia of the Law of Corporations* § 5283, at 464 (2011 rev. vol.). Under the Net Worth Sweep, by contrast, Treasury takes all of the Companies' net worth—their "residual earnings." Indeed, having effectively wiped out the Companies' remaining equity pursuant to a secret Administration policy, *see* Compl. ¶ 85, there is effectively no longer any lower-ranked equity over which Treasury's stock could take "priority." *See Folk on the Delaware General Corporation Law* § 151.04 (2015). Because the Net Worth Sweep in substance changed debt-like preferred stock into common stock, it constituted a purchase of new securities.

## III. Section 4617(b)(2)(A) 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. 30–34 (citing 12 U.S.C. § 4617(b)(2)(A)); Treas. Br. 21–28 (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 all of the claims at issue 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.

### A. Plaintiffs Have Standing To Bring Direct Claims Arising from Their Ownership of Stock.

1. 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 and Freddie*, it does nothing to divest shareholders of their own, personal economic rights in Fannie and Freddie and, therefore, does nothing to prevent shareholders 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's and Freddie's shareholders would continue to "have an economic interest in the companies" and would "retain all rights in the stock's financial worth." Compl. ¶ 39. If Defendants' current litigating position were correct, these repeated public assurances were blatantly false.[21]

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. *See Waterview Mgmt. Co. v. FDIC*, 105 F.3d 696, 699 (D.C. Cir. 1997) ("[T]o hold that the federal government could simply vitiate the terms of existing assets, taking rights of value from private owners with no compensation in return, would raise serious constitutional issues."); *see also, 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

[21] Adopting Defendants' position would make numerous additional conservatorship decisions nonsensical. For example, FHFA expressly suspended payment of dividends to private shareholders during conservatorship. But if FHFA had in fact succeeded to the shareholders' contractual dividend rights, any payment of dividends would have been to FHFA itself, not to shareholders. FHFA then would have had no need to announce *to itself* that it was halting the payment of dividends. Moreover, FHFA entered into contractual agreements with Treasury—a *shareholder* in the Companies—that provided Treasury with dividend and liquidation rights, and FHFA has paid tens of billions of dollars in dividends under those agreements. If the government's assertion were correct, Treasury's dividend rights would belong to FHFA, and these payments should have been retained by FHFA rather than given to Treasury.

actions of the same character may also qualify as a taking."). 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 causes of action 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.

*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); *see also id.* (opinion of Hamilton, J.) ("I join Judge Easterbrook's opinion for the court. His opinion accurately applies the difference between a shareholder's direct and derivative claims, *which all parties agree is the decisive legal question*.") (emphasis added). There is no rational reason for interpreting the provision at issue here differently than the analogous provision of FIRREA that Congress patterned it after, and Treasury and FHFA's disagreement with the FDIC is inexplicable.

The Seventh Circuit's (and the FDIC's) reading of FIRREA is not idiosyncratic. As the Seventh Circuit acknowledged, "*[n]o* federal court has read the statute" to transfer direct claims to the FDIC. *Id.* (emphasis added). *See, e.g., 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). 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.[22] Indeed, even the *Perry Capital* court implicitly recognized that HERA *does not* bar direct, as opposed to derivative, claims by shareholders. *See, e.g.*, *Perry Capital*, 70 F. Supp. 3d at 229 n.24 ("[I]f such a determination were necessary, the Court notes that it would find that the *Fairholme* plaintiffs' fiduciary duty claim is derivative in nature and, *therefore*, barred under § 4617(b)(2)(A)(i) as well.") (emphasis added).

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.

2. As we have demonstrated, *see supra* Part I.A, Plaintiffs' claims are direct rather than derivative. And because Plaintiffs' claims seek to vindicate rights that are personal and are not claims of the Companies, the fact that the conservator has succeeded to the shareholders' rights "with respect to [the Companies]" has no relevance here.

### B. Plaintiffs Have Standing To Bring Even Derivative Claims Where, as Here, the Conservator Has a Manifest Conflict of Interest.

1. As just explained, HERA does not bar direct claims by shareholders of entities in

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[22] *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).

conservatorship. But even if HERA generally were held to bar such claims (or if Plaintiffs' direct claims were construed to be derivative), HERA still would permit Plaintiffs to bring their 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 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 there is a "strong presumption that Congress intends judicial review of administrative action." *Bowen v. Michigan Acad. of Family Physicians*, 476 U.S. 667, 670 (1986). It is likewise 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).[23]

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

[23] 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.

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) (finding standing to sue "because of the FDIC's conflict of interest by which it is both alleged to have caused the breach and controls the depository institution itself"); *Delta Sav. Bank v. United States*, 265 F.3d 1017, 1024 (9th Cir. 2001) (adopting "a common-sense, conflict of interest exception to the commands of FIRREA" and permitting a shareholder to bring a derivative suit against one of the FDIC's "closely-related, sister agencies"). And in the context of HERA, even the authorities on which Defendants principally rely for the most part recognize a "conflict of interest exception" to the general rule urged by Defendants here. *See Kellmer*, 674 F.3d at 850; *In re Fed. Nat'l Mortg. Ass'n Sec., Derivative, & ERISA Litig.*, 629 F. Supp. 2d 1, 4 n.5 (D.D.C. 2009); *In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 798 (E.D. Va. 2009); *Esther Sadowsky Testamentary Trust*, 639 F. Supp. 2d at 350.

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 leading to the imposition of the conservator or receiver in the first place, as it would not permit shareholders to bring derivative actions asserting such claims during conservatorship or receivership.

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.

2. 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.

Treasury, relying on *Perry Capital*, nevertheless argues that the claims against it, as opposed to the claims against FHFA, do not present a manifest conflict of interest. Tr. Br. 27–28. FHFA, notably, does not disclaim a conflict in determining whether to sue Treasury, and the notion that FHFA is not conflicted is risible. Indeed, the Complaint alleges that Treasury *compelled* FHFA to enter the Net Worth Sweep, *see, e.g.*, Compl. ¶ 16; in light of that allegation (which must be taken as true), there is no reason to believe that Treasury nevertheless would allow FHFA to initiate a lawsuit challenging Treasury's actions. And even putting the issue of compulsion to the side, the Net Worth Sweep at a minimum is a joint FHFA-Treasury initiative and FHFA reasonably cannot be held to be free from bias in evaluating claims that Treasury acted illegally in agreeing to it.

In holding otherwise, *Perry Capital* attempted to distinguish this case from *Delta Savings*, a case in which the Ninth Circuit held that a stockholder of a bank in receivership had standing to sue the Office of Thrift Supervision ("OTS") because the bank's receiver, the FDIC, was conflicted. *See Perry Capital*, 70 F. Supp. 3d at 232–33. But whatever distinctions there may be in the relationship between FHFA and Treasury and the relationship between FDIC and OTS in *Delta Savings*—and any such distinctions are not as pronounced as *Perry Capital* made them out to be[24]—the bottom line should be the same: FHFA "should not have the final say on

[24] FHFA and Treasury "are not two disengaged bodies on the opposite ends of an organizational chart" but are "closely related entities," particularly when it comes to the Net

whether it is in [Fannie's and Freddie's] best interests to sue" Treasury for acting illegally in entering the Net Worth Sweep because FHFA "faces a conflict of interests when it contemplates" such a suit. *Delta Savings*, 265 F.3d at 1021–22.

Also relying on *Perry Capital*, FHFA briefly suggests that a conflict-of-interest exception is less suited to the conservatorship context than to the receivership context. *See* FHFA Br. 34. 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, *see supra* Part II.A.2.c, there is an even greater need for a conflict-of-interest exception to protect the interests of shareholders during conservatorship than during receivership.

**IV. Plaintiffs' Claims Are Ripe.**

Echoing the district court in *Perry Capital*, FHFA argues that Plaintiffs' contract claims with respect to their liquidation rights are not ripe because they are "contingent" on the Companies' liquidation—something that FHFA says has not yet occurred—FHFA Br. 35 (citing *Texas v. United States*, 523 U.S. 296, 300 (1988)), and because "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. 36; *see also* Treas. Br. 25 n.13.

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Worth Sweep. *See Delta Savings*, 265 F.3d at 1023. For example, the Secretary of the Treasury is "a member of [a Government] Board" that advises FHFA's director in carrying out his statutory duties. *Id.*; *see* 12 U.S.C. § 4513a. And FHFA and Treasury "play complementary roles in the process of" rehabilitating Fannie and Freddie, with FHFA having authority to appoint itself conservator and Treasury having the now-expired authority to invest in Fannie's and Freddie's equity securities. *Delta Savings*, 265 F.3d at 1023. (Contrary to *Perry Capital*, *see* 70 F. Supp. 3d at 232–33, this interrelationship cuts in favor of finding a conflict of interest, not against it.) FHFA simply "cannot be expected to objectively pursue lawsuits" against Treasury relating to the Net Worth Sweep, "even when it is in the best interest of [Fannie and Freddie] to do so." *Delta Savings*, 265 F.3d at 1023.

As an initial matter, this argument fundamentally misunderstands the nature of Plaintiffs' claim. Plaintiffs are not seeking liquidation payments. Rather they are seeking damages for the complete nullification of their contractual rights to participate in the liquidation process in the event that Fannie and Freddie are liquidated. And even if FHFA is correct that whether and how these rights will be *exercised* is contingent, the *existence* of these rights is not. And those rights had some economic value before the Net Worth Sweep—while the precise amount of that value might reasonably be disputed, its existence cannot—and that value was destroyed by the Net Worth Sweep, which permanently and completely nullified these rights. Far from being contingent or prospective, this injury was complete the moment Defendants implemented the Net Worth Sweep. Furthermore, even if FHFA is inclined to contest these obvious propositions, Plaintiffs' reasonable allegations to this effect must be credited for purposes of these motions to dismiss. And binding Eighth 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. *Bob's Home Serv., Inc. v. Warren Cnty*., 755 F.2d 625, 627–28 (8th Cir. 1985); *see also Vogel v. Foth & Van Dyke Assocs*., 266 F.3d 838, 840 (8th Cir. 2001).

In all events, FHFA's arguments fail even on their own terms. Plaintiffs have alleged that the Net Worth Sweep sets the Companies on an inexorable path to wind down by preventing them from building capital and that it guarantees that Plaintiffs will receive nothing when the liquidation process is complete. *See supra* Part II.A.2.c; Compl. ¶¶ 81, 98, 125. Plaintiffs' allegations are detailed and specific and must be accepted as true at this stage of the litigation.[25]

[25] *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' liquidation rights is legally irrelevant, for the possibility of future agency action does not suffice to foreclose judicial review of definitive agency action. 70 F.

Further, it is simply 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. 36. To the contrary, Plaintiffs have alleged that Defendants' nullification of their contractual rights has destroyed the value of their stock. *See* Compl. ¶¶ 71, 113, 125.

In short, there is nothing "hypothetical or speculative" about Plaintiffs' claims, *Nebraska Pub. Power Dist. v. MidAmerican Energy Co.*, 234 F.3d 1032, 1038 (8th Cir. 2000), further factual development would not assist the Court in resolving them, *see Pacific Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 203 (1983), and a judicial decision now would settle the parties' dispute, *see Ernst & Young v. Depositors Econ. Prot. Corp.*, 45 F.3d 530, 539–40 (1st Cir. 1995). And, in all events, as even FHFA recognizes, *see* FHFA Br. 35–38, 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 effectively extinguished *all* of Plaintiffs' rights as a preferred and common shareholders, not just their liquidation rights.

## V. Plaintiffs' Contract Counts State Claims for Which Relief Can Be Granted.

A. FHFA briefly argues that Plaintiffs' claims for breach of contract and for breach of the implied covenant of good faith and fair dealing must fail with respect to Plaintiffs' dividend rights because Plaintiffs "do not have a present or absolute right to dividends." FHFA Br. 37 (quoting *Perry Capital*, 70 F. Supp. 3d at 237). But, as with FHFA's ripeness argument, this argument misperceives Plaintiffs' claimed injury. Plaintiffs' complaint, except as noted below, is

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Supp. 3d at 235; *see American Petroleum Inst. v. EPA*, 906 F.2d 729, 739–40 (D.C. Cir. 1990). Indeed, on *Perry Capital*'s view, pre-enforcement suits would *never* be ripe, for it is always possible that government agencies or officials may change their minds and reverse even final agency decisions. *See Sackett v. EPA*, 132 S. Ct. 1367, 1372 (2012); *EPA v. National Crushed Stone Ass'n*, 449 U.S. 64, 72 n.12 (1980); *Abbott Labs. v. Gardner*, 387 U.S. 136, 151 (1967).

not that they had an "absolute right" to any particular dividend or liquidation payments. Rather, their complaint is that the Net Worth Sweep *eliminated* their economic interest in Fannie and Freddie and transferred that interest to Treasury. *See, e.g.*, Compl. ¶¶ 129–132; 140, 142, 144. Because Treasury is now entitled to *all* of the Companies' existing net worth and future profits, there is *nothing* left for Plaintiffs and other private shareholders, and there is no chance that Plaintiffs or other private shareholders will receive a dividend payment or a distribution of assets upon liquidation. In short, before the Net Worth Sweep Plaintiffs had an economic interest in Fannie and Freddie; now, they do not. By eliminating that economic interest, FHFA breached Plaintiffs' contracts and the implied covenant of good faith and fair dealing.

B. As noted above, Plaintiffs do raise an argument for a present right to dividends. "[S]ecurities are not classified merely by the label attached to them, but rather through an analysis of their functional characteristics." *See QVT Fund LP v. Eurohypo Capital Funding LLC I*, 2011 WL 2672092, at *10 (Del. Ch. July 8, 2011) (unpublished). After the Net Worth Sweep, Treasury's Government Stock, to the extent it is valid at all, is best characterized as common stock. *See supra* Part II.B. The concept of "preferred stock" entitled to 100% of a company's net worth is foreign to Delaware and Virginia law. The laws of both states presume that preferred stock will have certain *priorities* over other classes of stock, not that preferred stock will operate to the *exclusion* of and effectively *eliminate* all other classes of stock. *See* 8 DEL. CODE § 151(c); VA. CODE § 13.1-638. Furthermore, the right to the residual value of the firm—which is what Treasury is entitled to after the Net Worth Sweep—is a hallmark of common stock. *See Len v. Fuller*, 1997 WL 305833, at *4 (Del. Ch. May 30, 1997) (unpublished).

If Treasury's stock is considered common stock, the Companies' dividend distributions to Treasury breach the contracts of all other shareholders because private preferred shareholders are entitled to dividends *in preference to* common shareholders and private common shareholders are entitled to dividends *in parity with* other common shareholders. *See* Compl. ¶¶ 135, 139.

*Perry Capital* rejected this argument because "the characteristics of preferred stock that distinguish that stock from common stock—*e.g.*, senior-most dividend and liquidation rights—remain expressly and clearly stated under the Third Amendment." 70 F. Supp. 3d at 238 n.44 (quotation marks omitted). But what this misses is that the Net Worth Sweep *effectively eliminates* the economic rights of all other classes of stock, leaving Treasury as the Companies' *de facto* sole shareholder. Thus, to the extent Treasury's stock remains valid at all, it should be considered common stock, not preferred stock.

## CONCLUSION

For the foregoing reasons, Defendants' motions to dismiss should be denied.

Dated: October 26, 2015

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that on this 26th day of October 2015, I caused a true and correct copy of the foregoing to be filed electronically using the Court's CM/ECF system, causing a true and correct copy to be served on all counsel of record.

/s/ Alexander M. Johnson
Alexander M. Johnson

# EXHIBIT 1

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

| | | |
|---|---|---|
| **LOUISE RAFTER, *et al.*,** | ) | |
| **Plaintiffs,** | ) | |
| **v.** | ) | **Civil No. 14-1404 (RCL)** |
| **DEPARTMENT OF THE TREASURY, *et al.*,** | ) | |
| **Defendants.** | ) | |

**MEMORANDUM & ORDER**

Before the Court is the defendants' motion to strike the plaintiffs' notice of voluntary dismissal [17]. Upon consideration of the defendants' motion [16], the plaintiffs' opposition [18] thereto, the defendants' reply [19], the applicable law, and the entire record herein, the Court will DENY the defendants' motion to strike.

## I. BACKGROUND

This matter hinges on whether the complaint filed by the plaintiffs in this case was *automatically* consolidated with the Consolidated Class Action, *In re Fannie Mae/Freddie Mac Senior Preferred Stock Purchase Agreement Class Action Litigations*, No. 13 Misc. 1288, that this Court dismissed pursuant to its Memorandum Opinion in *Perry Capital LLC v. Lew*, No. 13 Civ. 1025, 2014 WL 4829559 (D.D.C. Sept. 30, 2014). As the Court will explain, no such automatic consolidation occurred.

This Court, then District (now Circuit) Judge Wilkins presiding, issued an Order consolidating seven lawsuits, each of which was "styled as a class action and/or a derivative action," into one Consolidated Class Action. Consolidation Order, *In re Fannie Mae/Freddie*

*Mac*, No. 13 Misc. 1288 (D.D.C. Nov. 18, 2013), ECF No. 1. The Court noted that the Consolidation Order shall also apply to "each putative class action and/or derivative action that is subsequently filed in or transferred to this Court that relates to the same subject matter as in the Consolidated Class Action." *Id.* ¶ 2. Yet, as described below, the Consolidation Order further delineated a series of steps to be followed for consolidation to take place. *See id.* ¶¶ 3, 6, 7.

The plaintiffs filed their complaint in this action against the Department of the Treasury and the Federal Housing Finance Authority ("FHFA") on August 15, 2014. Compl., ECF No. 1. The complaint featured purportedly *direct* claims for breach of fiduciary duty against FHFA and Treasury, among other claims. *See id.* Counts V-VII. A day earlier, the same plaintiffs in this case had filed a complaint in the Court of Federal Claims alleging derivative and takings claims. Compl., *Rafter v. United States*, No. 14 Civ. 740 (Fed. Cl. Aug. 14, 2014). The Court of Claims action was assigned to Judge Sweeney, who had already been assigned a related takings case brought by Fairholme Funds.[1] *See* Compl., *Fairholme Funds, Inc., v. United States*, No. 13 Civ. 465 (Fed. Cl. July 9, 2013).

On September 30, 2014, this Court dismissed the Consolidated Class Action, along with three other individual lawsuits, that had presented a number of claims closely related to the claims in *Rafter*. *Perry Capital*, 2014 WL 4829559. On October 10, 2014, the Clerk's Office accidentally terminated the *Rafter* case, only to fix its error later that same day. In light of the *Perry Capital* Opinion, the defendants in *Rafter* sought an extension of time to file dispositive motions regarding the effect of *Perry Capital* on the present case. *See* Mot., ECF No. 11. The Court granted the defendants' unopposed motion, setting November 3, 2014, as the due date for the defendants' respective briefs. Order, ECF No. 12.

[1] Fairholme Funds was one of the individual plaintiffs dismissed as part of the Court's *Perry Capital* decision.

On October 31, 2014—three days before the defendants' dispositive motions were due—the plaintiffs filed a notice of voluntary dismissal, ECF No. 16, pursuant to Federal Rule of Civil Procedure 41(a)(1)(A)(i). The Clerk's Office terminated the case on November 3, 2014. Three weeks later, Judge Sweeney of the Federal Court of Claims granted the *Rafter* plaintiffs' leave to file an amicus brief in the *Fairholme* action. *Fairholme*, No. 13 Civ. 465 (Fed. Cl. Nov. 24, 2014), ECF No. 108. In *Fairholme*, the government defendants had recently filed a motion for stay pending appeal of the *Perry Capital* decision to the Court of Appeals for the District of Columbia Circuit, or, in the alternative, dismissal based on *Perry Capital*'s alleged preclusive effect. *Id.*, ECF No. 103. The amicus brief noted that the *Perry Capital* decision cannot preclude the *Rafter* plaintiffs' related case in front of Judge Sweeney due to their voluntary dismissal of the case in front of this Court. *See* Amicus Brief 2-3 & n.1, *id.*, ECF No. 107-1.

Two weeks following the *Rafter* plaintiffs' amicus brief in *Fairholme* arguing against preclusion, the defendants in the present case filed their motion to strike the notice of voluntary dismissal. Mot., ECF No. 17. The defendants further request that the Court "declare that [the] [p]laintiffs' action was consolidated with the Consolidated Class Action pursuant to the Consolidation Order[] [and] [] declare that the Court's *Perry Capital* Order dismissing the Consolidated Class/Derivative Action also dismissed this action . . . ." *Id.* at 12.

## II. ANALYSIS

The Consolidation Order outlined the process necessary to consolidate a newly-filed or transferred "putative class action and/or derivative action that arises out of the subject matter of the Consolidated Class Action." The Clerk of the Court "shall . . . mail a copy of th[e] [Consolidation] Order to the attorneys for the plaintiff(s) in the newly filed . . . case" and "make the appropriate entry in the docket for this action." Consolidation Order ¶ 6(b), (c). The Court designed such a procedure to provide notice to the plaintiffs in the newly filed case that the Clerk's Office will consolidate their class/derivative action with the existing Consolidated Class Action *unless* they object to consolidation within ten days of receipt of the Order, "and this Court deems it appropriate to grant such [objection]." *See id.* ¶ 7. Moreover, the Order "*requests the assistance of counsel* in calling to the attention of the Clerk of this Court the filing . . . of any case which might properly be consolidated . . . ." *Id.* ¶ 3 (emphasis added). The implication of paragraph three is that the Clerk's Office—and the Court, for that matter—will not act sua sponte to declare that a newly filed lawsuit is consolidated with the Consolidated Class Action. An obvious means for the government defendants to call the attention of the Clerk's Office or the Court to a possible consolidation scenario in *Rafter* would have been to file a motion for consolidation. If the defendants had filed such a motion here, the plaintiffs would have had an opportunity to argue that their claims were, in fact, direct rather than derivative.

But the defendants never filed such a motion, or "called to the attention of the Clerk['s Office]" in any manner that this case "might be properly consolidated." *See id.* Consequently, the Clerk's Office never filed a copy of the Consolidation Order on the *Rafter* docket or mailed a copy to the plaintiffs, and the plaintiffs never had an opportunity to object to any potential consolidation. Instead, the defendants clearly believed this case would proceed separately, filing an unopposed motion for extension of time to submit dispositive motions "that address[] the effect of the *Perry Capital* decision on this case." Mot. 1-2, ECF No. 11. Nowhere in that motion—the defendants' only filing in this matter prior to their motion to strike the plaintiffs' notice of voluntary dismissal—did the defendants broach the issue of consolidation. Therefore, no consolidation occurred here.

This defined process for consolidation is especially important for cases, such as the one at present, where it is necessary for the Court to determine whether claims styled as direct in the wording of a complaint are, in fact, derivative and, therefore, qualify for consolidation under the Consolidation Order. The defendants contend that the Court's *Perry Capital* decision resolved that the *Rafter* plaintiffs' claims are derivative. It is true that there are apparent similarities in the nature of the fiduciary duty claims brought by both the plaintiffs in the instant suit, *see* Compl. Counts V-VII, and the *Fairholme* plaintiffs as part of the *Perry Capital* case, *see* Compl. Count VII, *Fairholme Funds, Inc. v. FHFA*, No. 13 Civ. 1053 (D.D.C. July 10, 2013), ECF No. 1. Yet the portions of the *Perry Capital* Opinion that, according to the defendants, allegedly "settled any debate" as to the nature of the *Rafter* plaintiffs' fiduciary duty claims are dicta that have no dispositive effect here. *See* Reply 2 (citing *Perry Capital*, 2014 WL 4829559, at *12 n.24, *16 n.39, *17, *19 n.45). Indeed, the *Perry Capital* Opinion explained that it was unnecessary for the Court to decide the question of whether the *Fairholme* plaintiffs' claims were direct or derivative. *Perry Capital*, 2014 WL 4829559, at *12 n.24 ("[T]here is no requirement for the Court to decide whether such claims are derivative or direct."). Rather, the Opinion only noted that *if* it had been necessary to decide such a question, the Court would have characterized the *Fairholme* plaintiffs' fiduciary duty claims, in the context of that lawsuit, as derivative. *Id.*[2] Here, the defendants never posed such a question to the Court. Consequently, the Court had no occasion to decide whether the plaintiffs' purportedly direct fiduciary duty claims were actually derivative and, thus, should be consolidated.

[2] Similarly, the defendants' remaining citations are to segments of the *Perry Capital* Opinion discussing a hypothetical scenario under which the plaintiffs were able to claim *present*—rather than prospective—damages regarding liquidation preferences and, to a lesser extent, dividend rights. *See id.* at *16 n.39, *17, *19 n.45. As the Court made clear, the plaintiffs *failed* to plead present damages. *E.g.*, *id.* at *16 n.39 (finding that the plaintiffs' liquidation preference claims were not ripe). Moreover, such dicta was not part of the Court's holding and in no way worked to *automatically* consolidate the *Rafter* plaintiffs' case with the cases decided in *Perry Capital*.

Finally, the Court feels obligated to respond to the government defendants' apparent suggestion that the *Rafter* case was properly closed, presumably in accordance with the Consolidation Order, only to be reopened again at the ex parte insistence of the *Rafter* plaintiffs' counsel. *See* Reply 3 & n.4. In truth, the Clerk's Office inadvertently terminated the *Rafter* case on October 10, 2014—the same day it correctly terminated the multiple cases involved in the Court's *Perry Capital* decision. This error was likely due to the fact that, following a notice submitted by the *Rafter* plaintiffs on August 15, 2014, ECF No. 3, *Rafter* was designated as "related" to the numerous plaintiffs whose claims the Court dismissed in *Perry Capital*. What is certain, however, is that, some hours later, the Clerk's Office reopened the *Rafter* case because the Court, upon receiving a termination notice as to *Rafter* through the ECF email system, informed the Clerk's Office of its blunder. Conspiracy theories aside, the defendants should rest assured that the Clerk's Office was not acting at the unilateral behest of the *Rafter* plaintiffs' counsel when it corrected its mistaken closure of the case. Since the defendants never raised the issue of consolidation, and the Court never filed any order on the docket, sua sponte, consolidating this case, it is inconceivable that the Clerk's Office decided, on its own accord, to terminate this case because it believed that *Rafter*'s purportedly direct claims were, in fact, derivative.[3]

Frustrated by the fact that the plaintiffs' voluntary dismissal occurred "one business day before Defendants' planned filing of dispositive motions," Mot. 6, and aware that the purpose of voluntary dismissal may have been to permit the plaintiffs to argue that preclusion does not apply to a separate action filed in another federal court, *id.* at 6-7; *see also* Amicus Brief 2-3 &

[3] The defendants seem to concede as much when they note that, "Plaintiffs cannot evade the effect of consolidation when their own actions—namely, designating their derivative claims as 'direct'—undoubtedly prevented the Clerk's Office from taking the[] administrative step[] [of consolidating the *Rafter* action with the existing class actions]." Reply 4.

n.1, *Fairholme*, No. 13 Civ. 465 (Fed. Cl. Nov. 21, 2014), ECF No. 107-1, the defendants seek to unwind the plaintiffs' voluntary dismissal of this case. There is no doubt that the plaintiffs voluntarily dismissed their case as part of a broader litigation strategy—and not because they suddenly decided their claims had no merit. But strategic conduct in the face of high-stakes litigation is not a punishable offense.

## III. CONCLUSION

For the foregoing reasons, it is hereby

**ORDERED** that the defendants' motion to strike the plaintiffs' notice of voluntary dismissal [17] is **DENIED**. This case remains dismissed.

Signed by Royce C. Lamberth, United States District Judge, on January 21, 2015.