IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

DAVID JACOBS and GARY HINDES, on behalf of themselves and all others similarly situated, and derivatively on behalf of the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation,	)	C.A. No. 15-708
Plaintiffs,	)	
v.	)	
THE FEDERAL HOUSING FINANCE AGENCY, *et al*.,	)	
Defendants,	)	

OPENING BRIEF IN SUPPORT OF MOTION TO DISMISS OF
<u>THE DEPARTMENT OF THE TREASURY</u>

Dated: November 13, 2015

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INTRODUCTION

The plaintiffs seek to challenge actions that were taken by the United States Department of the Treasury ("Treasury") and the Federal Housing Finance Agency ("FHFA") to rescue and stabilize two key financial institutions essential to the Nation's economy, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, "the Enterprises"). The plaintiffs assert claims materially identical to the claims that other district courts have already considered and rejected in disposing of ten earlier-filed, coordinated lawsuits in the District of Columbia, as well as an eleventh lawsuit in the Southern District of Iowa. *See Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 228-229 (D.D.C. 2014), *appeals docketed*, No. 14-5243 (D.C. Cir. Oct. 8, 2014); *Cont'l W. Ins. Co. v. Fed. Hous. Fin. Agency*, 83 F. Supp. 3d 828 (S.D. Iowa 2015). This complaint fails on the same grounds that those lawsuits failed, and for several, independent reasons, this suit should also be dismissed.

NATURE AND STAGE OF PROCEEDINGS

Plaintiffs David Jacobs and Gary Hindes ("Plaintiffs"), who own common and preferred shares of Fannie Mae and Freddie Mac, have brought suit against FHFA and Treasury based on their assertion that the Third Amendment expropriated the value of their stock. *See* Class Action and Derivative Complaint, ECF No. 14 ¶¶ 16, 60 (hereinafter, "Compl."). As noted above, this is the thirteenth lawsuit brought by Enterprises' shareholders challenging the Third Amendment. Ten nearly identical actions were dismissed by the U.S. District Court for the District of Columbia in their entirety (the "D.D.C. Actions"). *See Perry Capital*, 70 F. Supp. 3d at 208 (D.D.C. 2014). That decision has been appealed to the D.C. Circuit. The U.S. District Court for the Southern District of Iowa also dismissed a similar suit because it was barred by issue

preclusion in light of the *Perry Capital* decision, *see Cont'l W. Ins. Co.*, 83 F. Supp. 3d at 828, and it held in the alternative that, if preclusion did not bar the suit, dismissal was warranted on the merits. *Id.* at 840 n.6.[1] The plaintiff in *Continental Western* did not appeal.

SUMMARY OF ARGUMENT

First, as an initial matter, the Court lacks jurisdiction over the plaintiffs' claims against Treasury because they are barred by sovereign immunity. The plaintiffs seek injunctive, declaratory, and compensatory relief for their claims against Treasury, yet they fail to identify any waiver of sovereign immunity that would permit their suit. The claims against Treasury must be dismissed for this reason alone.

Second, the complaint is barred by the jurisdiction-withdrawal provision of the Housing and Economic Recovery Act of 2008 ("HERA"), 12 U.S.C. § 4617(f). Under controlling Third Circuit precedent, HERA's jurisdiction-withdrawal provision, like the materially identical provision in the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA"), prohibits courts from ordering equitable relief that would restrain or affect FHFA's exercise of its powers as conservator of the Enterprises, even if the conservator is alleged to have violated another provision of law. Plaintiffs cannot evade the jurisdictional withdrawal statute by joining FHFA's counter-party, Treasury, in this suit.

Third, HERA's prohibition against shareholder suits, 12 U.S.C. § 4617(b)(2)(A), independently bars the complaint. Multiple courts have recognized that this provision, at a minimum, precludes shareholders from asserting derivative claims on behalf of the Enterprises

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[1] Additional actions are pending in the U.S. District Court for the Northern District of Iowa, and the U.S. District Court for the Eastern District of Kentucky. *See Saxton v. FHFA, et al.*, No. 1:15-cv-47 (N.D. Iowa May 28, 2015); *Robinson v. FHFA, et al.*, No. 7:15-cv-109 (E.D. Ky. Oct. 23, 2015).

during conservatorship. Plaintiffs expressly label some of the counts in their complaint as "derivative." Although labeled as "direct," their other claims likewise are—in substance—derivative because they assert an injury to the Enterprises and seek relief that would flow to the Enterprises. Therefore, all of the counts in the complaint precluded by HERA's bar on jurisdiction and transfer of shareholder rights.

Fourth, the complaint asserts state law claims that are preempted by federal law governing the interpretation of the certificates of designation of preferred stock. Even if they were not preempted by federal law, however, plaintiffs' claims regarding Delaware and Virginia law fail to state a claim on the merits.

Fifth, the district court for the District of Columbia has already squarely held in the *Perry Capital* litigation that the same derivative claims as those asserted by the plaintiffs here are barred under HERA. That ruling has issue preclusive effect in this case.

This Court should enter a judgment consistent with the resolution of the *Perry Capital* and *Continental Western* cases, and dismiss the complaint for lack of subject-matter jurisdiction or, in the alternative, for failure to state a claim upon which relief can be granted.

STATEMENT OF FACTS

I. FANNIE MAE AND FREDDIE MAC

Fannie Mae and Freddie Mac are government-sponsored enterprises that provide liquidity to the mortgage market by purchasing whole loans from lenders, or by exchanging mortgage backed securities ("MBS") for whole loans, thereby freeing up lenders' capital to make additional loans. Compl. ¶ 30. These entities, which own or guarantee trillions of dollars of residential mortgages and MBS, have played a key role in housing finance and the U.S. economy.

In response to the developing financial crisis, in July 2008, Congress passed HERA, Pub. L. No. 110-289, 122 Stat. 2654 (2008). Compl. ¶¶ 33–34. HERA created the Federal Housing Finance Agency, an independent federal agency, to supervise and regulate Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. 12 U.S.C. § 4501 *et seq.*; Compl. ¶ 34. (Previously, the Enterprises had been regulated by the Office of Federal Housing Enterprise Oversight ("OFHEO"). *See* Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Pub. L. No. 102-550, §§ 1301–1395, 106 Stat. 3672, 3941–4012.). HERA also granted the Director of FHFA the authority to place Fannie Mae and Freddie Mac in conservatorship or receivership. *See* 12 U.S.C. § 4617(a). FHFA could use this discretionary authority to "be appointed conservator or receiver for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity." 12 U.S.C. § 4617(a)(2). The statute provides that, upon its appointment as the conservator or receiver, FHFA would "immediately succeed to … rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity and the assets of the regulated entity." *Id.* § 4617(b)(2)(A). The statute accords the conservator the power to "operate" and "conduct all business" of the Enterprises, *id.* § 4617(b)(2)(B), including the power to 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," *id.* § 4617(b)(2)(D), and to "transfer or sell" any of the Enterprises' assets or liabilities, *id.* § 4617(b)(2)(G).

HERA also amended the statutory charters of the Enterprises to grant the Secretary of the Treasury the authority to purchase "any obligations and other securities" issued by the Enterprises "on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine," provided that Treasury and the Enterprises reached a "mutual

agreement" for such a purchase. *See* 12 U.S.C. § 1719(g)(1)(A) (Fannie Mae); *id.* § 1455(*l*)(1)(A) (Freddie Mac). Treasury was required to determine, prior to exercising this purchase authority, that the purchase was necessary to "provide stability to the financial markets," "prevent disruptions" in mortgage financing, and "protect the taxpayer." *Id.* § 1719(g)(1)(B) (Fannie Mae); *id.* § 1455(*l*)(1)(B) (Freddie Mac). This purchase authority would expire on December 31, 2009, *id.* § 1719(g)(4); *id.*, § 1455(*l*)(4), but the statute expressly recited that Treasury would retain the power to exercise its rights with respect to previously-purchased securities after that sunset date, *id.* § 1719(g)(2)(D); *id.* § 1455(*l*)(2)(D).

In early September 2008, FHFA, in consultation with Treasury, determined that the Enterprises were operating in an unsafe and unsound manner. Press Release, Statement of FHFA Director James B. Lockhart at 1, 5 (Sept. 7, 2008) (cited in Compl. ¶ 35).[2] Accordingly, on September 6, 2008, the Director of FHFA placed them into conservatorship. On the day the conservatorships were announced, the director of FHFA stated that the action "addresses safety and soundness concerns [and that] . . . [t]here are pervasive weaknesses across the board, which have been getting worse in this market." *Id.*[3]

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[2] Director Lockhart's statement is available at http://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-FHFA-Director-James-B--Lockhart-at-News-Conference-Annnouncing-Conservatorship-of-Fannie-Mae-and-Freddie-Mac.aspx.

[3] On a motion to dismiss, the Court may consider documents relied upon in the complaint without converting the motion to dismiss into a motion for summary judgment. *See In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1426 (3d Cir. 1997) ("a document integral to or explicitly relied upon in the complaint may be considered without converting the motion to dismiss into one for summary judgment.") (internal quotation marks and alterations omitted).

II. TREASURY'S SENIOR PREFERRED STOCK PURCHASE AGREEMENTS WITH THE ENTERPRISES

In connection with the placement of the Enterprises in conservatorships, Treasury used its authority to provide the Enterprises with access to a lifeline of billions of dollars in taxpayer funds. *See* Compl. ¶ 36. Treasury entered into Senior Preferred Stock Purchase Agreements (the "PSPAs") with each Enterprise, through FHFA. Under the PSPAs, Treasury committed to advance funds to each Enterprise for each calendar quarter in which the Enterprise's liabilities exceeded its assets, in accordance with GAAP, so as to maintain the solvency (*i.e.*, positive net worth) of the Enterprise. If a draw was needed, FHFA submitted a request to Treasury to allow the Enterprise to draw on the funds committed under its PSPA. Treasury would then provide funds sufficient to eliminate any net worth deficit. *See* (Ex. A, Fannie Mae PSPA § 2.1, 2.2; Freddie Mac PSPA §§ 2.1, 2.2) (cited in, *e.g.*, Compl. ¶ 36). As of August 2012, Fannie Mae had drawn $116.15 billion and Freddie Mac had drawn $71.34 billion from Treasury. *See* Compl. ¶ 48. Under HERA, both Enterprises enter mandatory receivership, and their assets must be liquidated, if they maintain a negative net worth for 60 days. *See* 12 U.S.C. § 4617(a)(4)(A) (FHFA must place the Enterprise in receivership if the obligations of the Enterprise exceed its assets for 60 calendar days).

In exchange for the capital commitment and infusions that it provided to the Enterprises, Treasury received senior preferred stock with a liquidation preference,[4] warrants to purchase 79.9 percent of each Enterprise's common stock, and commitment fees. Compl. ¶¶ 8, 76; Fannie Mae PSPA §§ 3.1–3.4; Freddie Mac PSPA §§ 3.1–3.4. The face value of the liquidation

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[4] A liquidation preference is "[a] preferred shareholder's right, once the corporation is liquidated, to receive a specified distribution before common shareholders receive anything." BLACK'S LAW DICTIONARY 1298 (9th ed. 2009).

preference on Treasury's senior preferred stock was $1 billion from each Enterprise, and it increased dollar-for-dollar as either Fannie Mae or Freddie Mac drew on its PSPA funding capacity. Fannie Mae PSPA § 3.3; Freddie Mac PSPA § 3.3. Treasury received no additional shares of stock when the Enterprises made draws under the PSPAs. *See* Fannie Mae PSPA § 3.1, Freddie Mac PSPA §§ 3.1. Currently, Treasury has a combined liquidation preference of $189.5 billion for the two Enterprises. (This reflects approximately $187.5 billion in draws, plus the initial $2 billion in liquidation preference.) *See* Compl. ¶ 48.

Treasury also received quarterly dividends on the liquidation preference of its senior preferred stock. Compl. ¶ 36. Prior to the Third Amendment, the Enterprises paid dividends at an annual rate of ten percent of their respective liquidation preferences. (Ex. B, Fannie Mae Senior Preferred Stock Certificate § 5; Freddie Mac Senior Preferred Stock Certificate § 5) (cited in Compl. ¶ 36). (The quarterly dividend payment thus amounted to 2.5% of the liquidation preference.) Treasury would provide funds to the Enterprises to cure both Enterprises' negative net worth, which was caused in part by the payment of dividends to Treasury. However, each instance of Treasury providing funds to the Enterprises to pay quarterly dividend obligations back to Treasury increased the liquidation preference even further. In turn, this increased future quarterly dividend payments.

The original PSPAs also restricted dividend payments to all shareholders who were subordinate to Treasury in the capital structure. Fannie Mae PSPA § 5.1; Freddie Mac PSPA § 5.1; Compl. ¶ 36. Under these agreements, the Enterprises cannot pay or declare a dividend to subordinate shareholders without the prior written consent of Treasury so long as Treasury's preferred stock is unredeemed. *Id.* Nor can the Enterprises "set aside any amount for any such purpose" without the prior written consent of Treasury. *Id.*

The PSPAs also required the Enterprises to pay a periodic commitment fee to Treasury beginning on March 31, 2010. Fannie Mae PSPA §§ 3.1, 3.2; Freddie Mac PSPA §§ 3.1, 3.2. The periodic commitment fee "is intended to fully compensate [Treasury] for the support provided by the ongoing Commitment following December 31, 2009." *Id.* The amount of the fee for this continuing indefinite commitment of taxpayer funds was to be "determined with reference to the market value of the Commitment as then in effect," as mutually agreed between Treasury and the Enterprises, in consultation with the Chairman of the Federal Reserve. *Id.* Treasury's rights under the PSPAs—senior preferred stock with accompanying dividend rights, warrants to purchase common stock, and commitment fees—reflected the significant commitment taxpayers had made to the Enterprises.

In August 2012, Treasury and FHFA, acting as conservator for the Enterprises, entered into the Third Amendment to the PSPAs. Compl. ¶ 15. The Third Amendment eliminated the 10 percent fixed annual dividend in favor of a quarterly variable dividend in the amount (if any) of the Enterprise's positive net worth, minus a capital reserve. Compl. ¶ 15. (Ex. C, Third Amendment to Amended and Restated Fannie Mae PSPA, § 4 (Aug. 17, 2012); Third Amendment to Amended and Restated Freddie Mac PSPA, § 4 (Aug. 17, 2012)) (cited in Compl. ¶ 15). If either Enterprise's net worth is negative in a quarter, no dividend is due from that Enterprise. *Id*. This effectively ended the practice of the Enterprises drawing funds from Treasury in order to pay fixed dividends to Treasury. The Third Amendment also suspended the periodic commitment fee that each Enterprise would otherwise owe to the taxpayers for so long as the net worth dividend remained in effect. *Id.*

ARGUMENT

"In reviewing a facial challenge to its subject matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1), the Court employs the same standard as it uses to evaluate a motion to dismiss for failure to state a claim under Rule 12(b)(6)." *Christiana Care Health Servs., Inc. v. PMSLIC Ins. Co.*, No. CV 14-1420-RGA, 2015 WL 6675537, at *2 (D. Del. Nov. 2, 2015) (citing *Evanston Ins. Co. v. Layne Thomas Builders, Inc.*, 635 F. Supp. 2d 348, 352 (D. Del. 2009)). "In other words, the issue is whether the complaint's allegations, taken in the light most favorable to the plaintiff, show subject matter jurisdiction." *Id.* Actions are also subject to dismissal when a party fails to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6). In deciding a motion to dismiss under Rule 12(b)(6), a court must take all allegations in the complaint as true and view them in the light most favorable to the plaintiff. *Trump Hotels & Casino Resorts, Inc. v. Mirage Resorts Inc.*, 140 F.3d 478, 483 (3d Cir. 1998).

I. SOVEREIGN IMMUNITY BARS PLAINTIFFS' CLAIMS AGAINST TREASURY.

It is fundamental that "the United States, as sovereign, is immune from suit, save as it consents to be sued . . . and the terms of its consent to be sued in any court define that court's jurisdiction to entertain the suit." *United States v. Dalm*, 494 U.S. 596, 608 (1990) (citations omitted); *accord, e.g., United States v. Mitchell*, 445 U.S. 535, 538 (1980); *CNA v. United States*, 535 F.3d 132, 140–41 (3d Cir. 2008); *Becton Dickinson & Co. v. Wolckenhauer*, 215 F.3d 340, 345 (3d Cir. 2000). A waiver of sovereign immunity is not be implied, but must be unequivocally expressed, *Mitchell*, 445 U.S. at 538; and it must be strictly construed in favor of the sovereign. *See United States v. Nordic Vill., Inc.*, 503 U.S. 30, 34 (1992). Where the United States has not consented to suit, the court lacks jurisdiction over the subject matter of the action, and dismissal is required. *Richards v. United States*, 176 F.3d 652, 654 (3d Cir. 1999). As an

agency of the United States, Treasury is afforded sovereign immunity. *FDIC v. Meyer*, 510 U.S. 471, 474–75 (1994).

Congress has waived the United States' sovereign immunity only for certain actions that can be brought against the United States or against officials for acts taken in their official capacities. *See, e.g.*, Administrative Procedure Act ("APA"), 5 U.S.C. § 500 *et seq.*; Federal Tort Claims Act ("FTCA"), 28 U.S.C. § 1346; Tucker Act, 28 U.S.C. § 1491, 28 U.S.C. § 1346(a)(2). For several reasons, Plaintiffs cannot meet their burden to show that any of those waivers would apply to Plaintiffs' claims for "declaratory, equitable, and compensatory relief" against Treasury.[5]

First, while section 702 of the APA grants the United States' consent to suit in certain actions "seeking relief other than money damages," 5 U.S.C. § 702, this waiver of sovereign immunity is subject to certain significant exceptions. It does not apply where, as here, another statute limits judicial review of the agency action in question. *Id.* § 701(a)(1); *see Heckler v. Chaney*, 470 U.S. 821, 828 (1985) ("[B]efore any [APA] review at all may be had, a party must first clear the hurdle of § 701(a)."). As explained below, *see infra* Part II(A), HERA expressly bars judicial review of claims seeking equitable relief that would affect or restrain the powers

[5] Plaintiffs seek "declaratory, equitable, and compensatory relief" against Treasury based on two theories. First, plaintiffs claim that Treasury breached fiduciary duties to plaintiffs by entering into the Third Amendment. *See* Compl. ¶¶ 153–79 (Counts VII, VIII, and IX); *id.*, Prayer for Relief (H)–(J) (seeking declaration that defendants "breached their fiduciary duties to the Companies and their stockholders," and "compensatory damages, restitution, and/or disgorgement in favor of Plaintiffs . . . as a result of such Defendants' breaches of fiduciary duty"). Second, plaintiffs claim that the variable dividend under the Third Amendment is inconsistent with the corporate laws of Delaware and Virginia governing issuance of preferred stock. *See* Compl. ¶¶ 91–98 (Count I); *id.* ¶¶ 99–106 (Count II); Compl., Prayer for Relief (C–D) (requesting declaration that "that the Net Worth Sweep is void and unenforceable as a matter of Delaware and Virginia law," and "rescission of the Net Worth Sweep and restitution of the monies paid by the Companies to Treasury pursuant thereto").

that FHFA exercises as conservator of the GSEs, including the decision to enter into the Third Amendment. 12 U.S.C. § 4617(f). Plaintiffs assert claims seeking rescission, declaratory relief, and other equitable remedies based on defendants' decision to enter into the Third Amendment. *See, e.g.*, Compl., Prayer for Relief (C–D) (requesting declaratory relief and rescission); *id.* (H)–(J) (requesting declaratory relief and "restitution, and/or disgorgement in favor of Plaintiffs . . . as a result of such Defendants' breaches of fiduciary duty"). But their claims for equitable relief fall outside the APA's waiver of sovereign immunity for the same reason that they are barred under HERA.

The APA does not waive sovereign immunity for Plaintiffs' claims for a second, independent reason. Section 702 only grants the Court with jurisdiction over claims for specific relief founded upon federal law—not to claims premised solely on state law, like the ones that Plaintiffs assert here. In *Jaffee v. United States*, 592 F.2d 712 (3d Cir. 1979), the Third Circuit held that "section 702, when it applies, waives sovereign immunity in 'nonstatutory' review of agency action *under section 1331*." *Id.* at 718 (emphasis added). The Third Circuit reasoned that "Congress amended section 702 with a specific purpose of waiving sovereign immunity in equitable actions brought under section 1331." *Id.* "In these instances, judicial review is available, if at all, through actions involving matters which arise 'under the Constitution, Laws, or treaties of the United States as provided in section 1331(a) of title 28."[6] *Id.* (quoting H.R.

[6] The Third Circuit has made clear that the APA provides no independent basis for federal jurisdiction; thus, even where Section 702's waiver of sovereign immunity applies, the court nonetheless lacks subject matter jurisdiction where, as here, the complaint states no cause of action under federal law. In *Treasurer of New Jersey v. U.S. Dep't of Treasury*, 684 F.3d 382 (3d Cir. 2012), for example, the Third Circuit held that the plaintiffs' complaint presented a federal question under section 1331 where the plaintiffs had "advanced a significant Tenth Amendment claim in their complaint." *Id.* at 403. Because the plaintiffs had stated a "colorable and not frivolous" cause of action under the U.S. Constitution, the Third Circuit held that the

Rep. No. 94-1656, at 5); *cf. Treasurer of New Jersey v. U.S. Dep't of Treasury*, 684 F.3d 382, 400–01 (3d Cir. 2012) (section 702 of the APA waives sovereign immunity in action where claims for equitable relief arose under federal law) (citing *Jaffee*, 592 F.2d at 718). Plaintiffs' action, however, does not "arise under the Constitution, laws, or treaties of the United States." This is a "case about Delaware and Virginia corporate law." Compl. ¶ 1. The Third Circuit has never construed the waiver of sovereign immunity in section 702 of the APA to apply to claims premised on state law, and Plaintiffs cannot otherwise show that the United States has consented to suit for the equitable relief they seek.[7]

What is more, it is well-established that the waiver of sovereign immunity in section 702 of the APA does not apply to claims seeking money in compensation for losses alleged to have

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district court could exercise supplemental jurisdiction over the plaintiff's separate state-law claims that were related to the Tenth Amendment claim. *See id.* at 405 (citing *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 89 (1998)). The APA's waiver of sovereign immunity does not, however, confer jurisdiction over claims premised solely on state law, like plaintiffs' claims here.

[7] Plaintiffs assert in their complaint that jurisdiction exists under "12 U.S.C. §§ 1452(c), 1723a(a) and 4617, as well as 28 U.S.C. § 1331." Compl. ¶ 22. But none of those statutes create a federal cause of action against Treasury—they are, respectively, the Freddie Mac charter statute, the Fannie Mae charter statute, the conservatorship provision of HERA, and the general federal question statute. The sue-and-be-sued provisions of the Enterprises charters do not authorize lawsuits against the Department of Treasury, nor does HERA. The federal question statute, 28 U.S.C. § 1331, confers jurisdiction only for claims that "arise under the Constitution, laws, or treaties of the United States," not for claims founded on Delaware and Virginia state law. Plaintiffs do not identify any other provision that would serve as a waiver of sovereign immunity and basis for jurisdiction. They cite 28 U.S.C. § 1332, the diversity jurisdiction statute, and 28 U.S.C. § 1367, the supplemental jurisdiction statute. Neither statute serves as a waiver of sovereign immunity, however. *See New Jersey Sand Hill Band of Lenape & Cherokee Indians v. New Jersey*, No. CIV.A. 09-683 KSH, 2011 WL 1322316, at *4 (D.N.J. Mar. 31, 2011); *Holt v. Shinseki*, No. 2:13cv22, 2013 WL 5797382, at *3 (W.D. Pa. Oct. 28, 2013) ("28 U.S.C. § 1367(a), 'does not operate as a waiver of the United States' sovereign immunity.'") (quoting *Wilkerson v. United States*, 67 F.3d 112, 119 n.13 (5th Cir. 1995); *see also supra* note 6 (discussing *Treasurer of New Jersey*, 684 F.3d 382)).

been suffered. *See Dep't of Army v. Blue Fox, Inc.*, 525 U.S. 255, 261–64 (1999) (whether claim seeks "relief other than money damages" under section 702 "hinge[s] on the distinction between *specific relief and substitute relief*, not between equitable and nonequitable categories of remedies") (emphasis added) (citing *Bowen v. Massachusetts*, 487 U.S. 879 (1988)). Here, Plaintiffs seek "compensatory damages, restitution, and/or disgorgement" based on their allegations that they "have suffered damages" as "a direct and proximate result" of "Defendants' breaches of fiduciary duty." Compl., Prayer for Relief (I)–(J); Compl. ¶¶ 159, 167, 178; *see also* Compl., Prayer for Relief (C) (requesting "restitution of the monies paid by the Companies to Treasury"). However, under Supreme Court precedent, "compensatory damages, restitution, and/or disgorgement" are understood as forms of money damages for purposes of section 702, and consequently they do not fall within the APA's waiver of sovereign immunity for relief "other than money damages." *See Great–West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 210 (2002) ("Almost invariably . . . suits seeking (whether by judgment, injunction, or declaration) to compel the defendant to pay a sum of money to the plaintiff are suits for 'money damages,' as that phrase has traditionally been applied.") (citation omitted).

Plaintiffs cannot avail themselves of the waivers of sovereign immunity for damages claims provided under the FTCA or the Tucker Act. The FTCA's waiver of sovereign immunity is conditioned upon compliance with the procedures set forth in 28 U.S.C. §§ 2671–2680, which include a requirement that a plaintiff exhaust all administrative predicates prior to seeking relief against the United States. Plaintiffs nowhere indicate that they have complied with the FTCA's requirements of administrative exhaustion, let alone establish that their state law claims fall within the FTCA's narrow waiver of sovereign immunity. *See SRP ex rel. Abunabba v. United States*, 676 F.3d 329, 333 (3d Cir. 2012) ("[A] plaintiff bears the burden of establishing that his

claims fall within the scope of the FTCA's waiver of the federal government's sovereign immunity (i.e., that the requirements of 28 U.S.C. § 1346(b)(1) are met)."). Accordingly, plaintiffs fail to establish that the Court has jurisdiction over their claims.[8]

Nor can the plaintiffs pursue their claims under the Tucker Act, 28 U.S.C. § 1491.[9] That statute vests the Court of Federal Claims with exclusive jurisdiction in contract actions exceeding $10,000. *See Chabal v. Reagan*, 822 F.2d 349, 353–54 (3d Cir. 1987). Plaintiffs allege in their complaint that the amount in controversy in this case "exceeds $5 million." Compl. ¶ 22. In order to proceed in district court rather than the Court of Federal Claims, plaintiffs must "waive damages in excess of $10,000," *Chabal*, 822 F.2d at 353, something that they plainly have not done. The Little Tucker Act, then, cannot serve as a waiver of sovereign immunity allowing plaintiffs to proceed with their lawsuit in this Court.

In sum, the APA's waiver of sovereign immunity does not extend to Plaintiffs' state law claims or their claims for money damages, and Plaintiffs have otherwise failed to meet their burden of showing an unequivocal waiver of sovereign immunity as a basis for the Court's jurisdiction. *Global Fin. Corp. v. United States*, 67 F. App'x 740, 742 (3d Cir. 2003) (citing *Gould Elecs., Inc. v. U.S.,* 220 F.3d 169, 178 (3d Cir. 2000)). Plaintiffs' claims against Treasury therefore should be dismissed.

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[8] Plaintiffs cannot, in any event, satisfy the administrative-exhaustion requirement because their claims challenging the Third Amendment accrued more than two years before this suit was filed and are thus barred by the FTCA's statute of limitations. *See* 28 U.S.C. § 2401(b) (claims "shall be forever barred" unless "presented in writing to the appropriate Federal agency within two years after such claim accrues.").

[9] The Tucker Act constitutes a waiver of sovereign immunity with respect to claims for money damages that are "founded upon 'any express or implied contract with the United States,'" *United States v. Mitchell*, 463 U.S. 206, 215 (1983) (quoting 28 U.S.C. § 1491), but only where "the source of substantive law can fairly be interpreted as mandating compensation" by the United States for the plaintiff's damages. *Id.* at 218.

II. HERA BARS PLAINTIFFS FROM CHALLENGING THE THIRD AMENDMENT.

The Court lacks jurisdiction over Plaintiffs' claims because they violate two separate and independent barriers to judicial review that Congress erected when it enacted HERA. First, HERA withdraws jurisdiction for relief that would restrain the powers that FHFA exercises as conservator of the Enterprises, including the decision to enter into the Third Amendment. 12 U.S.C. § 4617(f). Second, HERA additionally prohibits suits based on Plaintiffs' status as shareholders in the Enterprises. *Id.* § 4617(b)(2)(A).

A. HERA Bars Plaintiffs' Requests for Injunctive, Declaratory, and Other Equitable Relief.

Section 4617(f) deprives the Court of jurisdiction over plaintiffs' claims seeking declaratory, injunctive, and other equitable relief that would restrain the conservator's ability to "exercise [its statutory] powers or functions," 12 U.S.C. § 4617(f). *See, e.g.*, Compl., Prayer for Relief (C–D) (requesting declaratory relief and rescission); *id.* (H)–(J) (requesting declaratory relief and "restitution, and/or disgorgement in favor of Plaintiffs"). Specifically, 12 U.S.C. § 4617(f) provides: "Except as provided in this section or at the request of the Director, no court may take any action to restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver." The Third Circuit held that a nearly identical statutory provision permits judicial review only "where the [agency] is acting clearly outside its statutory powers." *Gross v. Bell Sav. Bank PA SA*, 974 F.2d 403, 407 (3d Cir. 1992); *see also Town of Babylon v. FHFA*, 699 F.3d 221, 228 (2d Cir. 2012) (section 4617(f) "excludes judicial review of 'the exercise of powers or functions' given to the FHFA as a conservator").[10] The court in *Perry*

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[10] *Gross* interpreted 12 U.S.C. § 1821(j), which bars review of actions by the Resolution Trust Corporation (and its successor, the Federal Deposit Insurance Corporation ("FDIC")) as conservator or receiver of failed banking institutions. *Compare* FIRREA, 12 U.S.C. § 1821(j)

Capital adopted that same interpretation of HERA's jurisdiction-withdrawal provision, holding that § 4617(f) "effect[s] a sweeping ouster of courts' power to grant equitable remedies." *Perry Capital*, 70 F. Supp. 3d at 220 (quoting *Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995); *see also Massachusetts v. FHFA*, 54 F. Supp. 3d 94, 101 (D. Mass. 2014) ("Congress, by enacting HERA's [Section 4617(f)], expressly removed such conservatorship decisions from the courts' oversight."); *Centennial Associates Ltd. P'ship v. F.D.I.C.*, 927 F. Supp. 806, 812 (D.N.J. 1996) ("[T]o prevent interference with the receiver's management or disposition of institution assets, Congress crafted a broad measure [in section 1821(j)] depriving courts of the power to grant injunctions, specific performance, rescissions and other orders that affect the receiver's exercise of its statutory powers.").

Thus, HERA's jurisdiction-withdrawal clause permits review only "where the [agency] is acting clearly outside its statutory powers." *See Gross*, 974 F.2d at 407. By contrast, "where the [agency] performs functions assigned it under the statute, injunctive relief will be denied *even where the [agency] acts in violation of other statutory schemes*." *See id.* (emphasis added); *accord Ward v. Resolution Trust Corp.*, 996 F.2d 99, 103 (5th Cir. 1993) (because "disposing of assets of the failed thrift when acting as its conservator or receiver is a quintessential statutory power of the RTC," injunctive relief is unavailable even if the RTC is "improperly or even unlawfully exercising" that power). The prohibition against relief that would "restrain or affect" the actions of a conservator bars all "nonmonetary remedies, including injunctive relief, declaratory relief, and rescission." *See Freeman*, 56 F.3d at 1398–99; *see also* FHFA Br. 10–18.

("Except as provided in this section, no court may take any action, except at the request of the Board of Directors by regulation or order, to restrain or affect the exercise of powers or functions of the Corporation as a conservator or receiver.") *with* HERA, 12 U.S.C. § 4617(f) ("Except as provided in this section or at the request of the Director, no court may take any action to restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver.").

Plaintiffs cannot evade HERA's jurisdictional withdrawal provision by switching their target from the conservator to its counterparty, Treasury. Indeed, the Third Circuit has held—in a suit brought by Mr. Hindes, one of the plaintiffs here—that the materially identical provision of FIRREA precludes equitable relief against third parties where such relief would restrain or affect the conservator. *See Hindes v. FDIC*, 137 F.3d 148, 160 (3d Cir. 1998). In that case, the Third Circuit held that "the statute, by its terms, can preclude relief even against a third party . . . where the result is such that the relief 'restrain[s] or affect[s] the exercise of powers or functions of the [FDIC] as a conservator or a receiver.'" *Id.* (citation omitted) (quoting 12 U.S.C. § 1821(j)) (alterations in original).[11] That is precisely the result plaintiffs seek to accomplish here, asking the Court to re-write the agreement that has provided the Enterprises with operating capital during the conservatorships and spared them from mandatory receivership and liquidation. Binding circuit court precedent prevents such a result; plaintiffs' claims against defendants for equitable relief should be dismissed for this reason alone.

[11] *See also Telematics Int'l, Inc. v. NEMLC Leasing Corp.*, 967 F.2d 703, 707 (1st Cir. 1992) ("Permitting Telematics to attach the certificate of deposit, if that attachment were effective against the FDIC, would have the same effect, from the FDIC's perspective, as directly enjoining the FDIC from attaching the asset. In either event, the district court would restrain or affect the FDIC in the exercise of its powers as receiver."); *Kuriakose v. Fed. Home Loan Mortg. Corp.*, 674 F. Supp. 2d 483, 494 (S.D.N.Y. 2009) ("By moving to declare unenforceable the non-participation clause in Freddie Mac severance agreements, in essence Plaintiffs are seeking an order which restrains the FHFA from enforcing this contractual provision in the future …. HERA clearly provides that this Court does not have the jurisdiction to interfere with such authority."); *In re Fed. Home Loan Mortg. Corp. Derivative Litig.* ("*In re Freddie Mac*"), 643 F. Supp. 2d 790, 799 (E.D. Va. 2009), *aff'd sub nom. La. Mun. Police Emps. Ret. Sys. v. FHFA*, 434 F. App'x 188 (4th Cir. 2011) ("A court action can 'affect' a conservator even if, as in the cases at bar, the litigation is not directly aimed at the conservator itself.").

B. HERA Expressly Bars Shareholders From Prosecuting Claims Based on Their Status as Shareholders for the Duration of the Conservatorships.

A separate provision of HERA independently bars plaintiffs' claims. That provision states that FHFA "shall, as conservator or receiver, and by operation of law, immediately succeed to . . . all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity and the assets of the regulated entity." 12 U.S.C. § 4617(b)(2)(A)(i).

HERA's transfer of "stockholder" rights to FHFA thus bars this suit. FHFA, as the conservator of the Enterprises, has succeeded to all of the rights of the Enterprises' shareholders for the duration of the conservatorship, including the right to bring any suit predicated on a plaintiff's status as a shareholder of one or both of those entities. Because each of Plaintiffs' claims are based on their alleged rights as common and preferred shareholders of the Enterprises (Compl. ¶¶ 24-25), those claims—whether styled as "derivative" or "direct"—are barred because the conservator alone holds "all" shareholder rights during conservatorship. *See* FHFA Br. 18–22.

Moreover, HERA "plainly transfers shareholders' ability to bring *derivative* suits—a 'right, title, power, or privilege'—to FHFA." *Kellmer v. Raines*, 674 F.3d 848, 850 (D.C. Cir. 2012) (emphasis added and internal alterations omitted). This statutory provision thus "bars shareholder derivative actions," *id.*, because Congress took care to "transfer[] everything it could to the conservator," *id.* at 851 (quoting *Pareto v. FDIC*, 139 F.3d 696, 700 (9th Cir. 1998)); *see Perry Capital*, 70 F. Supp. 3d at 229-30; *Continental Western*, 83 F. Supp. 3d 828, 840 n.6.[12]

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[12] Numerous other courts are in accord. *See, e.g.*, *La. Mun. Police Emps. Ret. Sys. v. FHFA*, 434 F. App'x 188 (4th Cir. May 5, 2011); *Gail C. Sweeney Estate Marital Trust v. U.S. Treasury*, 68

Here, plaintiffs expressly plead that several of their claims are "derivative." *See* Compl. ¶¶ 91-106 (Counts I and II for alleged violation of state statutes concerning preferred stock); *id*. ¶¶ 169-190 (Counts IX and X for alleged breaches of fiduciary duty). HERA bars these claims.

Although plaintiffs label some of their claims as "direct" (Counts III–VIII, Compl. ¶¶ 107–68) or both "direct and derivative" (Counts I & II, Compl. ¶¶ 91–106), those claims are, in substance, purely derivative under the two prong test set forth in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1037 (Del. 2004).[13] Under *Tooley*, claims are derivative if they (i) allege harm suffered by the corporation rather than directly by the stockholders individually, or (ii) seek relief that would flow in the first instance to the corporation rather than directly to the stockholder.

To answer the first *Tooley* prong—which asks "who suffered the alleged harm (the corporation or the suing stockholders, individually)"?—the Court need look no further than plaintiffs' own complaint, which alleges that the Third Amendment was "contrary to the best interests" of the Enterprises, "egregiously unfair," "waste[ful]," and "detriment[al]" to the Enterprises. Compl. ¶¶ 65-66, 157-158, 165, 173, 177, 184, 188. Indeed, plaintiffs' central theory of the case is that the Third Amendment allegedly depletes the Enterprises' assets, "strip[ing] Fannie Mae and Freddie Mac of their ability to rebuild their capital reserves or to ever again distribute dividends or otherwise deliver any value to plaintiffs or the other member of the

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F. Supp. 3d 116, 119 (D.D.C. 2014); *Esther Sadowsky Testamentary Trust v. Syron*, 639 F. Supp. 2d 347, 351 (S.D.N.Y. 2009).

[13] As discussed further below, the Enterprises are federally chartered entities whose corporate practices are governed by federal law and, to the extent not inconsistent with federal law, Delaware law (Fannie Mae) and Virginia law (Freddie Mac). *See infra* Pt. III. For purposes of the present motion only, Treasury assumes—without conceding—that Delaware or Virginia law concerning whether a claim is direct or derivative is not inconsistent with federal law, and thus could apply here.

Classes holding stock in the Companies." *Id.* ¶ 18. Because plaintiffs cannot "prevail without showing an injury to the corporation[s]"—indeed, they *allege* injury to the corporations—plaintiffs' claims are derivative. *Tooley*, 845 A.2d at 1036.

Further confirming that plaintiffs' claims are based on alleged harm to the Enterprises is the fact that the complaint is predicated on allegations that plaintiffs' shares have lost "value" or that the price of the shares has declined as a result of the Third Amendment. *See, e.g.*, Compl. ¶¶ 16, 18, 49, 51, 165, 157. That is, plaintiffs allege that their shares are now worth less because the Third Amendment allegedly leaves the company with less money to pay plaintiffs dividends or liquidation preferences or proceeds. *See, e.g., id.* ¶ 16 (alleging Third Amendment makes it "impossible for either Company . . . to ever pay a dividend" to the shareholder plaintiffs); *id.*¶ 60 (same with respect to liquidation proceeds). But it is well-established that reduction in stock value is an "*indirect* injury" that is contingent upon an injury to the company itself; "[i]t does not arise out of any independent or direct harm to the stockholders, individually." *Tooley*, 845 A.2d at 1037. Accordingly, where, as here, alleged wrongdoing "deplete[d] corporate assets that might otherwise [have] be[en] used to benefit the stockholders, such as through a dividend," the claims are derivative because the wrongdoing "harms the stockholders only derivatively so far as their stock loses value." *Protas v. Cavanagh*, No. CIV.A. 6555-VCG, 2012 WL 1580969, at *6 (Del. Ch. May 4, 2012); *see also Perry Capital*, 70 F. Supp. 3d at 229 n.24, 235 n.39 (claims alleging "damage to the price of their [Enterprise] shares, as valued by the market . . . are considered derivative under Delaware law"); *id.* 239 n.45 (claims alleging "present damage to

the 'value' of the plaintiffs' investment . . . [are] considered derivative and barred under HERA").[14]

Plaintiffs' claims also are derivative under the second *Tooley* prong, which provides that a claim is direct only if the relief sought "flows directly to the stockholders, not to the corporation." *Id.* Here, the central "relief" sought—rescinding the Third Amendment and returning its resulting dividends from Treasury to the Enterprises—obviously would flow to the Enterprises. *See* Compl., Prayer for Relief (C) (seeking "rescission of the Net Worth Sweep and restitution of the monies paid by the Companies to Treasury pursuant thereto"); *id.* at (D) (seeking declaration that "the Net Worth Sweep is void and unenforceable as a matter of Delaware and Virginia law"); *id.* at (I) (seeking "compensatory damages, restitution, and/or disgorgement in favor of the Enterprises and against Defendants FHF A and Treasury"). The court in *Perry Capital* agreed, finding the materially identical claims to be derivative because the recovery sought would "not flow 'directly to the stockholders,'" but instead "would flow first and foremost to the [Enterprises]." *See Perry Capital*, 70 F. Supp. 3d at 235 n.24 (citation omitted). The same is true here.

[14] The Delaware Supreme Court's recent decision in *NAF Holdings, LLC v. Li & Fung (Trading) Limited,*. 118 A.3d 175 (Del. 2015), is irrelevant. In that case, the court merely held that where a plaintiff-shareholder sued a third party for breach of a contract to which the shareholder was a direct party, that claim was not rendered derivative merely because plaintiff's damages would be measured by harm to the company in which the plaintiff held its stock. *Id.* at 180–82. Here, by contrast, plaintiffs' contract claims relate to the Third Amendment, to which the individual shareholders were neither parties nor third party beneficiaries. Although plaintiffs purport to sue the Conservator (standing in the shoes of the Enterprises) for breach of plaintiffs' own stock certificates with the Enterprises, on the theory that the Conservator allegedly wasted corporate assets, thereby reducing plaintiffs' ability to recover dividends or liquidation preferences through their stock ownership, Compl. ¶ 107-152, this claim alleges, as discussed above, at most an indirect injury to plaintiffs. It is therefore derivative.

In sum, HERA bars each of plaintiffs' claims, whether considered direct or derivative, because they are based on plaintiffs' purported "rights" as Enterprise shareholders and the conservator has succeeded to "all" such "rights" during conservatorship. 12 U.S.C. § 4617(b)(2)(A)(i). In all events, plaintiffs' claims are—in substance—derivative, and thus are barred for that reason as well. *See id.*; *Kellmer*, 674 F.3d at 850.[15]

III. PLAINTIFFS FAIL TO STATE A CLAIM UNDER VIRGINIA AND DELAWARE LAW.

Plaintiffs' complaint against FHFA and Treasury should be dismissed under Rule 12(b)(1) because of the jurisdiction-withdrawal and transfer of rights provisions of HERA and principles of sovereign immunity. However, even if the Court were to assume the existence of subject matter jurisdiction, the complaint fails to state a claim on the merits and should be dismissed under Rule 12(b)(6).

A. The PSPA and Stock Certificates Must be Interpreted Under Federal Law.

Plaintiffs assert that Delaware and Virginia law apply to the PSPAs and senior preferred stock certificates "under the terms of [the Enterprises'] bylaws and the Amended and Restated Certificate of Designation of Terms of the Senior Preferred Stock." Compl. ¶ 11. That is incorrect. Federal law, and the stock certificates themselves, take precedence over any conflicting provision of state law. In arguing to the contrary, plaintiffs have ignored the Supremacy Clause and overlooked the plain terms of the Enterprises' bylaws and the stock certificates.

[15] To the extent plaintiffs argue that the Court should create an exception to the plain meaning of the statute for derivative actions where the conservator purportedly faces a conflict of interest, the Court should reject such a request. The *Perry Capital* court's holding that no "conflict of interest" exception exists under HERA is binding here as a matter of issue preclusion. *See infra* Part IV. In all events, this Court should likewise reject any such exception, which would be inconsistent with the plain language of the statute. *See also* FHFA Br. at 21-22.

Federal law preempts any asserted fiduciary duties under Delaware and Virginia law because such duties would be inconsistent with Treasury's obligation under HERA to act in the best interests of the public and the taxpayers. *See Starr Int'l Co. v. Fed. Reserve Bank of New York*, 742 F.3d 37, 41-42 (2d Cir. 2014) ("Delaware fiduciary duty law cannot be applied to FRBNY's rescue activities consistently with adequate protection of the federal interests at stake in stabilizing the national economy. . . . This private duty would present a significant and direct conflict with FRBNY's obligation to act in the public interest as a fiscal agent of the United States and to take action in unusual and exigent circumstances when its failure to act would adversely affect the economy.") (internal quotations and citations omitted).

In addition, the senior preferred stock certificates themselves confirm that plaintiffs cannot rely on state law to impose fiduciary duties on Treasury. The certificates state that they are to be construed "in accordance with and governed by the laws of the United States, provided that the law of the [State of Delaware (Fannie Mae) / Commonwealth of Virginia (Freddie Mac)] shall serve as the federal rule of decision in all instances except where such law is inconsistent with the Company's enabling legislation, its public purposes or any provision of this Certificate." Fannie Mae PSPA Certificate ¶ 10(e); Freddie Mac PSPA Certificate ¶ 10(e). The preferred stock certificates directly provide that Delaware or Virginia law does not apply where state law requirements are "inconsistent with . . . *any provision of this certificate*." *Id.* (emphasis added). Thus, even if plaintiffs were correct that the variable dividend formula is impermissible under Delaware and Virginia law (and, as explained below, they are not), their state law claims must be

dismissed because the stock certificates themselves, rather than any provision of state law, would control in the event of any conflict between state law and the terms of the certificates.[16]

Moreover, because the certificates must above all be construed "in accordance with and governed by the laws of the United States," Delaware and Virginia law do not apply to questions settled by federal law. HERA, the source of federal law, permits the conservator to operate the Enterprises, carry on the business of the Enterprises, and transfer or sell any asset of the Enterprises. *See* FHFA Brief at 15-16. Those provisions of HERA cannot be constrained by the operation of state law. *See Gross*, 974 F.2d at 407; *In re Columbia Gas Sys. Inc.*, 997 F.2d 1039, 1055 (3d Cir. 1993) ("It is axiomatic that federal law governs questions involving the interpretation of a federal statute.").

Relying on Delaware and Virginia corporate law to interpret the stock certificates would also be inappropriate because doing so would be "inconsistent with the Company's enabling legislation [and] its public purposes." Fannie Mae PSPA Certificate ¶ 10(e); Freddie Mac PSPA Certificate ¶ 10(e). HERA amended the Enterprises' charters and granted Treasury the temporary authority to provide emergency financing to the Enterprises where such financing was necessary to "provide stability to the financial markets; prevent disruptions in the availability of mortgage finance; and protect the taxpayer." 12 U.S.C. § 1719(g)(1)(B); 12 U.S.C. § 1455(l)(1)(B). Congress does not authorize the rescue of distressed financial institutions "to advance the interests of the particular distressed financial institution (or its shareholders)." *Starr Int'l Co. v. Fed. Reserve Bank of New York*, 906 F. Supp. 2d 202, 243 (S.D.N.Y. 2012). Instead,

[16] The Third Amendment changed the dividend formula stated in the preferred stock certificates. Third Amendment to Amended and Restated Fannie Mae PSPA, § 4 (Aug. 17, 2012); Third Amendment to Amended and Restated Freddie Mac PSPA, § 4 (Aug. 17, 2012). Plaintiffs concede in paragraph 15 of their complaint that the Third Amendment "amend[ed] the Fannie Mae and Freddie Mac Senior Preferred Stock Certificates of Designation."

the role of federal agencies in such instances is "to serve the public interest." *Id.* Indeed, HERA directs Treasury to consider a number of factors "to protect the taxpayers," including "[t]he need for preferences or priorities regarding payments to the Government," and "[r]estrictions on the use of corporation resources, including limitations on the payment of dividends and executive compensation and any such other terms and conditions as appropriate for those purposes." 12 U.S.C. § 1719(g)(1)(C)(i),(vi).

Nor do the PSPAs create any fiduciary duties to plaintiffs. The PSPAs are agreements between FHFA – acting as conservator – and Treasury, and the agreements explicitly exclude third-party beneficiaries such as the plaintiffs. *See* Fannie Mae PSPA § 6.1; Freddie Mac PSPA § 6.1.

Finally, the Enterprises' bylaws do not impose state law limitations upon the actions of the conservator or Treasury. The regulation cited by plaintiffs in their complaint, 12 C.F.R. § 1710.10 (cited in Compl. ¶¶ 2, 32), provides that federal law governs the operations of the Enterprises. 12 C.F.R. § 1710.10(a) ("[t]he corporate governance practices and procedures of each Enterprise shall comply with applicable chartering acts and other Federal law, rules, and regulations . . . "). Paragraph (b) of § 1710.10 does authorize the Enterprises to elect a body of state law for their corporate governance procedures, but only "[t]o the extent not inconsistent with paragraph (a) of this section," 12 C.F.R. § 1710.10(b)(1), that is, to the extent state law is not inconsistent with federal law. The Enterprises' bylaws thus do not constrain Treasury's authority under HERA to invest in the Enterprises upon such terms and conditions that Treasury deems necessary to protect the taxpayers. *See* 12 U.S.C. § 1719(g)(1)(A); 12 U.S.C. § 1455(l)(1)(A).

B. Treasury Does Not Owe Fiduciary Duties to the Shareholders of the Enterprises Under State Law, and the Variable Dividend Complies with Delaware and Virginia Law.

Even if they were not preempted by federal law, plaintiffs' claims regarding Delaware and Virginia law fail to state a claim on the merits. Nothing in state law would support imposing any fiduciary duty on Treasury, and the variable dividend is a valid preferred stock dividend under state law.

Fiduciary duty obligations exist only for a controlling shareholder, defined as a shareholder owning more than fifty percent of the voting power of the company, or a shareholder who exercises "actual control" over the board of directors of a company. *See Zimmerman v. Crothall*, 62 A.3d 676, 699-700 (Del. Ch. 2013) ("A shareholder will be considered 'controlling' if it either owns more than 50% of the voting power of the company, or exercises 'actual control' over the board of directors during the course of a particular transaction."); *see also Brown v. Scott Cnty. Tobacco Warehouses*, 5 Va. Cir. 75, 79 (Scott County Cir. Ct. 1983). Neither part of that test is satisfied by Treasury's ownership of senior preferred stock.

Treasury does not possess voting rights in the Enterprises by virtue of the PSPAs. The PSPAs create a liquidation preference in favor of Treasury, but they do not confer voting or control rights. *See* Fannie Mae Senior Preferred Stock Certificate § 5; Freddie Mac Senior Preferred Stock Certificate § 5 ("Except as set forth in this Certificate or otherwise required by law, the shares of the Senior Preferred Stock shall not have any voting powers, either general or special."). Treasury's warrants to purchase common stock also confer no voting rights.

Nor does Treasury exercise "actual control" over the business and affairs of the Enterprises. FHFA, the conservator of the Enterprises, is an independent regulator. By statute, FHFA, "when acting as conservator . . . shall not be subject to the direction or supervision of any

other agency of the United States." *Id.* § 4617(a)(7). The complaint asserts that Treasury exercises actual control over the Enterprises because of: (1) "Treasury's control of the provisions of funds to the Companies," (2) "Treasury's consent rights over the companies repaying the Senior Preferred Stock or exiting conservatorship," and (3) "Treasury's influence over FHFA officials, many of whom were employees of Treasury." Compl. ¶ 64.

None of these assertions satisfies the standard for "actual control." The fact that Treasury has made a binding commitment to provide funds to the Enterprises under the PSPAs is not a mechanism for controlling those companies. *See Gail C. Sweeney Estate Marital Trust*, 68 F. Supp. 3d at 124 ("Treasury is obligated to provide funding" under the PSPAs even if it were to be sued by FHFA, and so existence of those agreements does not create a conflict of interest between Treasury and FHFA). Treasury's rights under the PSPAs ensure only that the Enterprises cannot exit conservatorship and return to the market with the ongoing commitment of taxpayer funds without the consent of Treasury; this allegation does not establish operational control of the Enterprises by Treasury. Conclusory assertions of "influence" (of unspecified scope) over various "officials" (who are likewise unspecified) are similarly insufficient to demonstrate that Treasury is in "actual control" of FHFA.

Finally, plaintiffs' claims concerning the import of the DGCL and VSCA are incorrect. The variable dividend satisfies the DGCL and VSCA requirements. The DGCL is "a broadly enabling statute," *In re Topps Co. Shareholders Litig.*, 924 A.2d 951, 958 (Del. Ch. 2007), "widely regarded as the most flexible in the nation because it leaves the parties to the corporate contract (managers and stockholders) with great leeway to structure their relations . . .". *Jones Apparel Grp., Inc. v. Maxwell Shoe Co.*, 883 A.2d 837, 845 (Del. Ch. 2004). A dividend rate can be variable, *see NBC Universal v. Paxson Commc'ns Corp.*, No. CIV.A. 650-N, 2005 WL

1038997, at *1 (Del. Ch. Apr. 29, 2005) (dividend rate subject to reset), or even zero, *see Shintom Co. v. Audiovox Corp.*, No. CIV.A. 693-N, 2005 WL 1138740, at *2 (Del. Ch. May 4, 2005) *aff'd*, 888 A.2d 225 (Del. 2005). Similarly, the VSCA permits dividends to be "calculated in any manner." Va. Code Ann. § 13.1-638(C). *See also* FHFA Br. 28–29. None of these provisions precludes the Third Amendment's variable dividend formula.

IV. THE JUDGMENT IN THE *PERRY CAPITAL* ACTIONS PRECLUDES PLAINTIFFS' DERIVATIVE CLAIMS.

Finally, the doctrine of issue preclusion bars re-litigation of plaintiffs' shareholder derivative claims for breach of fiduciary duty against both FHFA and Treasury.[17] First, plaintiffs' derivative claims raise legal issues that are nearly identical to those previously adjudicated in *Perry Capital*, including whether HERA bars plaintiffs from asserting derivative claims against FHFA or Treasury during conservatorship, even where the conservator allegedly has a "conflict of interest."[18] In addition, the issues were actually litigated, *see Perry Capital*, 70 F. Supp. 3d at 229–33, and the court's conclusions were essential to its dismissal with respect to

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[17] A final judgment bars successive litigation of an issue of fact or law in a second action if (1) the identical issue was previously adjudicated; (2) the issue was actually litigated; (3) the previous determination was necessary to the decision; and (4) the party being precluded from relitigating the issue was fully represented in the prior action." *Howard Hess Dental Labs. Inc. v. Dentsply Int'l, Inc.*, 602 F.3d 237, 247-48 (3d Cir. 2010) (citation omitted).

[18] *Compare* Compl. ¶¶ 107–90; *with* Compl. ¶¶ 121–45, ECF No. 1, *Fairholme Funds, Inc. v. Fed. Hous. Fin. Agency*, No. 1:13-cv-1053 (D.D.C.); Compl. ¶¶ 137–66, ECF No. 1, *Continental Western*, No. 4:14-cv-042 (S.D. Iowa). The D.D.C. held that the plaintiffs' claims, including the breach of fiduciary duty claims, were barred under HERA, both under the jurisdiction-withdrawal provision of 12 U.S.C. § 4617(f), and as derivative claims subject to HERA's bar on shareholder suits, 12 U.S.C. § 4617(b)(2)(A). *Perry Capital*, 70 F. Supp. 3d at 229-33 & n.24. The court likewise dismissed the plaintiffs' breach of contract and breach of implied covenant claims against as unripe and for failure to state a claim, insofar as the plaintiffs sought to recover dividends. *Id.* at 233–39. Finally, the court ruled that those contractual claims are derivative and thus barred by HERA. *Id.* at 235 n.39, 239 n.45.

the derivative claims.[19] *Id.* Finally, like plaintiffs here, the plaintiffs in the *Perry Capital* litigation brought claims on behalf of the Enterprises, the real parties in interest in both cases.[20] plaintiffs here were thus fully represented in the *Perry Capital* litigation. *See Cramer v. Gen. Tel. & Electronics Corp.*, 582 F.2d 259, 267 (3d Cir. 1978) (affirming summary judgment based on claim preclusion because, "[a]lthough different shareholders brought the two actions, the actual plaintiff on whose behalf the claims were brought is the identical corporation"); *In re Sonus Networks, Inc., S'holder Derivative Litig.*, 499 F.3d 47, 64 (1st Cir. 2007). Issue preclusion thus bars plaintiffs' claims, all of which, as discussed above, *see supra* Part II(B), are derivative in nature. At a minimum, though, issue preclusion bars the claims plaintiffs expressly label as "derivative"—namely, Counts I and II for alleged violation of state statutes concerning preferred stock (Compl. ¶¶ 91–106), and Counts IX and X for alleged breaches of fiduciary duty (*id.* ¶¶ 169–90). Because the issues to be litigated with respect to the derivative claims would be the same "no matter which shareholder served as nominal plaintiff," and "defendants have already been put to the trouble of litigating the very question at issue, . . . the policy of repose strongly militates in favor of preclusion." *Sonus*, 499 F.3d at 64.[21]

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[19] The *Perry Capital* judgment is "final" notwithstanding the fact that an appeal of that judgment is pending in the D.C. Circuit. *See Cont'l Western*, 83 F. Supp. 3d at 838–40. The pendency of an appeal does not diminish the collateral estoppel effect of a judgment. *See Horsehead Indus., Inc. v. Paramount Commc'ns, Inc.*, 258 F.3d 132, 142 (3d Cir. 2001).

[20] Although some of the plaintiffs in *Perry Capital* contended that their breach of fiduciary duty claims were direct, other plaintiffs asserted expressly derivative breach of fiduciary duty claims. *See* 70 F. Supp. 3d at 218 ("The class plaintiffs have brought . . . derivative claims for breach of fiduciary duty."); *id.* at 229 ("The class plaintiffs bring derivative claims against both FHFA and Treasury on behalf of Fannie Mae and Freddie Mac.").

[21] *See also Arduini v. Hart*, 774 F.3d 622, 633 (9th Cir. 2014) (similar); *Cottrell v. Duke*, 737 F.3d 1238, 1243 (8th Cir. 2013) (similar); *Respler ex rel. Magnum Hunter Res. Corp. v. Evans*, 17 F. Supp. 3d 418, 421 (D. Del. 2014) (similar); *Delaware Cnty. Employees Ret. Fund v.*

CONCLUSION

For the foregoing reasons, as well as for the reasons set forth in FHFA's brief, the Court should dismiss the complaint for lack of subject matter jurisdiction. Alternatively, the Court should dismiss this case for failure to state a claim upon which relief can be granted.

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Respectfully submitted,

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Portnoy, No. CIV.A. 13-10405-DJC, 2014 WL 1271528, at *7–8 (D. Mass. Mar. 26, 2014) (similar); *Hanson v. Odyssey Healthcare, Inc.*, No. 3:04-CV-2751-N, 2007 WL 5186795, at *5 (N.D. Tex. Sept. 21, 2007) (similar).