IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

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

REPLY IN SUPPORT OF PLAINTIFFS' APPLICATION FOR CERTIFICATION TO THE DELAWARE AND VIRGINIA SUPREME COURTS OF NOVEL AND UNDECIDED ISSUES OF STATE LAW

Plaintiffs David Jacobs and Gary Hindes, on behalf of themselves and all others similarly situated, and derivatively on behalf of the Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac," and, together with Fannie Mae, the "Companies"), hereby submit this reply in support of their application requesting this Court to certify novel and undecided questions of state law (the "State Law Questions") to the Delaware and Virginia Supreme Courts (the "Certification Motion").[1]

[1] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Certification Motion and/or in Plaintiffs' Brief in Opposition to Defendants' Motions to Dismiss.

Defendants Federal Housing Finance Agency ("FHFA"), in its capacity as conservator of the Companies, and United States Department of the Treasury ("Treasury") oppose the Certification Motion largely by referring to the arguments set forth in their briefing in support of their motions to dismiss. For the reasons stated in Plaintiffs' Brief in Opposition to Defendants' Motions to Dismiss, which Plaintiffs hereby incorporate by reference, the arguments that Defendants have raised in support of their motions to dismiss fail on their merits and do not warrant the denial or delay of the Certification Motion.

Defendants make two arguments in opposition to the Certification Motion. *First*, Defendants argue that the State Law Questions are not outcome determinative because Plaintiffs' claims are precluded by federal law. Defs.' Opp. at 2-3. *Second*, Defendants argue that "[t]his case does not involve novel issues of first impression likely to have broad implications beyond this case[.]" Defs.' Opp. at 5. Both of these arguments are meritless and should be rejected.

Defendants first argue that before reaching the merits of the questions Plaintiffs seek to have certified, the Court will be required to determine whether Plaintiffs' claims are precluded by "(1) the jurisdiction-withdrawal provision contained in 12 U.S.C. § 4617(f), . . . (2) FHFA's succession to all shareholder rights during conservatorship, . . . and (3) Treasury's sovereign immunity and the intergovernmental immunity component of the Supremacy Clause." Defs.' Opp. at 2-3. But that is not so.[2] The Supreme Court, to be sure, has held that "Article III jurisdiction is always an antecedent question" that must be addressed before the merits of a case. *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 101 (1998). But here, the "triad of injury in fact, causation, and redressability," which "constitute[ ] the core of Article III's case-or-

[2] Even if the Court were inclined to decide these issues first, the Court still should then certify the State Law Questions to the Delaware and Virginia Supreme Courts in order to assist the Court in deciding the remaining issues presented by the motions to dismiss.

controversy requirement," *id*. at 103-04 (footnote omitted), has not and cannot seriously be contested: The Net Worth Sweep willfully, wrongfully, and inequitably destroyed Plaintiffs' economic interest in Fannie Mae and Freddie Mac, and the relief that they seek would redress that harm. The defenses that Defendants cite do not alter this conclusion, and they need not be addressed before their defenses on the merits.

When applicable, the first provision cited by Defendants, 12 U.S.C. § 4617(f), simply limits the *relief* a court may grant ("no court may take any action to restrain or affect the exercise of powers or functions of the Agency as a conservator or receiver"); it does not oust a court of *jurisdiction* to hear a case altogether. "In recent years, the Supreme Court has been especially critical of courts' 'profligate' and 'less than meticulous' use of the term" jurisdiction. *Animal Science Products, Inc. v. China Minmetals Corp.*, 654 F.3d 462, 466 (3d Cir. 2011) (quoting *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 511 (2006)). Congress must "clearly state" limitations it places on courts' jurisdiction, *Sebelius v. Auburn Reg'l Med. Ctr*., 133 S. Ct. 817, 824 (2013), and limiting the relief courts may grant generally does not suffice. Indeed, the Supreme Court has explained that it is "unreasonable to read" as jurisdictional a statute "merely specifying the remedial powers of the court." *Steel Co.*, 523 U.S. at 90; *see also Avco Corp. v. Aero Lodge No. 735*, 390 U.S. 557, 561 (1968); *Davis v. Passman*, 442 U.S. 228, 239 n.18 (1979). Any such conclusion would be particularly unreasonable in the context of HERA, which elsewhere expressly ousts courts of jurisdiction to hear certain claims against FHFA acting as receiver. *See* 12 U.S.C. § 4617(b)(11)(D). "The unambiguous jurisdictional terms of [§ 4617(b)(11)(D)] show[s] that Congress would have spoken in clearer terms if it intended [§ 4617(f)] to have similar jurisdictional force." *See Gonzalez v. Thaler*, 132 S. Ct. 641, 649 (2012); *see also*

Musacchio v. United States, 136 S. Ct. 709, 717 (2016).[3] Because the § 4617(f) issue is not a jurisdictional one, the Court is free to bypass it to address other merits issues.

Even if § 4617(f) were jurisdictional (which it is not), federal courts routinely certify questions of state law where the answer to such questions could determine federal jurisdiction. *See, e.g., Leck v. Cont'l Oil Co.*, 892 F.2d 68 (10th Cir. 1989) (after certifying questions of state law to, and receiving answers from, the Oklahoma Supreme Court regarding jurisdictional question, reversing the district court's dismissal of action for lack of subject matter jurisdiction). Here, the answers to the State Law Questions will demonstrate the inapplicability of § 4617(f). As explained in Plaintiffs' Brief in Opposition to Defendants' Motions to Dismiss (*see* pp. 35-37), because the Net Worth Sweep violates Delaware and Virginia corporate law, the rules of decision for purposes of the Companies' corporate governance, FHFA exceeded and violated its statutory authority under HERA by implementing the Net Worth Sweep. Thus, if the Delaware and Virginia Supreme Courts answer the State Law Questions in the negative (*i.e.*, the corporate laws of Delaware and Virginia do not permit a preferred stock dividend right like the Net Worth Sweep), then § 4617(f) would have no application here.[4]

[3] Interpreting § 4617(f) as not affecting the Court's jurisdiction is also consistent with the Third Circuit's treatment of FIRREA's analogous provision, 12 U.S.C. § 1821(j). *See, e.g., Gross v. Bell Sav. Bank PaSA*, 974 F.2d 403, 406 n.7 (3d Cir. 1992) (court analyzed case "under § 1821(j), *rather than* under the jurisdictional aspects of § 1821(d)(13)(D)" (emphasis added)).

[4] Section 4617(f) also cannot be read in the manner Defendants suggest because it would vest FHFA with "unreviewable power to do as it pleases." *Rechler P'ship v. Resolution Trust Corp.*, 1990 WL 711357, at *4 (D. N.J. Sept. 7, 1990). Fannie Mae and Freddie Mac opted to be governed by Delaware and Virginia law, respectively, for purposes of their corporate governance, and Defendants elected to apply those state laws to the PSPAs. Defendants now claim that § 4617(f) bars this Court from deciding the validity of a provision in those contracts under those state laws. That is, Defendants effectively argue that HERA permits FHFA to enter into state law contracts while violating applicable state law with impunity. That cannot be—and is not—the law. *See id.*

Like § 4617(f), the second provision cited by Defendants—which provides that upon appointment as conservator FHFA "immediately succeed[ed] to . . . all rights . . . of any stockholder . . . with respect to [Fannie Mae and Freddie Mac] and [their] assets," 12 U.S.C. § 4617(b)(2)(A)—does not mention the Court's subject-matter jurisdiction. Nor does it deprive Plaintiffs of Article III standing. The Net Worth Sweep effectively destroyed Plaintiffs' stock, and there is no question that that stock survived imposition of conservatorship and FHFA's succession to certain stockholder rights. *See, e.g.*, Compl. ¶¶ 5-6; Statement of FHFA Director James B. Lockhart at News Conference Announcing Conservatorship of Fannie Mae and Freddie Mac (Sept. 7, 2008), http://goo.gl/vfGuQ7 ("[T]he common and all preferred stocks will continue to remain outstanding."). Rather than depriving Plaintiffs of constitutional standing, § 4617(b)(2)(A) simply limits their ability to assert certain claims during conservatorship.[5] This at most is akin to a question of statutory standing, and such questions need not be addressed before other merits issues. *See Bowers v. Nat'l Collegiate Athletic Ass'n*, 346 F.3d 402, 415 (3d Cir. 2003).

Treasury's purported sovereign immunity from suit likewise need not be addressed before reaching the merits.[6] As an initial matter, FHFA has not invoked sovereign immunity. Therefore, regardless of whether Treasury's immunity argument is valid (and it is not), the issues Plaintiffs seek to have certified may still be reached with respect to FHFA—and, potentially, be extended to Treasury despite the immunity assertion. *See Starkey ex rel. A.B. v. Boulder County Social Services*, 569 F.3d 1244, 1260-63 (10th Cir. 2009) (reaching merits of plaintiffs' claims

[5] As Plaintiffs have explained in their opposition to the motions to dismiss, § 4617(b)(2)(A) does not preclude the claims Plaintiffs assert here. But for the reasons explained in the text, the Court need not decide that issue before the issues raised in the Certification Motion.

[6] Treasury's "intergovernmental immunity" argument does not address jurisdiction but rather whether the Supremacy Clause precludes Plaintiffs' claims on the merits. *See* Tr. MTD Br. 22. It thus clearly does not need to be addressed before any other merits argument.

without deciding defendants' immunity argument). Furthermore, it is not clear that this Court must address immunity before the merits even with respect to Treasury. Although the issue has split the circuits, the Third Circuit has held that *Steel Co.* does not preclude courts from bypassing issues of *state* sovereign immunity under the Eleventh Amendment to reach the merits. *Bowers*, 346 F.3d at 418. Using similar reasoning, the D.C. Circuit has held that the same is true with respect to federal sovereign immunity, *see In re Sealed Case No. 99-3091*, 192 F.3d 995, 1000-01 (D.C. Cir. 1999), and this Court should do the same. At this point, however, the Court need not reach the issue because, as just explained, the sovereign-immunity defense at most shields Treasury, not FHFA.

Finally, contrary to Defendants' contentions, this Court should certify the State Law Questions to the Delaware and Virginia Supreme Courts because the answers to these questions will have broad implications stretching far beyond this case, affecting every Delaware and Virginia stock corporation and their directors, officers, and stockholders. While Defendants attempt to portray this case as presenting a "unique fact pattern . . . unlikely to recur," *see* Defs.' Opp. at 5, that simply is not true. The Delaware and Virginia courts routinely handle cases challenging corporate transactions that benefit a single, controlling stockholder at the expense of all other stockholders. Though we have never before seen a preferred stock dividend right such as the Net Worth Sweep—indeed, that fact, in and of itself, says all that needs to be said about its legality as a matter of corporate law—it nevertheless remains a structural concept that controlling stockholders of other corporations subject to Delaware and Virginia corporate law might attempt to seize upon to unfairly eliminate the economic interests of minority stockholders if its invalidity is not swiftly confirmed. Certifying the State Law Questions now to the Delaware and Virginia Supreme Courts will allow those courts to provide guidance to directors

of every Delaware and Virginia stock corporation that they may not unilaterally contract away all of the net worth and profits of the corporation for all time to a single preferred stockholder.

The facts that Treasury is the preferred stockholder here and that the Companies are in conservatorship do not make it unlikely that a Net Worth Sweep-like preferred stock dividend right will be seen again. Rather, that our federal government would so cavalierly impose such an illegal and inequitable preferred stock dividend provision on the Companies and their other stockholders makes it all the more likely that private, for-profit parties would do so as well absent decisions from the Delaware and Virginia Supreme Courts confirming the invalidity of such provisions under those states' corporate laws. Indeed, the federal government's actions here, as conservator and preferred stockholder, serve as an imprimatur for such invalid action that is not present when private parties play the same roles. If these actions are allowed to stand, private parties governed by Delaware and Virginia corporate law will copy it freely, on the grounds that "the government did it so we can too." Whatever moral authority the federal government purports to bring to the situation cannot be used to violate state corporate laws that federal law does not preempt. To the contrary, the federal government, for all its public responsibilities, deserves to be held to a higher, and not a lower, standard of conduct than private parties in similar situations.

For the reasons set forth above and in the Certification Motion, the Court should grant the Certification Motion and certify the State Law Questions to the Delaware and Virginia Supreme Courts in accordance with Del. Supr. Ct. R. 41 and Del. Const. Art. IV, § 11(8), and Va. Supr. Ct. R. 5:40(a) and Va. Const. Art. VI, § 1, respectively.

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