IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

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

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

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INTRODUCTION

As was the case with the numerous lawsuits that preceded it, the claims in this suit fail for lack of jurisdiction and, further, fail to state a claim. The plaintiffs in this case are shareholders in the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, "the Enterprises"), and they follow earlier, unsuccessful shareholder-plaintiffs in demanding a better deal for themselves at the expense of taxpayers, who have provided $187 billion to stabilize the Enterprises and have committed a further $258 billion to ensure their viability.

Their suit should be dismissed for any one of five independent and purely legal reasons: First, because section 4617(f) of HERA withdraws subject matter jurisdiction over "any action to restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver." This jurisdiction-withdrawal provision thus bars any claim for relief aimed at setting aside the conservator's agreement with Treasury over the provision of funds to the Enterprises. Second, as plaintiffs concede in their opposition brief, there is no waiver of sovereign immunity for their money damages claims against Treasury, and section 702 of the APA does not waive sovereign immunity for actions brought entirely under state law in any event. Third, FHFA, as conservator, has succeeded by operation of law "all rights, titles, powers, and privileges" of each Enterprise and its shareholders, 12 U.S.C. § 4617(b)(2), and thus plaintiffs lack standing to assert their claims. Fourth, even aside from the limitations of HERA, plaintiffs' suit must be dismissed because federal law, not state law, applies to Treasury's provision of emergency funding to the Enterprises, and plaintiffs fail to state a claim under state law in any event. Fifth, this case is barred by issue preclusion in light of the dismissal of similar derivative actions by the U.S. District Court for the District of Columbia ("D.D.C."). Although that case is on appeal – and

oral argument on the appeal is scheduled for April 15, 2016 – that ruling is nonetheless final for purposes of issue preclusion.

DISCUSSION

I. Plaintiffs' Claims Against Treasury Are Barred by HERA's Jurisdiction-Withdrawal Provision

Plaintiffs' suit is barred by 12 U.S.C. § 4617(f), which provides that "no court may take any action to restrain or affect the exercise of powers or functions of [FHFA] as a conservator" of the Enterprises. Like its FIRREA analogue, *see* 12 U.S.C. § 1821(j), HERA's jurisdiction-withdrawal provision "effect[s] a sweeping ouster of courts' power to grant equitable remedies" to parties challenging actions taken by FHFA as conservator. *Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995) (interpreting FIRREA's equivalent anti-injunction provision); *Town of Babylon v. Fed. Hous. Fin. Agency*, 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."). This provision "by its terms, can preclude relief even against a third party, including the FDIC in its corporate capacity, 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.' After all, an action can 'affect' the exercise of powers by an agency without being aimed directly at it." *Hindes v. FDIC*, 137 F.3d 148, 160 (3d Cir. 1998).

Plaintiffs argue, implausibly, that *Hindes* and related precedents are limited to cases "challenging the conduct or attempting to enforce the legal obligations of *the federal conservator or receiver or its ward*." Brief in Opposition at 43, D.I. 23 ("Opp."). This effort to distinguish *Hindes* fails on its own terms, as plaintiffs' complaint accuses FHFA and the Enterprises of violating the same state law-based "legal obligations" that it accuses Treasury of violating. *See* Compl. ¶¶ 91-106 (form of dividends); 153-190 (breach of fiduciary duty).

In any event, the cases, including the Third Circuit's decision in *Hindes*, do not support plaintiffs' approach. In *Hindes*, the court explained that the statute precludes any claim that would *affect* the conservator's operations: "section 1821(j) precludes a court order against a third party which would affect the FDIC as receiver, where the relief would have the same practical result as an order directed against the FDIC in that capacity." *Hindes*, 137 F.3d at 161. Because the relief Mr. Hindes sought in his prior lawsuit against the FDIC "clearly would 'affect the exercise of powers or functions of the [FDIC] as conservator or receiver,'" the Third Circuit concluded that it was barred by the jurisdiction-withdrawal provision. *Id.*[1]

This approach is consistent across the federal courts. *See 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."); *see also Dittmer Properties, L.P. v. F.D.I.C.*, 708 F.3d 1011, 1017 (8th Cir. 2013) ("[I]f plaintiffs such as Dittmer are allowed to attack the validity of a failed institution's assets by suing the remote purchaser, such actions would certainly restrain or affect the FDIC's powers[.]"). Plaintiffs' contention that section 4617(f) cannot "empower FHFA to use contracts to immunize third parties," Opp. at 42, has it backwards. As *Hindes* and similar precedents hold, jurisdiction-withdrawal provisions exist to prevent interference with a conservator's efficient

[1] *Coit Independence Joint Venture v. Federal Savings and Loan Insurance Corp.*, 489 U.S. 561, 575 (1989), does not support plaintiffs' interpretation of the jurisdiction-withdrawal provision. Opp. at 42. Plaintiffs' complaint in this case, which seeks to enjoin both sides of a contract agreed to by the conservator, is exactly the type of "collateral attack[] attempting to restrain the receiver from carrying out its basic functions" that the Court recognized would be barred. *Coit*, 489 U.S. at 575.

operation of a distressed financial institution by also preventing interference with the actions of counter-parties with whom the conservator or receiver transacts business.[2]

Plaintiffs seek to rewrite agreements that the conservator entered into in order to ensure the solvency of the Enterprises after the financial crisis, and they pursue relief that would apply to both FHFA and Treasury: rewriting the Preferred Stock Purchase Agreements ("PSPAs") to retain features that plaintiffs like (the unprecedented and continuing commitment of hundreds of billions in taxpayer funds to the Enterprises) but invalidating features that they dislike (the variable dividend payments of the Third Amendment). *See* Compl., Prayer for Relief (C), (D), (H), (I). An injunction against either Treasury or FHFA under these circumstances would "restrain or affect" the exercise of the conservator's powers, and indeed two courts have reached this exact conclusion with respect to the Third Amendment. *See Cont'l W. Ins. Co. v. Fed. Hous. Fin. Agency*, 83 F. Supp. 3d 828, 840 & n.6 (S.D. Iowa 2015); *Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 222-23 (D.D.C. 2014).

II. Plaintiffs' Claims Against Treasury Are Barred by Sovereign Immunity

Plaintiffs concede in their opposition brief that the only applicable waiver of sovereign immunity in this case is section 702 of the APA, and that "Section 702 may not permit this Court

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[2] Plaintiffs cite to two inapposite cases to support their argument that 12 U.S.C. § 4617(f) does not bar their claims. *See* Opp. at 44 & n.53. In neither case was the conservator or receiver a party, as the conservator is here. In one case, the court held that section 1821(j) did not apply where the lawsuit "focused on [the third-party's] actions not the actions of the FDIC," and it did "not believe" that the relief sought "would have a chilling effect on the FDIC's ability to transfer bundles of trust deeds to third parties." *Stommel v. LNV Corp.*, No. 2:13CV821DAK, 2014 WL 1340676 (D. Utah Apr. 4, 2014). In the other case, plaintiffs had sought a recovery only against the third-party, and the court held that relief "would not restrain or affect [the FDIC as receiver] in any way." *LNV Corp. v. Outsource Serv. Mgmt., LLC*, No. CIV 13-1926 JNE/LIB, 2014 WL 834977 at *4 (D. Minn. Mar. 4, 2014). Similarly, while the Third Circuit cautioned that the principle in *Hindes* "should not be overread," it was stating that it may not reach the same result in a case where an order against a third party "would be of little consequence" to the conservator or receiver, not to a case seeking the "dramatic and fundamental" interference plaintiffs seek here. *Hindes*, 137 F.3d at 161.

to require Treasury to pay compensatory damages to Plaintiffs." Opp. at 29. That is a significant concession, as their complaint is replete with references to "damages" allegedly suffered as a result of the Third Amendment. *See* Compl. ¶¶ 1, 97, 105, 159, 167. However, plaintiffs attempt to salvage their claim for monetary relief by stating, incorrectly, that section 702 "certainly permits the Court to require Treasury to return to Fannie and Freddie the unlawful 'dividends' extracted pursuant to the Net Worth Sweep." Opp. at 29. That is incorrect. "Restitution," as plaintiffs characterized this relief in their complaint, *see* Compl., Prayer for Relief (C) (requesting "restitution of the monies paid by the Companies to Treasury"), is not specific relief as contemplated by section 702. "[R]eliance on 5 U.S.C. § 702 is not well taken because . . . regardless of its terminology, the 'restitution' or 'reimbursement' sought is monetary compensation for [alleged] monetary damage," and "[t]he relief [sought] is therefore barred by the Constitution." *California v. United States*, 104 F.3d 1086, 1095 (9th Cir. 1997).

Plaintiffs' reliance on *Bowen v. Massachusetts*, 487 U.S. 879 (1988), is misplaced. *Bowen* held that section 702 permitted a suit to enforce a statutory entitlement to withheld federal grant-in-aid money. *Id.* at 900-01. Under *Bowen*, section 702's waiver applies if the suit seeks to "enforce the statutory mandate itself, which happens to be one for the payment of money." *Zellous v. Broadhead Assocs*., 906 F.2d 94, 97 (3d Cir. 1990). But *Bowen* does not permit plaintiffs to re-cast any judicial order for the payment of money as "relief other than money damages." 5 U.S.C. § 702; *see Hubbard v. Adm'r, E.P.A.*, 982 F.2d 531, 536 (D.C. Cir. 1992). Plaintiffs are not suing for the enforcement of a statutory mandate, under either federal law or Delaware or Virginia state law, that Treasury pay them, or the Enterprises, a sum of money. In the absence of such a statutory *entitlement* to the payment of money, their claim seeks money damages and is barred by sovereign immunity. *See Dep't of Army v. Blue Fox, Inc*., 525

U.S. 255, 263 (1999) (equitable lien used to satisfy "a claim for unjust enrichment" is not a form of specific relief); *see also id.* at 264 ("Our holding today is in accord with our precedent establishing that sovereign immunity bars creditors from attaching or garnishing funds in the Treasury.").

Further, Plaintiffs openly admit that their complaint contains no federal cause of action, Pls. Opp. 30 n.32 ("Nor need Plaintiffs identify a federal cause of action to assert *state* law claims such as those at issue here." (emphasis in original)), and they make no attempt to show that their claims arise "under the Constitution, Laws, or treaties of the United States." 28 U.S.C. § 1331(a). They nonetheless invoke the APA's waiver of sovereign immunity in section 702 and argue that section 1367 establishes supplemental jurisdiction for their claims against Treasury. That is incorrect.

The APA's waiver of sovereign immunity in section 702 applies, if at all, only in actions over which the Court has original jurisdiction. *Jaffee v. United States*, 592 F.2d 712, 718 (3d Cir. 1979) (holding that "section 702, when it applies, waives sovereign immunity in 'nonstatutory' review of agency action under section 1331"). Section 1367, the sole provision on which plaintiffs rely to establish jurisdiction for their claims against Treasury, Opp. at 30 n.32, provides only for supplemental jurisdiction, not original jurisdiction. Thus, even if section 1367 could provide supplemental jurisdiction over a plaintiff's state-law claims against a private party defendant, the statute cannot be used to override the United States' sovereign immunity with respect to plaintiffs' state-law claims.

Plaintiffs rely on *Treasurer of New Jersey v. U.S. Dep't of Treasury*, 684 F.3d 382 (3d Cir. 2012), for the proposition that the "state-law character of Plaintiffs' claims is [] irrelevant to the broad APA waiver of sovereign immunity." Opp. at 29 (quoting *id*. at 400 n.19). But that

case in fact confirms that this Court lacks subject matter jurisdiction over plaintiffs' claims against Treasury. There, the Third Circuit made clear that it could exercise jurisdiction over the state-law claims only where plaintiffs had established jurisdiction under section 1331 for "a significant Tenth Amendment claim in their complaint." *Id.* at 403. *Treasurer of New Jersey* does not, however, stand for the proposition that the United States has waived its sovereign immunity for suits premised solely on state law, like plaintiffs' action here.

Further, plaintiffs incorrectly argue that the "sue-and-be-sued provisions" in the statutes enacting the Enterprises' charters establish subject matter jurisdiction over plaintiffs' claims seeking equitable and declaratory relief against the conservator. *See* Pls. Opp. 30 n.32. Those provisions authorize the Enterprises, in their corporate names, "to sue and to be sued, and to complain and to defend." 12 U.S.C. § 1723a(a) (Fannie Mae); *id.* § 1452(c) (Freddie Mac). To any extent that these provisions afford jurisdiction,[3] the scope of that jurisdiction is necessarily limited by HERA, which expressly deprives all courts of jurisdiction over any equitable and

[3] Plaintiffs' reliance on *Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Raines*, 534 F.3d 779 (D.C. Cir. 2008), is inapposite. There, the D.C. Circuit held that Fannie Mae's sue-and-be-sued provision confers jurisdiction in shareholder derivative suits brought on behalf of Fannie Mae against the company's directors. *Id.* at 787-88. *Pirelli* did not involve claims against the FHFA as conservator, and the case does not remotely stand for the proposition that the sue-and-be-sued provisions of both Enterprises' charters grant federal jurisdiction over claims against FHFA, *see* Pls. Opp. 30 n.32, where HERA provides directly to the contrary. Even setting aside this problem, plaintiffs fail to explain how *Pirelli* can be squared with Third Circuit precedent. In *Lindy v. Lynn*, 501 F.2d 1367 (3d Cir. 1974), the Third Circuit, interpreting a statutory provision that is identical to Fannie Mae's sue-and-be-sued provision, held that the provision does *not* confer federal subject matter jurisdiction. *Id.* at 1369 ("The same is true of 12 U.S.C. § 1702, which makes the Secretary suable in his official capacity in a court which is otherwise of competent jurisdiction. Here it is clear that the district court is not otherwise of competent jurisdiction to entertain this lawsuit."). Thus, there is no Third Circuit precedent supporting plaintiffs' contention that the sue-and-be-sued provision confers federal jurisdiction in suits against Fannie Mae; in fact, in a pending petition for a writ of certiorari in *Lightfoot* v. *Cendant,* No. 14-1055 (S. Ct.), the Supreme Court has invited the Solicitor General to submit its views on this very question. *See* 136 S.Ct. 289 (Mem) (Oct. 5, 2015).

declaratory claims seeking relief affecting the powers of the conservator. 12 U.S.C. § 4617(f). Further, contrary to plaintiffs' assertion, Pls. Opp. 30 n.32, HERA's section 4617(b)(2)(A) does not grant jurisdiction over plaintiffs' claims against the conservator, as we explain next.

III. HERA's Transfer of Shareholder Rights Provision Bars Plaintiffs' Claims

Under HERA, 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). This provision, by its terms, bars any suit predicated on plaintiffs' status as shareholders brought "with respect to the regulated entity and the assets of the regulated entity." It also "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). Plaintiffs try to escape the effect of section 4617(b) by arguing that their claims are derivative, not direct. While it makes no difference, because the statute applies with equal force to derivative or direct claims asserted with respect to the assets of the Enterprises, plaintiffs' claims are in fact derivative.

Plaintiffs' claims are derivative under the first prong of the *Tooley* test because they are based on alleged harm to the Enterprises, not the shareholders individually. *See Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004). Plaintiffs' theory is that the Third Amendment deprives the Enterprises of monies that could otherwise be used to pay dividends or proceeds from a liquidation, thereby diminishing the value of Plaintiffs' shares. Indeed, Plaintiffs admit that their claims are predicated on the alleged "elimination of economic value of their shares," and alleged "loss of a contingent future interest that precipitates a reduction in its value at present." Opp. 54. It is black letter law that such claims are derivative,

not direct, because reduction in stock value is an "*indirect* injury" that is contingent upon an injury to the company itself. *Tooley*, 845 A.2d at 1037. Indeed, an alleged "deplet[ion of] corporate assets that might otherwise [have] be[en] used to benefit the stockholders, such as through a dividend," which "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) (emphasis added); *see also Perry Capital*, 70 F. Supp. 3d at 229 n.24, 235 n.39 and n.45 (noting materially-identical shareholder claims based on Third Amendment are derivative).

Plaintiffs cannot recast their claims as direct by including the additional allegation that the Third Amendment harmed their purported contract rights as shareholders--that is, their rights under a purported contract between them and the Enterprises flowing from their status as holders of Enterprise shares. *See* Opp. at 45. That is just another way of saying that the value of their shares was allegedly harmed as the result of a contract between the Conservator and Treasury--a contract to which the shareholders were not parties. The alleged harm to their purported contract rights *with the Enterprises* is simply a byproduct of the alleged harm to the Enterprises. *See In re Ionosphere Clubs, Inc.*, 17 F.3d 600, 606-07 (2d Cir. 1994) (rejecting same argument and holding claims are derivative where "[t]he injury to the Preferredholders' contractual rights to receive dividend and sinking fund payments was not inflicted 'directly' or 'independently of the corporation'"). Plaintiffs also incorrectly suggest that the *Tooley* test should not apply at all to their contract claims in light of the recent decision in *NAF Holdings, LLC v. Li & Fund (Trading) Ltd.*, 118 A.3d 175 (Del. 2015). That is incorrect. In *NAF Holdings*, the Delaware Supreme Court did not overturn or displace *Tooley*. *See, e.g.*, *Jackson v. Fischer*, No. 11-cv-2753, 2015 WL 5569133, at *19 (N.D. Cal. Sept. 21, 2015) (applying *NAF Holdings* and *Tooley* to find claim derivative). Rather, *NAF Holdings* addresses only claims brought by a shareholder-

plaintiff for breach of a commercial contract that the shareholder had entered directly with a third party. The individual shareholder was the contract signatory and party, with benefits intended to flow through her corporation, which was only a third-party beneficiary of the contract. 118 A.3d at 176. *NAF* came to the uncontroversial conclusion that a direct signatory to a contract with a third party may sue directly for breach of that contract. *Id*. at 180-82. Here, plaintiffs are not asserting any claims based on a contract between themselves and third parties; they are seeking to challenge agreements between Treasury and the Enterprises in which they hold shares—agreements to which they are not a party.[4] *NAF* reaffirms the applicability of *Tooley* where, as here, a shareholder's claims arise out of a "breach of contract that [the company] had signed." 118 A.3d at 178.

Nor can plaintiffs recast their breach of fiduciary duty claims against Treasury and FHFA as direct claims. Opp. at 46-48. Claims that a majority shareholder breached a fiduciary duty to minority shareholders with respect to a corporate transaction are typically derivative claims. *See, e.g., Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1218 (Del. 2012) (claim that controlling shareholder and the corporation's director breached a fiduciary duty to minority shareholders by causing the corporation to pay an "unfair price" for an asset was a derivative claim). Plaintiffs nevertheless argue that "some wrongs harm *both* the corporation and its stockholders directly and can be challenged through *either* derivative or direct actions." Opp. 45 n.54. But the cases upon which Plaintiffs rely are based on a narrow Delaware law exception that has no application here. That exception applies only in cases in which:

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[4] In *NAF* the Delaware Supreme Court specifically distinguished NAF's commercial contractual suit, based on its individual rights under the contract, from the plaintiff-stockholders in *Tooley*, because in *Tooley*, the plaintiffs had no separate contractual right to bring a claim and had no contractual rights under the merger agreement. 118 A.3d at 182, n.10. So too here, plaintiffs have no actionable contractual right to payment for their stock.

> (1) a stockholder having majority or effective control causes the corporation to issue 'excessive' shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders.

Gentile v. Rossette, 906 A.2d 91, 100 (2006). Further, the share issuance must increase the majority shareholders' voting power to the detriment of the minority shareholders. *Id*. at 99-100. None of these elements is present here.

As explained *infra* pages 17-18, Treasury is not a controlling shareholder and does not owe a fiduciary duty to the Enterprises' shareholders. In any event, even if Treasury could be deemed a controlling shareholder, the exception would be inapplicable. The Third Amendment merely altered the way Treasury's dividends are calculated under the existing stock. It did not result in the issuance of any additional shares of stock, let alone "excessive" shares. Nor did the Third Amendment alter the percentage of GSE shares outstanding that Treasury owns or decrease the percentage owned by private investors. Accordingly, it did not alter Treasury's voting rights—Treasury has none—or its ownership stake in the GSEs.[5]

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[5] *See Innovative Therapies, Inc. v. Meents*, No. 12–3309, 2013 WL 2919983, at *5 (D. Md. June 12, 2013) (declining to apply the exception where, as here, the "allegations rest solely on a purported loss in the economic value of [plaintiff's] ownership stake rather than any loss of voting power"); *see also Protas*, 2012 WL 1580969, at *6 (declining to apply exception); *Nikoonahad v. Greenspun Corp.*, No. C09-02242, 2010 WL 1268124, at *5 (N.D. Cal. Mar. 31, 2010) (same). Plaintiffs also cite the unpublished trial court decision in *In re: El Paso Pipeline Partners, L.P. Deriv. Litig.*, 2015 WL 7758609 (Del. Ch. Dec. 2, 2015). *El Paso* a makes clear that a claim for damages to a corporation, such as that here, must be brought as a derivative action. "Treating a dual-natured claim as *derivative* for purposes of *claim initiation* achieves the important goals of screening out weak claims and providing an efficient and centralized mechanism for conducting the litigation." 2015 WL 7758609 at *2 (emphasis added). *El Paso* treated the claim as direct only for purposes of "claim continuation," where a subsequent merger would deprive plaintiffs of standing to pursue an already-initiated action. ("Treating a dual-natured claim as direct for purposes of claim continuation preserves the ability of investors to pursue legitimate litigation … [where a subsequent transaction] eliminated the plaintiff's standing to sue derivatively.") *Id*.

Plaintiffs' claims also are derivative under the second prong of the *Tooley* test because the remedy plaintiffs seek – vacating the Third Amendment and returning to the Enterprises all dividends paid thereunder – would flow directly to, and affect the contract rights of, the Enterprises, not the shareholders. As *Perry Capital* held, such relief "would flow first and foremost to the [Enterprises]" and would "not flow directly to the [shareholder] plaintiffs." 70 F. Supp. 3d at 230 n.24 (emphasis in original). Plaintiffs attempt to avoid this conclusion by proposing they be paid directly. Opp. at 47-48. But the court "should look to the nature of the wrong and to whom the relief *should* go." *Tooley*, 845 A.2d at 1039 (emphasis added). Here, because the fundamental injury alleged is the "looting" of the Enterprises (Opp. at 16), the relief (if any) that would flow from such an alleged injury to the Enterprises, not plaintiffs.

Finally, plaintiffs cannot circumvent the bar on derivative suits through a purported "conflict of interest" exception. Opp. at 51-52. No such exception exists. *See* FHFA Reply at 11-14. Even if it existed, the exception would not apply here. The fact that FHFA and Treasury made an agreement that plaintiffs allege to be unlawful, Opp. at 51, does not establish a conflict of interest. If it did, every transaction FHFA entered would be subject to challenge by shareholders, because FHFA and the counter-party would qualify as alleged joint tortfeasors.[6]

IV. Federal Law, Not State Law, Governs the Taxpayers' Investments in the Enterprises

Plaintiffs argue that state corporate law applies to the senior preferred stock held by Treasury because, prior to the passage of HERA and the commencement of the conservatorships,

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[6] Even the two courts that have adopted the conflict of interest exception have rejected such a far-reaching rule. *See First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279, 1295 (Fed. Cir. 1999) (emphasizing that the conflict-of-interest exception will apply "only . . . in a very narrow range of circumstances"); *Delta Sav. Bank v. United States*, 265 F.3d 1017, 1023 (9th Cir. 2001) ("We do not suggest that the FDIC-as-receiver is faced with a disqualifying conflict every time a bank-in-receivership is asked to sue another federal agency.").

Fannie Mae's and Freddie Mac's corporate bylaws designated the corporate law of Delaware and Virginia, respectively, to apply to some aspects of their corporate governance. Opp. at 16. Plaintiffs' argument is mistaken for three reasons.

First, by their terms, the bylaws do not support Plaintiffs' choice-of-law theory. The bylaws themselves provide that state law applies only "to the extent not inconsistent with . . . Federal law, rules, and regulations." Fannie Mae Bylaws § 1.05; *see also* Freddie Mac Bylaws § 11.03 (Virginia law applies only "to the extent not inconsistent with" federal law.). Likewise, the regulation authorizing the Enterprises to select a body of state corporate law in their bylaws, 12 C.F.R. § 1710.10, provided that, "The corporate governance practices and procedures of each Enterprise *shall comply with applicable chartering acts and other Federal law, rules, and regulations*." *Id*. § 1710.10(a) (emphasis added). An Enterprise could designate a body of state law to apply to its corporate governance practices, but only "[t]o the extent not inconsistent with" the preceding sentence. *Id.* § 1710.10(b). Thus, by their terms, the bylaws and the regulation on which they are based recognize that federal law, and not state law, is the primary source of authority for the Enterprises.

Second, plaintiffs' attempt to apply state law to Treasury's senior preferred stock conflicts with the Enterprises' federal charters and the stock certificates held by Treasury. The Constitution grants the federal government the "[p]ower to dispose of and make all needful Rules and Regulations respecting the . . . Property belonging to the United States . . . ." U.S. Const. Art. IV, § 3, cl. 2. The Constitution thus authorizes the federal government to establish the rules concerning financial instruments to which it is a party. *See Treasurer of New Jersey*, 684 F.3d at 410. In accordance with that constitutional authorization, the governing provisions of HERA, which amended the Enterprises' charters, both state that the "obligations and other securities"

purchased by Treasury shall be "issued by the Corporation *under any section of this chapter*, on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine." 12 U.S.C. § 1455(*l*)(1)(A) (emphasis added); *see also id.* § 1719(g)(1)(A) (same language with respect to Fannie Mae). Federal law authorized the Enterprises to issue the senior preferred stock, and expressly permitted Treasury to establish the terms of those investments.[7] One such term of the senior preferred stock is that the terms of the certificates themselves override any conflicting provision of state law. Fannie Mae PSPA Certificate ¶ 10(e); Freddie Mac PSPA Certificate ¶ 10(e).

Plaintiffs wrongly seek to dismiss that language in the stock certificates on the theory that the certificates are "creatures of state law," and thus that state law applies regardless of the certificates' terms. Opp. at 3, 17. This claim is wrong. As explained above, the PSPAs and senior preferred stock are authorized by, and issued under, federal law. Plaintiffs' related argument that the Enterprises' articles of incorporation trump the stock certificates, *see* Opp. at 19, is also mistaken. This contention overlooks the crucial fact that the Enterprises are federally chartered and *not* incorporated under state law, s*ee Perry Capital*, 70 F. Supp. 3d at 215, and are authorized by their federal charters (not by state law) to issue common and preferred stock. *See* 12 U.S.C. § 1453(a); *id.* § 1718(a). State law thus cannot provide a basis for setting aside a provision of the senior preferred stock certificate.

Third, Plaintiffs' insistence that state law applies to the senior preferred stock also fails in light of two principles derived from the Supremacy Clause—intergovernmental immunity and preemption. *See* Treasury Opening Br. at 22, D.I. 20. "Under the intergovernmental immunity

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[7] The Preferred Stock Purchase Agreements with both Enterprises note that the preferred stock was issued by the Enterprises pursuant to this authority in their federal charters. *See* Fannie Mae PSPA at 1, Ex. A to Treasury Mot. to Dismiss, D.I. 20-1; Freddie Mac PSPA at 1, Ex. A to Treasury Mot. to Dismiss, D.I. 20-1.

component of Supremacy Clause jurisprudence, the states may not directly regulate the federal government's operations or property. . . [T]he Constitution itself specifies that Congress retains the '[p]ower to dispose of and make all needful Rules and Regulations respecting the . . . Property belonging to the United States. . . .'" *State of Ariz. v. Bowsher*, 935 F.2d 332, 334 (D.C. Cir. 1991) (citing U.S. Const., art. IV, § 3, cl. 2); *see also Hancock v. Train*, 426 U.S. 167, 179 (1976) ("[W]here Congress does not affirmatively declare its instrumentalities or property subject to regulation, the federal function must be left free of regulation.") (internal quotations omitted); *Middletown Twp. v. N/E Reg'l Office, U.S. Postal Serv.*, 601 F. Supp. 125, 127 (D.N.J. 1985) (same). The Third Circuit, on the basis of the Supremacy Clause, rejected efforts by several states to subject bonds issued by Treasury to the requirements of their general unclaimed property statutes, describing their effort to impose "a direct regulation of the Federal Government in contravention of the Supremacy Clause" as "not permissible." *Treasurer of New Jersey*, 684 F.3d at 412. Declaring a security held by the federal government, and authorized by federal law, "void *ab initio* and unenforceable" based on state law, Opp. at 22-23, is just such a constitutionally impermissible "direct regulation" of the federal government.

In addition, under settled principles of preemption, state law is inapplicable if it conflicts with federal law, such as HERA. Implied conflict preemption, the form at issue here, exists where the challenged state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Arizona v. United States*, 132 S. Ct. 2492, 2501 (2012). "[S]tate law is naturally preempted to the extent of any conflict with a federal statute." *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372 (2000).

Plaintiffs' claim that FHFA and Treasury have not identified "a specific, purported conflict between HERA and Delaware or Virginia corporate law," Opp. at 16, ignores the

arguments of the defendants' opening briefs. *See* Treasury Opening Br. at 24-25; FHFA Opening Br. at 26-28, D.I. 18. First, imposing state law fiduciary duties, as plaintiffs seek to do in counts VII-X of their complaint, would be inconsistent with Treasury's statutory mandates to assist in stabilizing the housing market, and to structure its investment "to protect the taxpayers." 12 U.S.C. §§ 1455(*l*)(1)(C), 1719(g)(1)(C). Congress instructed the Secretary to consider a number of factors inconsistent with a fiduciary duty to shareholders, including "the 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 . . . ." *Id.* § 1719(g)(1)(C)(i),(vi) (emphasis added).

Plaintiffs cite two other considerations on that list as supposedly consistent with a fiduciary duty – "[t]he corporation's plan for the orderly resumption of private market funding or capital market access," and "[t]he need to maintain the corporation's status as a private shareholder-owned company." *Id.* §§ 1719(g)(1)(C)(iii),(v), 1455(*l*)(1)(C)(iii),(v); Opp. at 17. However, plaintiffs leave out the fact that those factors apply only insofar as is necessary "[t]o protect the taxpayers." *Id.* §§ 1719(g)(1)(C), 1455(*l*)(1)(C). Congress did not require Treasury to consider the interests of private shareholders in a way that would conflict with the taxpayers' interests, and indeed HERA transfers shareholder rights and privileges to FHFA. HERA thus cannot properly be read to incorporate a fiduciary duty that would require Treasury to place the interests of shareholders above those of the taxpayers. HERA in fact instructs Treasury to consider actions directly *contrary* to the interests of shareholders, including limiting the payment of dividends to them, and requiring that the Enterprises provide the taxpayers "preferences or priorities regarding payment[]." Plaintiffs cite no authority holding that a federal agency extending emergency funding is bound by state law fiduciary duties, and previous cases, that

plaintiffs do not bother to cite or discuss, have rejected this argument. *See Starr Int'l Co., Inc. 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.").

Moreover, imposing the limitations on the form of dividends that plaintiffs claim to find in Delaware and Virginia state corporate law would also be inconsistent with HERA's provision that the "obligations or other securities" held by Treasury are to be made "on such terms and conditions *as the Secretary may determine*." 12 U.S.C. §§ 1455(*l*)(1)(A), 1719(g)(1)(A) (emphasis added); *cf. Am. Legion v. Derwinski*, 54 F.3d 789, 799 (D.C. Cir. 1995) (finding similar language to confer "broad discretion" upon an agency). Subjecting the terms and conditions of Treasury's senior preferred stock to the limitations that plaintiffs claim to find in Delaware and Virginia state law would be inconsistent with this explicit grant of authority.

V. In Any Event, Plaintiffs' Claims Fail as a Matter of State Law

Plaintiffs' claims would fail even if state corporate law could be applied to Treasury. A controlling shareholder of a corporation either owns a majority of the corporation's voting shares, or it exercises "actual control" over the corporation's affairs. *Starr Int'l Co. v. Fed. Reserve Bank of New York*, 906 F. Supp. 2d 202, 221-25 (S.D.N.Y. 2012); *see also Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987). Treasury is not and has never been a majority shareholder. It does not have voting rights in the Enterprises, and its rights as a senior preferred shareholder are entirely contractual. Plaintiffs cite to cases supposedly demonstrating that "[s]tockholders with far less control than Treasury possesses over the Companies have been found to be controllers under Delaware and Virginia law." Opp. at 27.

Each of those cases involved shareholders owning voting stock in the corporation.[8] Tellingly, plaintiffs cannot cite a single case in which a preferred shareholder with no voting rights was held to be a controlling shareholder.

That Treasury holds warrants to purchase common stock and contractual rights of refusal over the issuance of stock or debt does not establish control of the Enterprises. Opp. at 25. The mere "potential ability to exercise control" through exercise of a warrant does not suffice to create a fiduciary duty; the plaintiff must instead plead and show "the actual exercise of that ability." *In re Sea-Land Corp. S'holders Litig.*, 1987 WL 11283, at *5 (Del. Ch. May 22, 1987) (unpublished). Nor do Treasury's contractual rights as a preferred shareholder establish control. Opp. at 26. Even "a significant shareholder, who exercises a duly-obtained contractual right that somehow limits or restricts the actions that a corporation otherwise would take, does not become, without more, a controlling shareholder for that particular purpose." *Superior Vison Servs. v. ReliaStar Life Ins. Co.*, 2006 WL 2521426, at *5 (Del. Ch. Aug. 25, 2006); *see also Starr*, 906 F. Supp. 2d at 221-25. Finally, plaintiffs are incorrect about the requirements of Delaware and Virginia law with respect to the form of dividends. *See* FHFA Reply Br. at 19-20.

VI. Plaintiffs' Arguments Against Issue Preclusion Fail

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[8] *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1112 (Del. 1994) ("Alcatel owned 43.3 percent of Lynch's outstanding stock; designated five of the eleven members of Lynch's board of directors; two of three members of the executive committee; and two of four members of the compensation committee."); *Hamilton Partners, L.P. v. Highland Capital Mgmt., L.P.*, No. CIV.A. 6547-VCN, 2014 WL 1813340, at *8 (Del. Ch. May 7, 2014) (defendant was "the holder of 48% of AHP's common stock"); *In re Loral Space & Commc'ns Inc.*, No. CIV.A. 2808-VCS, 2008 WL 4293781, at *21 (Del. Ch. Sept. 19, 2008) ("With 36% of the votes, MHR had substantial blocking power."); *In re Cysive, Inc. Shareholders Litig.*, 836 A.2d 531, 551-52 (Del. Ch. 2003) ("Carbonell holds a large enough block of stock to be the dominant force in any contested Cysive election."). Virginia law defines interested shareholders in terms of voting rights. See Va. Code Ann. § 13.1-725 (defining, for purposes of affiliated transactions statute, "interested shareholder" to means "any person that is . . . the beneficial owner of more than 10 percent of any class of the outstanding *voting* shares of the corporation.") (emphasis added).

Plaintiffs argue that issue preclusion should not apply because defendants "have failed to demonstrate the identity of both issues and parties that would be required to support" issue preclusion. Opp. at 55. Plaintiffs are incorrect.

First, plaintiffs argue that issue preclusion does not apply to their state law claims because the *Perry Capital* plaintiffs did not "assert[] those claims." Opp. at 56. Plaintiffs similarly argue that the derivative claims in *Perry Capital* were for breach of fiduciary duty, and not for breach of contract or the implied covenant of good faith and fair dealing. Opp. at 57. Plaintiffs' arguments ignore black letter law: Issue preclusion bars "successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment, *even if the issue recurs in the context of a different claim*." *Taylor v. Sturgell*, 553 U.S. 880, 892 (2008) (emphasis added); *see also Peloro v. United States*, 488 F.3d 163, 174 (3d Cir. 2007) (same). The issues of whether HERA bars all claims seeking equitable relief and all shareholder derivative claims, notwithstanding an alleged conflict of interest, were actually litigated in *Perry Capital* and were necessary for that court's dismissal of the derivative claims. *Perry Capital*, 70 F. Supp. 3d at 224-32. Plaintiffs do not argue otherwise. Thus, they are barred from relitigating those issues here, even under the guise of a different derivative claim.[9]

Second, plaintiffs are incorrect that prior dismissals for lack of standing, including *Perry Capital*, are not "on the merits" and do not bar subsequent derivative suits. Opp. at 58-59. "It has long been the rule that principles of res judicata apply to jurisdictional determinations—both subject matter and personal." *Ins. Corp. of Ireland v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 702 (1982) ; *see also Hill v. Potter*, 352 F.3d 1142, 1146-47 (7th Cir. 2003)

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[9] Plaintiffs' reliance on the D.D.C.'s *Rafter* order, Opp. at 57, is inapt: whether the court's conclusion in *Perry Capital* that the contract claims were derivative can be characterized as a holding vs. *dicta* is irrelevant since the court also considered and dismissed *expressly* derivative claims as barred by HERA. That holding precludes plaintiffs' expressly derivative claims here.

("Dismissals for want of subject-matter jurisdiction . . . are preclusive with respect to the jurisdictional ruling") (Posner, J.). Furthermore, plaintiffs' citations to authority regarding dismissal for failure to meet statutory prerequisites, such as demand futility, or "failing to post a bond," are inapt. 7C Fed. Prac. & Proc. Civ. § 1840 (3d ed.) ("Wright & Miller"). When—as here—the underlying standing issue "is the same regardless of which shareholder brings suit," preclusion prevents relitigation of the question. *Arduini v. Hart*, 774 F.3d 622, 634 (9th Cir. 2014). Plaintiffs' reliance on *Smith v. Bayer Corp.*, 131 S. Ct. 2368 (2011) to suggest "due process" forecloses preclusion, Opp. at 59, likewise ignores a critical distinction between class actions and derivative suits. The derivative shareholder-plaintiff "is not seeking to enforce an individual right" but instead "is suing on behalf of the corporation" and binds the corporation as the real party in interest. Wright & Miller, § 1840.

Finally, plaintiffs complain in passing that they "cannot be presumed to have been on notice that their rights were at issue in" *Perry Capital*. Opp. at 58. But there is no "notice" requirement for issue preclusion to apply to subsequent derivative actions. *See Arduini*, 774 F.3d at 637-38. Courts routinely apply issue preclusion in subsequent derivative actions without considering notice. *See Cottrell v. Duke*, 737 F.3d 1238 (8th Cir. 2013); *In re Sonus Networks, Inc, S'holder Derivative Litig.*, 499 F.3d 47, 64 (1st Cir. 2007).

CONCLUSION

For the foregoing reasons, and for those stated in the reply brief of FHFA, the Court should grant the motions to dismiss.

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Respectfully submitted,

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