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Case No. 12105-

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

TIMOTHY J. PAGLIARA, Plaintiff, v. FEDERAL NATIONAL MORTGAGE ASSOCIATION, Defendant.	)))))))))))	C.A. No. __________

VERIFIED COMPLAINT

Plaintiff Timothy J. Pagliara (the "Stockholder"), by and through his undersigned counsel, brings this Verified Complaint against the Federal National Mortgage Association ("Fannie Mae") for books and records, pursuant to Section 220 of the Delaware General Corporation Law ("DGCL"). In support of his claims, the Stockholder alleges as follows:

NATURE OF THE ACTION

1. By this action, the Stockholder requests that the Court permit the Stockholder to inspect the books and records of Fannie Mae that are sought by the Stockholder's demand dated January 19, 2016 (the "Demand") (Exhibit A hereto). Fannie Mae had no legitimate basis to refuse the Demand.

2. Since its privatization decades ago, Fannie Mae has been a private corporation, governed by Delaware law, with private stockholders and a board of

directors (the "Board"). Although it is now under temporary conservatorship (the "Conservatorship"), Fannie Mae has not changed: *First*, the statute that authorized the Conservatorship, the Housing and Economic Recovery Act of 2008 ("HERA"), expressly preserved Fannie Mae's status as a private corporation and the interests of Fannie Mae's private stockholders. *Second*, HERA did not change Fannie Mae's governing Delaware law. It rather gave the conservator, the Federal Housing Finance Agency ("FHFA"), authority to use powers governed by Delaware law: some of the pre-existing powers of Fannie Mae and its stockholders, Board and management. *Finally*, after initially succeeding under HERA to some of the Board's powers, FHFA promptly re-delegated the powers back to the Board.

3. The Demand fully satisfied Delaware law's requirements for a stockholder's inspection of corporate books and records. *First*, it satisfied Section 220's formal requirements: It stated the Stockholder's status as a stockholder, was accompanied by evidence of beneficial ownership, and stated that such evidence was a true and correct copy of what it purported to be. *Second*, it stated proper purposes: to investigate misconduct by the Board and others, communicate with other stockholders about the misconduct and value the Stockholder's investment in Fannie Mae. *Finally*, as required to substantiate the investigatory purpose, it set forth credible bases to believe that the misconduct to be investigated had occurred.

The Court therefore should summarily order Fannie Mae to comply with the Demand.

4. The Demand detailed the Stockholder's credible bases to suspect wrongdoing in certain unlawful and inequitable transactions:

5. *First*, at the behest of Fannie Mae's controlling stockholder, the United States Department of the Treasury ("Treasury"), the Board either approved or failed to take reasonable steps to prevent the third amendment to Fannie Mae's Amended and Restated Senior Preferred Stock Purchase Agreement with Treasury (the "Third Amendment"). This transaction between Fannie Mae and its controlling stockholder was grossly unfair to Fannie Mae and violated the DGCL.

6. *For no return consideration to Fannie Mae whatsoever*, the Third Amendment massively increased the dividend on Treasury's preferred stock in Fannie Mae (the "Senior Preferred Stock"). The dividend was increased from 10% in cash (12% in stock) per annum to Fannie Mae's *entire net worth* in perpetuity (the "Net Worth Sweep"). Since its adoption, the Third Amendment has increased the dividends paid to Treasury by $78.2 billion.

7. When the Third Amendment was adopted, the Board knew that the Third Amendment was blatantly unfair to Fannie Mae. It knew that Fannie Mae's entire future net worth would be far greater than the annual dividend of 10% in cash (or 12% in stock). As detailed herein, when the Third Amendment was

adopted, Fannie Mae stood on the precipice of enormous income: it expected historically high profits for the foreseeable future and a massive increase in its net worth from the reversal of its prior write-offs of deferred tax assets and increases in loss reserve.

8. There could be no scenario in which the Net Worth Sweep would be better for Fannie Mae than the pre-existing dividend. Nothing could be worse for Fannie Mae and its stockholders than the forfeiture of Fannie Mae's entire net worth.

9. In approving or acquiescing in the Third Amendment or simply failing to oppose it, the Board breached its fiduciary duty of loyalty. The books and records sought by the Demand will allow the Stockholder to investigate the manner in which the Board breached this duty. Under Delaware law, a board breaches its fiduciary duty of loyalty if it approves or acquiesces in a transaction with a controlling stockholder that is not entirely fair to the corporation. The Board apparently did not oppose the Third Amendment internally, did not oppose the Third Amendment publicly and did not seek declaratory or injunctive relief to prevent it. A board may not sit idly by while a controlling stockholder loots the corporation.

10. In approving or acquiescing in the Third Amendment, the Board also committed statutory and contractual breaches. As detailed herein, the Third

Amendment violated Sections 242(b)(2) and 151 of the DGCL and the certificates of designation for the junior preferred stock (the "Junior Certificates").

11. *Second*, after the Third Amendment, the Board further breached its fiduciary duty to protect Fannie Mae from harm. After the Third Amendment, the Board had ample time, more than seven months, to protect Fannie Mae from the first of the dividends under the Net Worth Sweep, and the Board remains able to stop the New Worth Sweep at any time. Nonetheless, the Board has failed to take any action to protect Fannie Mae from the Net Worth Sweep. As detailed herein, due to its massive profitability and enormous balance sheet, Fannie Mae could easily have refinanced and redeemed the Senior Preferred Stock, or the Board could have sought judicial intervention to halt the Net Worth Sweep. But the Board has done nothing.

12. *Third*, since the Third Amendment, the Board has breached both fiduciary and statutory duties in apparently approving the payment of the dividends under the Net Worth Sweep. Under the DGCL, the Federal National Mortgage Association Charter Act (the "Charter Act") (the statute that created Fannie Mae) and even the Third Amendment, there is no requirement that Fannie Mae declare and pay dividends under the Net Worth Sweep. All three leave that decision to the Board's discretion. The Board nonetheless apparently approved tens of billions of dollars of dividends under the Net Worth Sweep to benefit Treasury at Fannie

Mae's expense. A board breaches its fiduciary duty when it approves dividends payable under an agreement that is void or voidable. The Board's approval of unnecessary dividends to Treasury constituted further unfair transactions with a controlling stockholder.

13. In approving the dividends, the Board also apparently breached Section 170 of the DGCL. The publicly available information suggests that the capital for Fannie Mae's preferred stock was impaired for all the dividends under the Net Worth Sweep. Section 170 prohibits the payment of dividends under such circumstances. The DGCL explicitly imposes liability on the Board for the resulting harm to Fannie Mae.

14. Even if the dividends were somehow paid without the Board's approval, the Board failed to oppose them, such as by directing Fannie Mae's personnel not to pay them, stating its opposition to them or seeking declaratory or injunctive relief. Such failures also constitute breaches of fiduciary duty.

15. *Finally*, the Board breached its fiduciary duty of loyalty by approving Fannie Mae's multi-million dollar investments in Common Securitization Solutions, LLC ("CSS"), the Common Securitization Platform (the "CSP") and the single security (the "Single Security"). These investments were approved not for Fannie Mae's financial benefit, but to further federal policy objectives. Not only does Fannie Mae have no obligation to gratuitously fund these government

projects, but the Board knew that the investments will harm Fannie Mae by eliminating its competitive advantage over its principal competitor, the Federal Home Loan Mortgage Corporation ("Freddie Mac"). The Board breached its fiduciary duty of loyalty by approving or not opposing these investments.

16. The Demand states credible bases for believing that the Board and others have engaged in misconduct. The Stockholder respectfully requests that the Court summarily enter an order permitting the Stockholder to inspect the books and records sought in the Demand.

* * *

17. As demonstrated by the Demand and this detailed complaint, there is much that the Stockholder knows about the transactions that are the subject of his Demand. There also is much that the Stockholder may reasonably infer from what he knows. Nonetheless, there is much that the Stockholder does not know about the transactions, particularly concerning the Board's analysis of and participation in the transactions.

18. For example, the Stockholder does not know whether the Board expressly approved the Third Amendment, opposed it internally or simply stood idly by while it was effectuated. The Stockholder also does not know whether the Board affirmatively approved the dividends paid pursuant to the Net Worth Sweep,

opposed them internally or simply let them be paid. The Demand seeks books and records to answer these questions and many others.

JURISDICTION

19. This Court has jurisdiction over this action pursuant to Section 220 of the DGCL because, through this action, the Stockholder seeks the inspection of books and records of a corporation under Delaware law.

THE PARTIES

I. Timothy J. Pagliara

20. The Stockholder, Mr. Pagliara, is the founder, Chairman and Chief Executive Officer of CapWealth Advisors LLC, an SEC-registered investment advisory firm in Franklin, Tennessee. CapWealth Advisors LLC manages over $1 billion in client assets and provides wealth management services for individuals, families, foundations and institutions. The Stockholder is also the founder of Investors Unite, a non-profit coalition that facilitates discussion and information exchange concerning Fannie Mae. The Stockholder brings this action in his personal capacity as an individual stockholder.

21. The Stockholder purchased 202,300 shares of Fannie Mae Series S preferred stock, with a total liquidation preference of approximately $5.1 million, on September 12, 2008; 33,750 shares of Fannie Mae Series S preferred stock, with a total liquidation preference of approximately $844,000, and 84,375 shares of Fannie Mae Series T preferred stock, with a total liquidation preference of

approximately $2.1 million, on November 3, 2009; and 86,600 shares of Fannie Mae Series T preferred stock, with a total liquidation preference of approximately $2.2 million, on December 15, 2010. He has held these shares continuously since these purchases.

II. Fannie Mae

22. Fannie Mae is a federally chartered, publicly-traded, for-profit corporation governed by Delaware law, with its principal office in the District of Columbia.

23. Fannie Mae's Board currently consists of the following persons: Egbert L. J. Perry, director since December 2008 and Chairman of the Board since March 2014; Amy E. Alving, since October 2013; William T. Forrester, since December 2008; Hugh R. Frater, since January 2016; Brenda J. Gaines, since September 2006; Renee L. Glover, since January 2016; Frederick B. Harvey III, since August 2008; Robert H. Herz, since June 2011; Diane C. Nordin, since November 2013; Jonathan Plutzik, since November 2009; and David H. Sidwell, since December 2008. Each of Fannie Mae's directors is paid between $160,000 and $290,000 annually for serving on the Board.

24. Timothy J. Mayopoulos, Fannie Mae's President and Chief Executive Officer, has also been a director since June 2012. Mr. Mayopoulos's annual base salary is $600,000.

III. Freddie Mac

25. Freddie Mac was established by the Federal Home Loan Mortgage Corporation Act. Like Fannie Mae, Freddie Mac is a federally chartered, publicly-traded, private corporation. Freddie Mac is subject to many of the same regulations as Fannie Mae and was involved in certain of the events to be investigated through the Demand.

FACTUAL BACKGROUND

I. Fannie Mae's Predecessor Was Formed in 1938

26. In 1938, the United States Congress ("Congress") amended the National Housing Act (the "NHA") to authorize the creation of "national mortgage associations" to (1) "make real-estate loans[,]" (2) "purchase, service, or sell any mortgages, or partial interests therein," (3) "purchase, service, or sell uninsured first mortgages and such other liens" and (4) "[t]o borrow for any of the foregoing purposes through the issuance of notes, bonds, debentures, or other such obligations as hereinafter provided." Pub. L. No. 423, § 301, 52 Stat. 23 (1938). Pursuant to the amended NHA, the Federal Housing Administration chartered the National Mortgage Association, Fannie Mae's predecessor, "to assist private markets in providing a steady supply of funds for housing."[1]

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[1] Office of Management and Budget, *The Budget For Fiscal Year 2010, Government-Sponsored Enterprises* 1339 (2010), *available at*

27. On July 1, 1948, Congress amended the NHA again, this time to "[e]stablish[] [the] Federal National Mortgage Association" (Fannie Mae), by statute. Pub. L. No. 864, § 301, 62 Stat. 1207 (1948).

28. In 1954, Congress began the process of privatizing Fannie Mae through the Charter Act. The Charter Act's purposes included "establish[ing] in the Federal Government a secondary market facility for home mortgages" while "provid[ing] that the operations of such facility shall be financed by private capital to the maximum extent feasible[.]" Pub. L. No. 560, § 301, 68 Stat. 612 (1954).

29. The Charter Act reorganized Fannie Mae as a mixed ownership corporation. "Initial capital [for Fannie Mae] was subscribed for by the Secretary of the Treasury (approximately $10 million) and preferred stock was issued to the Treasury."[2] "[L]enders selling mortgages to [Fannie Mae] in its secondary market functions [were required] to make capital contributions to [Fannie Mae] equal to not less than 3 percent of the unpaid principal amount of the mortgages involved, or such greater percentages as might be determined[,]" and "[c]ommon stock was

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https://www.gpo.gov/fdsys/pkg/BUDGET-2010-APP/pdf/BUDGET-2010-APP-4.pdf.

[2] Congressional Research Service, Library of Congress, *A Chronology of Housing Legislation and Selected Executive Actions*, *1892-2003*, § IV (Mar. 2004), *available at* https://www.gpo.gov/fdsys/pkg/CPRT-108HPRT92629/html/CPRT-108HPRT92629.htm (hereinafter "A Chronology of Housing Legislation").

to be issued to the mortgage sellers as evidence of their capital contributions."[3] Initially, all of Fannie Mae's stock was non-voting.

30. The Charter Act authorized Fannie Mae to provide services that the private sector was not then providing. Fannie Mae was explicitly authorized to:

> (a) provide supplementary assistance to the secondary market for home mortgages by providing a degree of liquidity for mortgage investments, thereby improving the distribution of investment capital available for home mortgage financing; (b) provide special assistance . . . for the financing of (1) selected types of home mortgages . . . originated under special housing programs designed to provide housing of acceptable standards at full economic costs for segments of the national population that are unable to obtain adequate housing under established home financing programs, and (2) home mortgages generally as a means of retarding or stopping a decline in mortgage lending and home building activities . . . ; and (c) manage and liquidate the existing mortgage portfolio of [Fannie Mae] in an orderly manner, with a minimum of adverse effect upon the home mortgage market and minimum loss to the Federal Government.

Pub. L. No. 560, § 301, 68 Stat. 612-13 (1954). Under the Charter Act, Fannie Mae was controlled by the Housing and Home Finance Agency (the "HHFA") and directors appointed by HHFA. Pub. L. No. 560, § 308(a), 68 Stat. 620 (1954).

31. The Charter Act called for certain of Fannie Mae's operations to become "fully self-supporting" and separately provided that certain of Fannie Mae's obligations "are not guaranteed by the United States and do not constitute a

[3] A Chronology of Housing Legislation § IV.

debt or obligation of the United States or of any agency or instrumentality thereof . . . ." Pub. L. No. 560, §§ 304(a)-(b), 305(b), 306(b), 68 Stat. 615-18 (1954).

32. The Charter Act further provided for an eventual transition to full private ownership of Fannie Mae. It directed HHFA to,

> after all of the preferred stock of [Fannie Mae] held by the Secretary of the Treasury has been retired, . . . transmit to the President for submission to the Congress recommendations for such legislation as may be necessary or desirable . . . in order that such operations may thereafter be carried out by a privately owned and privately financed corporation.

Pub. L. No. 560, § 303(g), 68 Stat. 615 (1954).

II. Fannie Mae Was Fully Privatized Between 1968 and 1970

33. In 1968, as previewed by the Charter Act, the federal government privatized Fannie Mae as a Government-Sponsored Entity ("GSE"). Specifically, through the Housing and Urban Development Act of 1968 (the "HUD Act"), Congress reorganized Fannie Mae into "two separate and distinct corporations"[4]: (1) a "for-profit, shareholder-owned company[,]"[5] which continued to be known as Fannie Mae "to conduct the secondary mortgage market operations assigned to the

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[4] Pub. L. No. 90-448, § 801, 82 Stat. 536 (1968).

[5] FHFA Office of Inspector General, *A Brief History of the Housing Government-Sponsored Enterprises*, at 3, *available at* http://fhfaoig.gov/LearnMore/History (last visited Mar. 14, 2016).

previous [Fannie Mae],"[6] and (2) a government owned corporation, known as the Government National Mortgage Association (a/k/a Ginnie Mae). Pub. L. No. 90-448, §§ 801-02, 82 Stat. 536 (1968).

34. The HUD Act provided "for the repayment of capital stock held by the Treasury"[7] and converted the previously non-voting common stock held by private stockholders into voting common stock. "This reorganization removed Fannie Mae from the federal budget, and Fannie Mae began funding its operations through the stock and bond markets."[8] Fannie Mae completed its privatization in 1970. Since then, Fannie Mae has never ceased operating as a privately-owned, publicly-traded corporation.

35. As a private corporation, Fannie Mae is federally regulated by provisions in the Charter Act and was subject to regulations issued by the Department of Housing and Urban Development ("HUD") from 1968 to 2008. The Charter Act restricts what mortgages Fannie Mae can purchase. These restrictions are similar to regulations limiting the loans and extensions of credit a bank can extend to a single borrower. HUD has also issued regulations

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[6] A Chronology of Housing Legislation § V.

[7] A Chronology of Housing Legislation § V.

[8] FHFA Office of Inspector General, *A Brief History of the Housing Government-Sponsored Enterprises*, at 3 (footnote omitted), *available at* http://fhfaoig.gov/LearnMore/History (last visited Mar. 14, 2016).

encouraging Fannie Mae to promote low- and moderate-income housing. These regulations are similar to regulations issued by the Board of Governors of the Federal Reserve System to encourage banks to "meet the credit needs of the local communities," including low- and moderate-income neighborhoods. 12 C.F.R. § 228.11(b) (2011).

A. Fannie Mae is a publicly-traded corporation

36. When Fannie Mae's privatization was completed in 1970, Fannie Mae's common stock began trading on the New York Stock Exchange ("NYSE"). Since then, Fannie Mae has issued to private stockholders additional common stock and numerous series of preferred stock, all of which remain freely transferable to this day. In 1988, Fannie Mae was added to the Standard & Poor's 500 Index.

37. In March 2003, Fannie Mae voluntarily registered its common stock and began filing financial reports with the U.S. Securities and Exchange Commission (the "SEC").

38. According to Fannie Mae's 10-K for 2015, as of January 1, 2016, Fannie Mae had 1,158,082,750 shares of common stock, as well as the following classes and shares of preferred stock, outstanding to private stockholders:

Series of Preferred Stock Issued	Amount Outstanding	Liquidation Preference Per Share[9]	Aggregate Liquidation Preference[10]
Series D	3,000,000	$50	$150,000,000
Series E	3,000,000	$50	$150,000,000
Series F	14,000,000	$50	$690,000,000
Series G	6,000,000	$50	$288,000,000
Series H	8,000,000	$50	$400,000,000
Series I	6,000,000	$50	$300,000,000
Series L	7,000,000	$50	$345,000,000
Series M	9,000,000	$50	$460,000,000
Series N	5,000,000	$50	$225,000,000
Series O	50,000,000	$50	$2,500,000,000
Convertible Series 2004-1	24,922	$100,000	$2,492,000,000
Series P	40,000,000	$25	$1,000,000,000
Series Q	15,000,000	$25	$375,000,000
Series R	21,000,000	$25	$530,000,000
Series S	280,000,000	$25	$7,000,000,000
Series T	89,000,000	$25	$2,225,000,000
TOTAL	556,024,922	N/A	$19,130,000,000

B. Fannie Mae is governed by its Board

39. Under the Charter Act, Fannie Mae's Board is responsible for overseeing Fannie Mae. The Charter Act provides:

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[9] In each case, the liquidation preference equals the stated amount plus the dividend (whether or not declared) accrued for the then-current quarterly dividend period.

[10] The figures provided in this chart are copied from page F-51 of Fannie Mae's 10-K for 2015. With the exception of the figure for the amount outstanding of Convertible Series 2004-1 and the liquidation preference per share, Fannie Mae has rounded the figures to the nearest million.

> Within the limitations of law and regulation, the board shall determine the general policies which shall govern the operations of the corporation, and shall have the power to adopt, amend, and repeal bylaws governing the performance of the powers and duties granted to or imposed upon it by law. The board of directors shall select and effect the appointment of qualified persons to fill the offices of president and vice president, and such other offices as may be provided for in the bylaws.

12 U.S.C. § 1723 (2008).

C. Fannie Mae is a commercially successful business

40. Fannie Mae is fully self-supporting, through a diversified business handling multiple aspects of securitizing and guaranteeing mortgages.

41. Fannie Mae holds a commanding position in the mortgage securitization market: it purchases mortgages from large institutions, including mortgage banking companies, investment banks, commercial banks, credit unions, community banks, insurance companies and state and local finance agencies. It then packages these mortgages into mortgage-backed securities ("MBS") and sells them to private investors. Fannie Mae guarantees, for a fee, the performance of the MBS that it sells. It also operates a multifamily mortgage business, using its proprietary "Underwriting and Servicing Platform."

42. Freddie Mac and other private financial institutions compete with Fannie Mae in the mortgage securitization market. But, Fannie Mae's MBS trade at a premium in the market over any other MBS, including the MBS created and

sold by Freddie Mac. Fannie Mae's March 31, 2008 10-Q estimated that Fannie Mae's new single-family mortgage-related securities issuances market share was 50.1%.

D. Fannie Mae is governed by Delaware law

43. In 2002, Fannie Mae's then-regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO"), by regulation, directed Fannie Mae to "follow the corporate governance practices and procedures of the law of the jurisdiction in which the principal office of [Fannie Mae] is located, as amended; Delaware General Corporation Law, Del. Code Ann. tit. 8, as amended; or the Revised Model Business Corporation Act, as amended." 12 C.F.R. § 1710.10 (2002).

44. Through its bylaws, Fannie Mae "elected to follow the applicable corporate governance practices and procedures of the Delaware General Corporation Law, as the same may be amended from time to time."[11] Fannie Mae's inclusion of this provision in its bylaws "constitute[d] inclusion in the corporation's 'certificate of incorporation' for all purposes of the Delaware General Corporation Law."[12]

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[11] Fannie Mae Bylaws (am. through Jan. 30, 2009) § 1.05 (Exhibit B hereto).

[12] *Id.*

45. Consistent with this election, on August 21, 2002, Fannie Mae filed a certificate of incorporation in Delaware (Exhibit C hereto).[13] Fannie Mae therefore has been a Delaware corporation governed by Delaware law since 2002.

III. Fannie Mae Remained Profitable Leading up to the Financial Crisis

46. In the years leading up to the 2007-2009 financial crisis (the "Financial Crisis"), Fannie Mae was a highly profitable enterprise that regularly declared and paid dividends to its stockholders. As reported in Fannie Mae's SEC filings, it earned net income of $8.1 billion in 2003, $5 billion in 2004, $6.3 billion in 2005 and $4.1 billion in 2006. According to Fannie Mae's 10-K for 2006, as of December 31, 2006, Fannie Mae's mortgage portfolio was valued at $728.9 billion, and its combined mortgage credit book of business was $2.526 trillion.

47. Fannie Mae's Board exercised its discretion under Section 170 of the DGCL "to declare and pay dividends upon the shares of its capital stock." Fannie Mae distributed approximately $1.8 billion in dividends in 2003, $2.2 billion in dividends in 2004, $1.4 billion in dividends in 2005, $1.7 billion in dividends in 2006 and $2.4 billion in dividends in 2007.

[13] After its incorporation in Delaware, Fannie Mae did not file annual reports with the Delaware Division of Corporations or pay franchise taxes. As a result, Fannie Mae is not currently in good standing with the Secretary of the State of Delaware.

IV. The Financial Crisis Imposed Losses on Fannie Mae

48. Although Fannie Mae suffered losses during the Financial Crisis, it remained solvent and well-capitalized. In the fourth quarter of 2007, Fannie Mae ended its long string of profitable quarters by recording a loss of $3.6 billion. In the first half of 2008, it recorded two additional consecutive losses – $2.2 billion and $2.3 billion. Even with these losses, as of June 30, 2008, per Fannie Mae's 10-Q for the second quarter of 2008, Fannie Mae still had core capital of $46.9 billion and net assets of $41.2 billion, well in excess of its regulatory requirements.

49. Due to legislative and regulatory restrictions, Fannie Mae's mortgage portfolio has always been more conservative than the overall American mortgage market. For example, "[l]oans serviced for [Fannie Mae and Freddie Mac] have a higher concentration of prime mortgages than mortgages serviced for private investors or held on the servicers' balance sheets and, as a result, have lower delinquencies and foreclosures in process."[14]

50. These risk moderation efforts proved effective, even at the height of the Financial Crisis. At the end of the third quarter of 2008, the percentage of mortgages in Fannie Mae's portfolio that was delinquent or in foreclosure had

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[14] Treasury, Comptroller of the Currency, *OCC and OTS Mortgage Metrics Report, First Quarter 2009*, at 16 (2009), *available at* http://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics/mortgage-metrics-q1-2009-pdf.pdf.

increased to only 2.4%, as compared to an overall delinquency or foreclosure rate of approximately 8.5% for first lien residential mortgages serviced by national banks and federally regulated thrifts. And, "by the end of 2008, [Fannie Mae and Freddie Mac securitized] mortgages were far less likely to be seriously delinquent than were non-GSE securitized mortgages: 6.2% versus 28.3%."[15]

51. On July 10, 2008, the Director of OFHEO, who would become FHFA's Director, James Lockhart, stated:

> [OFHEO] has been monitoring and continues to monitor closely Fannie Mae . . . and the mortgage and financial markets. . . .
>
> As I have said before, [Fannie Mae is] adequately capitalized, holding capital well in excess of OFHEO-directed requirement, which exceeds the statutory minimums. [Fannie Mae and Freddie Mac] have large liquidity portfolios, access to the debt market and over $1.5 trillion in unpledged assets.[16]

52. Despite its losses, between May and August of 2008, Fannie Mae successfully raised $7.4 billion in new funds through equity issuances and raised $3.5 billion through a three-year note sale in August 2008. In August 2008, Fannie

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[15] National Commission on the Causes of the Financial and Economic Crisis in the United States, *The Financial Crisis Inquiry Report*, at xxvi (Jan. 2011), *available at* https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

[16] Letter to the Honorable Jacob J. Lew, Secretary of the Treasury, from Ralph Nader (May 23, 2013), *available at* https://blog.nader.org/wp-content/uploads/2013/05/lew-5-18-13-11.pdf (quoting announcement).

Mae publicly stated that it was not seeking support from either Treasury or the Federal Reserve.

53. Nonetheless, Treasury had concluded that it should take control of Fannie Mae to manage the Financial Crisis. According to the former Secretary of Treasury, Henry M. Paulson, Jr., "[I had] come to the conclusion that taking [Fannie Mae] over was the best way to avert a meltdown, keep mortgage financing available, stabilize markets, and protect the taxpayer."[17]

V. In July 2008, Congress Passed HERA, Authorizing the Conservatorship and Granting FHFA Broad, but Still Limited, Powers Over Fannie Mae

54. In July 2008, at Treasury's urging, Congress enacted HERA, the Housing and Economic Recovery Act of 2008, to provide mortgage and financial markets with added security during the Financial Crisis.

55. Under HERA, Fannie Mae's regulator, OFHEO, was replaced by the newly created FHFA. If necessary, HERA authorized FHFA to put Fannie Mae, Freddie Mac and the "Home Loan Banks" into conservatorship (or receivership).

56. HERA granted FHFA two distinct roles with respect to Fannie Mae: that of regulator; and potentially that of conservator or receiver.

57. As regulator, FHFA has authority to modify or create regulations governing Fannie Mae and the other entities regulated by FHFA, but must follow a

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[17] Henry M. Paulson, Jr., *On the Brink: Inside the Race to Stop the Collapse of the Global Financial System* 3 (2013) (hereinafter "*On the Brink*").

specific process to do so. HERA provides that FHFA, as regulator, "may prescribe such regulations as the Agency determines to be appropriate regarding the conduct of conservatorships or receiverships." HERA § 1367(b)(1), 12 U.S.C. § 4617(b)(1) (2008). Any such regulations need to conform to the limitations imposed by HERA.

58. By FHFA's own explanations, any changes effected by regulation also (1) need to be published in the Federal Register, including justification and analysis, (2) need to be subject to public comment for 30-180 days, and (3) when published in final form, need to be accompanied by a response to the issues raised by public comments and an updated analysis and justification.

59. FHFA's powers as conservator do not require the same notice and comment period as required in FHFA's role as regulator. However, under HERA, FHFA is limited to exercising the powers of the regulated entity and its stockholders, board and management. As conservator, FHFA merely succeeded to their powers with respect to the regulated entity and its assets:

> (A) SUCCESSOR TO REGULATED ENTITY.—The Agency shall, as conservator or receiver, and by operation of law, immediately succeed to—
>
> (i) 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; and

> (ii) title to the books, records, and assets of any other legal custodian of such regulated entity.

HERA § 1367(b)(2)(A), 12 U.S.C. § 4617(b)(2)(A) (2008).

60. As the United States Court of Appeals for the Ninth Circuit recently explained:

> Nor does the [FHFA]'s conservatorship transform [the GSEs] into federal instrumentalities. We agree that the FHFA has "all the rights, titles, powers and privileges of" [the GSEs] . . . . However, this places FHFA in the shoes of [the GSEs], and gives the FHFA *their* rights and duties, not the other way around.

United States v. Aurora Loan Servs., Inc., No. 14-15031, slip op. at 6 (9th Cir. Feb. 22, 2016).

61. As FHFA merely stands in the shoes of the regulated entity and its stockholders, board and management, FHFA is subject to the same laws to which the latter are subject, including applicable corporation law. As conservator of Fannie Mae, FHFA therefore would be subject to the corporation law of Delaware.

62. HERA provides FHFA as conservator with only limited incidental powers. It grants FHFA authority to:

> (i) exercise all powers and authorities specifically granted to conservators or receivers, respectively, under this section, and such incidental powers as shall be necessary to carry out *such powers*; and
>
> (ii) take any action *authorized by this section,* which the Agency determines is in the best interests of the regulated entity or the Agency.

HERA § 1367(b)(2)(J), 12 U.S.C. § 4617(b)(2)(J) (2008) (emphasis added).

63. Under HERA, FHFA's powers as conservator may only be used for specifically stated purposes. FHFA may use them only as "(i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." HERA § 1367(b)(2)(D), 12 U.S.C. § 4617(b)(2)(D).

64. In particular, HERA requires that, when FHFA disposes of Fannie Mae's assets, it do so only for Fannie Mae's financial benefit:

> In exercising any right, power, privilege, or authority as conservator or receiver in connection with any sale or disposition of assets of a regulated entity for which [FHFA] has been appointed conservator or receiver, [FHFA] shall conduct its operations in a manner which—
>
> (i) maximizes the net present value return from the sale or disposition of such assets;
>
> (ii) minimizes the amount of any loss realized in the resolution of cases; and
>
> (iii) ensures adequate competition and fair and consistent treatment of offerors.

HERA § 1367(b)(11)(E), 12 U.S.C. § 4617(b)(11)(E) (2008).

VI. FHFA Placed Fannie Mae Into Conservatorship on September 7, 2008

A. Fannie Mae was placed into conservatorship to reassure the market

65. To reassure mortgage and financial markets and establish a conduit for Treasury to provide liquidity to such markets, Treasury caused FHFA to place Fannie Mae into conservatorship on September 7, 2008.

66. Although FHFA was the entity that formally placed Fannie Mae into conservatorship, it is clear that Treasury had controlled the decision. As former Treasury Secretary Paulson has explained, "I concluded that the only solution was to get FHFA to put the GSEs into receivership."[18] "[One] of the many actions I took" was "seizing control of the quasi-governmental mortgage giants, Fannie Mae and Freddie Mac[.]"[19] Former Representative Barney Frank said of the former Treasury Secretary, "he exercised th[e] conservatorship powers."[20]

67. The Conservatorship was not a response to some collapse in Fannie Mae's own financial condition. It rather was a response to the more general Financial Crisis. The Congressional Report on the imposition of the Conservatorship explained that:

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[18] *On the Brink* at 162.

[19] *Id.* at xiv.

[20] *Id.* at xli.

> Much of the current stress in housing and credit markets is based on uncertainty about the true values of mortgage-related financial instruments (and, of course, of houses themselves). As long as further declines are considered likely, market participants will be uncertain about each other's financial condition, and lending markets will remain tight. By intervening and in effect stating that it will bear any further losses to the GSEs (which hold a significant share of all home mortgage assets), the Treasury hopes to reduce that uncertainty and create conditions under which markets can return to normal.[21]

68. Contemporaneously with the commencement of the Conservatorship, Treasury directed Fannie Mae to *increase* its mortgage purchases, thereby *increasing* its mortgage portfolio by nearly $100 billion to $850 billion. In October 2008, Bloomberg News reported that Fannie Mae, consistent with this directive from Treasury, "began notifying bond traders . . . that [it] need[ed] to buy $20 billion a month in mostly subprime, Alt-A and non-performing prime mortgage securities."[22]

69. Had Fannie Mae's own financial condition been a concern, Treasury would not have directed Fannie Mae to expand its investment in the unstable

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[21] Mark Jickling, *CRS Report for Congress: Fannie Mae and Freddie Mac in Conservatorship*, at 5 (Sept. 15, 2008), *available at* http://www.readbag.com/fpc-state-documents-organization-110097.

[22] Dawn Kopecki, *Fannie, Freddie to Buy $40 Billion a Month of Troubled Assets*, Bloomberg News (Oct. 11, 2008).

housing market. Treasury rather did so to provide support and liquidity for the overall housing market.[23]

70. Michael J. Williams, Fannie Mae's President and CEO from 2009 to 2012, recognized that Fannie Mae's funding of the housing market during the financial crisis helped "families to buy, refinance or rent homes" and "reduc[ed] foreclosures that don't need to happen."[24]

B. The Conservatorship was to be temporary

71. Under HERA, the Federal Deposit Insurance Act, which HERA follows verbatim,[25] and common law, conservatorship is a process to stabilize a troubled institution with the objective of returning it to normal business operations.

72. FHFA's regulations state, a "conservator's goal is to continue the operations of a regulated entity, rehabilitate it and return it to a safe, sound and

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[23] Vikas Bajaj & Charles Duhigg, *Fannie Mae Loses $29 Billion on Write-Downs* (Nov. 10, 2008), http://www.nytimes.com/2008/11/11/business/economy/11fannie.html?_r=0; *see also* Dawn Kopecki, Bloomberg News, Oct. 11, 2008 ("Less than two weeks [after the Conservatorship's imposition], Fannie [Mae was] . . . told to ramp up [its] mortgage bond purchases as the financial crisis deepened and credit activity came to a near standstill.").

[24] *Remarks Prepared for Delivery by Michael J. Williams, President and Chief Executive Officer of Fannie Mae* (Apr. 8, 2010), *available at* http://www.fanniemae.com/portal/about-us/media/speeches/2010/speech-williams-drexel-univ.html.

[25] S*ee* 12 U.S.C. § 1821(d)(2)(D).

solvent condition."[26] Then-acting FHFA Director Edward J. DeMarco explained, the only "post-conservatorship outcome[] . . . that FHFA may implement today under existing law," "is to reconstitute [Fannie Mae] under [its] current charter[]."[27]

73. When the Conservatorship was imposed, Treasury agreed with this position: "Upon the Director's determination that the Conservator's plan to restore the Company to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship."[28]

74. Fannie Mae's stock was not canceled or redeemed when the Conservatorship was imposed. FHFA Director Lockhart assured Congress that Fannie Mae's "shareholders are still in place[,] . . . common shareholders have an economic interest in the companies" and that "going forward there may be some value" in that interest.[29]

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[26] Conservatorship and Receivership, 76 Fed. Reg. 35,724, 35,730 (June 20, 2011).

[27] Letter from Edward J. DeMarco, Acting Director, FHFA, to Chairmen and Ranking Members of the Senate Committee on Banking, Housing, and Urban Affairs and to the House Committee on Financial Services, at 7 (Feb. 2, 2010).

[28] OFHEO, *Fact Sheet*: *Questions and Answers on Conservatorship*, at 2 (Sept. 7, 2008), *available at* https://www.treasury.gov/press-center/press-releases/Documents/fhfa_consrv_faq_090708hp1128.pdf.

[29] Sept. 25, 2008, Hearing, U.S. House of Representatives, Committee on Financial Servs, H.R. Hrg. 110-142 at 29-30, 34.

C. Fannie Mae's Board was reconstituted and its powers restored

75. HERA authorizes FHFA, "by regulation or order," to "provide for the exercise of any function by any stockholder, director, or officer of any regulated entity for which the Agency has been named conservator or receiver." HERA § 1367(b)(2)(C), 12 U.S.C. § 4617(b)(2)(C) (2008).

76. Using this authority, FHFA reconstituted Fannie Mae's Board on November 24, 2008 and re-delegated to the Board the powers of the Board to which FHFA had succeeded when the Conservatorship took effect. FHFA announced that the Board would fulfill the same role as a typical corporate board, including overseeing compensation, audits and governance.

77. Among other authority, FHFA specifically empowered the Board to: "review and approve matters related to . . . (i) paying dividends or other distributions on or repurchasing Fannie Mae equity securities; (ii) issuing additional equity securities (except in limited instances); . . . (v) issuing subordinated debt; . . . [and] (vii) engaging in a non-ordinary course transaction with an affiliate, unless transaction terms are at least as favorable as those that could be obtained in an arm's length transaction with an unrelated third party[.]"[30]

[30] *Fannie Mae Corporate Governance Guidelines*, at 1 (Nov. 13, 2015), *available at* http://www.fanniemae.com/resources/file/aboutus/pdf/corpgovguidelines.pdf.

As these powers were governed by Delaware law, the Board's exercise of the powers remained governed by Delaware law.

78. Under the structure that FHFA established, the Board was required to "consult with and obtain the consent of the conservator[,]" for some actions.[31] Thus, FHFA could block Fannie Mae from taking some actions approved by the Board if consistent with FHFA's fiduciary duties. But, FHFA could not make the Board approve any action.

79. As recently as February 18, 2016, the current Director of FHFA, Melvin Watt, reiterated the Board's role overseeing the day-to-day operations of Fannie Mae and responsibility to "effectively run[]" Fannie Mae: the Board is "responsible – like boards of directors at other companies – for overseeing their business activities."[32]

80. Neither HERA nor any regulation passed pursuant to HERA, modified the Board's fiduciary or statutory duties to Fannie Mae and its stockholders.

[31] *Id.*

[32] *Prepared Remarks of Melvin L. Watt, Director of FHFA, at the Bipartisan Policy Center* (Feb. 18, 2016), *available at* http://www.fhfa.gov/Media/PublicAffairs/Pages/Prepared-Remarks-Melvin-Watt-at-BPC.aspx.

FHFA Director Watt publicly acknowledged, on February 18, 2016, that the Board continues to be "subject to corporate governance standards."[33]

VII. Treasury Bought Senior Preferred Stock From Fannie Mae As Soon As the Conservatorship Was Imposed

A. HERA authorized Treasury to invest in stock of Fannie Mae

81. HERA authorized Treasury, upon the commencement of Fannie Mae's Conservatorship, to invest in Fannie Mae stock until December 31, 2009. In exercising this limited authority, Treasury was required to consider "the need to maintain [Fannie Mae's] status as a private shareholder-owned company" and to "plan for the orderly resumption of private market funding or capital market access." HERA § 1117(g)(1)(C), 12 U.S.C. §1719(g)(1)(C) (2008).

82. HERA required that any investment by Treasury must be on terms agreeable to Fannie Mae: "Nothing in this subsection requires [Fannie Mae] to issue obligations or securities to the Secretary [of the Treasury] without mutual agreement between the Secretary and [Fannie Mae]." HERA § 1117(g)(1)(A), 12 U.S.C. § 1719 (g)(1)(A) (2008).

[33] *Id.*

B. Treasury purchases the Senior Preferred Stock

83. On the same day that the Conservatorship was imposed, Treasury caused Fannie Mae to enter a Preferred Stock Purchase Agreement (the "PSPA") with Treasury.

84. Under the PSPA, Fannie Mae agreed to issue to Treasury one million shares of Senior Preferred Stock, a newly created class of securities. The certificate of designation for the Senior Preferred Stock (the "Senior Certificate")[34] set forth the rights, powers and preferences of Treasury's Senior Preferred Stock. Treasury's Senior Preferred Stock had an initial liquidation preference of $1,000 per share, $1 billion total.

85. Treasury also received a warrant to purchase 79.9% of Fannie Mae's common stock at any time for $0.00001 per share (the "Warrant"). Although Treasury has not yet exercised the Warrant, it may do so at any time with *de minimus* cost.[35] Through the Warrant, Treasury can exercise voting control of

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[34] Unless otherwise noted, both the Certificate of Designation of Terms of Variable Liquidation Preference Senior Preferred Stock, Series 2008-2 dated September 7, 2008, and the Amended and Restated Certificate of Designation of Terms of Variable Liquidation Preference Senior Preferred Stock, Series 2008-2, dated September 27, 2012, are referred to herein interchangeably as the Senior Certificate, because they are identical in all relevant respects.

[35] For Treasury to exercise the Warrant as of the date of this filing, giving it ownership of 79.9% of Fannie Mae's common stock, Treasury would need to pay only approximately $46,035 in total.

Fannie Mae whenever it desires. The PSPA also gave Treasury the right to veto an extensive list of corporate actions until the end of Treasury's funding commitment. As the Congressional Budget Office informed Congress in 2011, "[t]he federal conservatorship of Fannie Mae . . . result[ed in] ownership and control by the Treasury . . . ."[36]

86. In turn, under the PSPA, Treasury provided Fannie Mae with a funding commitment of up to $100 billion. In a "fact sheet" released by Treasury in 2008 addressing the PSPA, Treasury admitted that "[t]his number is unrelated to the Treasury's analysis of the current financial conditions of the GSEs."[37] Rather, the "amount [was] chosen to demonstrate a strong commitment to the GSEs' creditors and mortgage backed security holders."[38] Any draw on the funding commitment increases the liquidation preference on the Senior Preferred Stock by the amount drawn. That is, the aggregate liquidation preference on Treasury's

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[36] Congressional Budget Office, Statement of Deborah Lucas, *The Budgetary Cost of Fannie Mae and Freddie Mac and Options for the Future Role in the Secondary Mortgage Market*, at 2 (June 2, 2011), *available at* https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/06-02-gses_testimony.pdf.

[37] Treasury Office of Public Affairs, *Fact Sheet: Treasury Senior Preferred Stock Purchase Agreement* (Sept. 7, 2008), *available at* https://www.treasury.gov/press-center/press-releases/Documents/pspa_factsheet_090708%20hp1128.pdf.

[38] *Id.*

Senior Preferred Stock increases by one dollar for each dollar Fannie Mae draws from Treasury under the PSPA.

87. The PSPA authorized FHFA to require Fannie Mae to draw funds under Treasury's commitment at the end of each quarter in an amount equal to any deficits in Fannie Mae's net worth calculated according to Generally Accepted Accounting Principles ("GAAP"). The draw down requirement is based on accounting principles; not Fannie Mae's cash flow needs. Fannie Mae could be required to draw down funds that it did not need to fund its ongoing operations.

C. The PSPA provided for a fixed, cash or stock dividend

88. Treasury's Senior Preferred Stock is senior to all other classes and series of Fannie Mae stock. When issued, each share entitled Treasury to receive a cumulative cash dividend of 10% per annum of the share's liquidation preference or, if the dividend were paid in kind, 12% per annum, until all cumulated dividends were paid in cash.

89. Under the Senior Certificate, cash dividends could only issue if declared by the Board "in its sole discretion, out of funds legally available therefor[.]" The Charter Act imposes the same limitation: "the corporation may make such capital distributions . . . as may be declared by the board of directors." Charter Act § 303(c)(1) (July 21, 2010), 12 U.S.C. § 1718(c)(1) (2008). As does the DGCL: "[t]he directors of every corporation . . . may declare and pay dividends

upon the shares of its capital stock either (1) out of its surplus . . . ; or (2) . . . out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year." 8 *Del. C.* § 170(a).

90. If the Board did not wish to—or Fannie Mae legally could not—pay a cash dividend, the dividends on the Senior Preferred Stock would be paid in kind by increasing the liquidation preference of the outstanding Senior Preferred Stock—an option Treasury publicly enunciated in the fact sheet it released upon entry into the PSPA.

91. There was never any risk that Fannie Mae would become insolvent due to the dividend terms of Treasury's Senior Preferred Stock, both because the dividends could be paid in kind and because Delaware law prohibits the payment of dividends that would render a company insolvent.

D. The Restated PSPA and First and Second Amendments to the Restated PSPA

92. On September 26, 2008, Treasury entered into the Amended and Restated Senior Preferred Stock Purchase Agreement with Fannie Mae (the "Restated PSPA"). The Restated PSPA made only minor changes to the provisions in the PSPA concerning the rights of the holders of defaulted debt securities issued by Fannie Mae to seek relief to cure the outstanding payment defaults.[39]

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[39] *Compare* PSPA §§ 6.1, 6.4, *with* Restated PSPA §§ 6.1, 6.4.

93. On May 6, 2009, Fannie Mae entered into an Amendment to the Restated PSPA (the "First Amendment"), increasing Treasury's funding commitment from $100 billion to $200 billion.

94. On December 24, 2009, one week before Treasury's temporary authority under HERA to acquire Fannie Mae securities expired, Fannie Mae and Treasury entered into a second amendment to the Restated PSPA (the "Second Amendment").

95. The Second Amendment again increased Treasury's funding commitment, this time to an amount established by a formula. Under that formula, Treasury committed to provide Fannie Mae with a total of up to the greater of: (i) $200 billion, or (ii) $200 billion plus Fannie Mae's quarterly negative net worth for 2010, 2011, and 2012, less Fannie Mae's positive net worth, if any, on December 31, 2012. On January 1, 2013, the cap became fixed for future years.

VIII. Upon Entry Into the Conservatorship, Treasury Immediately Caused Fannie Mae to Write Down Its Tax Assets, Increase Its Loss Reserve and Draw Funds From Treasury

96. Almost immediately upon entering into the PSPA, Treasury, through FHFA, caused Fannie Mae to write down its deferred tax assets and increase its provision for credit losses by enormous amounts (together the "Accounting Losses"). In its first year in the Conservatorship, as shown by Fannie Mae's SEC filings from September 30, 2008 to September 30, 2009, Fannie Mae wrote off its

deferred tax assets by $48.9 billion. During the next few years, Fannie Mae wrote off approximately an additional $10 billion in deferred tax assets for a total of $58.9 billion. From September 30, 2008 to September 30, 2009, Fannie Mae increased its provision for credit losses by $56.97 billion. Between these two categories of accounting charges, in the first year of the Conservatorship, Fannie Mae incurred $105.87 billion in non-cash Accounting Losses. In that same time period, Fannie Mae reported only $13.9 billion in actual credit losses.

97. The deferred tax assets were written off on the dubious ground that Fannie Mae would never return to profitability and therefore would never benefit from the tax assets. This position was particularly dubious because at least a material portion of Fannie Mae's deferred tax assets were low-income housing tax credits ("LIHTC"), which are transferrable; even in 2008, LIHTC were traded for 60-80 cents on the dollar.

98. The Accounting Losses have been criticized by commentators. For example, HousingWire reported: "The Deferred Tax Asset Reserve should have never been booked in the first place. Using the uncertainty of conservatorship as a reason to impair while ignoring the previous 18 years of profitability is unreasonable and incorrect."[40] As detailed below, Fannie Mae would subsequently

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[40] Trey Garrison, *The Three-card Monte Accounting of Fannie, Freddie Conservatorship*, HousingWire (June 23, 2015),

reverse approximately $50 billion of the write-offs of the deferred tax assets and also reverse more than $40 billion of the increased provision for credit losses.

99. The Accounting Losses dragged Fannie Mae's net worth substantially negative, from a positive $41.4 billion to quarterly deficits of tens of billions of dollars as each of the Accounting Losses were recorded.

100. Under the PSPA, FHFA required Fannie Mae to draw cash from Treasury to eliminate each deficit in net worth. In the first year of the Conservatorship, the combined effect of the PSPA and the Accounting Losses forced Fannie Mae to draw approximately $44.9 billion in cash from Treasury's funding commitment.

101. As the Accounting Losses were non-cash charges, Fannie Mae did not need the funds drawn from Treasury to address them. It rather used the funds to expand its mortgage portfolio, injecting the cash into the mortgage market, as Treasury had directed.

102. In 2008, Fannie Mae, together with Freddie Mac, which was similarly controlled by Treasury, purchased about 80% of all new home mortgages in the United States. As shown by Fannie Mae's monthly statements concerning its mortgage portfolio, in its first year in the Conservatorship, Fannie Mae increased

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http://www.housingwire.com/blogs/1-rewired/post/34280-the-three-card-monte-accounting-of-fannie-freddie-conservatorship.

its expenditures to acquire mortgages by $101.8 billion over the prior year. With this investment, despite liquidations, foreclosures, and related factors, Fannie Mae increased the value of its mortgage portfolio by $31.3 billion. Upon information and belief, it appears that Fannie Mae used Treasury's funding substantially for the purpose of increasing its rate of investment in the home mortgage market.

IX. In Mid-2012, Fannie Mae Had Become Highly Profitable and Stood on the Verge of Enormous Net Worth

103. Despite the Financial Crisis, the imposition of the Conservatorship and the not-yet-reversed Accounting Losses, Fannie Mae's stock continued to trade on the NYSE for years. In June 2010, however, FHFA ordered Fannie Mae to "delist from NYSE, saying the decision was based on the weak stock price . . . , not due to any change in condition at [Fannie Mae] or outlook for [its] future[]."[41] Since June 2010, Fannie Mae's stock has continued to be traded over the counter, through the OTC Bulletin Board.

104. By 2012, the housing market was rebounding and the default rate on mortgages held by Fannie Mae was falling. In a news release, Fannie Mae reported net income of $5.1 billion for the second quarter 2012. At that point, Fannie Mae's executives announced that "Fannie Mae has strong potential earnings power that can deliver considerable value to taxpayers over the long

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[41] Julianne Pepitone, *Fannie Mae and Freddie Mac delist from NYSE*, CNN Money (July 7, 2010), http://money.cnn.com/2010/07/07/markets/fannie_freddie_tickers/.

term."[42] Fannie Mae's 10-K for 2012 announced: "We expect to remain profitable for the foreseeable future . . . ."

105. Fannie Mae posted a profit in every quarter of 2012. Fannie Mae's 10-K for 2012, signed by the Board, explained that "[o]ur net income of $17.2 billion in 2012 is the largest in our history." Fannie Mae paid Treasury's 10% annualized cash dividends ($2.9 billion per quarter) out of these profits, with nearly $6 billion left over.

106. Fannie Mae's future appeared even brighter. The 10-K for 2012 stated, "[W]e expect improvements in the credit quality of our loan acquisitions since 2009 and increases in our charged guarantee fees on recently acquired loans to benefit our results for years to come."

107. Fannie Mae was also nearing foreseeably lucrative settlement agreements with numerous entities, including Bank of America, N.A., CitiMortgage, Inc., Citigroup, Inc., JPMorgan Chase Bank, N.A., JP Morgan Chase & Co., Wells Fargo Bank, N.A., SunTrust Banks, Inc., Flagstar Bancorp, Inc., PNC, HSBC Bank USA, N.A., UBS Americas Inc., Deutsche Bank AG, Morgan Stanley, SG Americas, Inc., Credit Suisse Holdings (USA) Inc., and Bank

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[42] New Release, Fannie Mae, *Fannie Mae Reports Net Income of $5.1 Billion for Second Quarter 2012* (Aug. 8, 2012), *available at* http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2012/q22012_release.pdf.

of America Corporation. The agreements related to claims by Fannie Mae that these entities breached their representations and warranties when they sold mortgages to Fannie Mae and made material misstatements and omissions regarding the characteristics of loans underlying MBS sold to Fannie Mae. The agreements would produce over $18 billion for Fannie Mae in 2013 and early 2014.

108. Fannie Mae also announced that it was on the verge of reversing the write-off of its deferred tax assets. The reversal of the write-off of Fannie Mae's tax assets alone was then expected to produce approximately *$58.9 billion* in net worth for Fannie Mae, as demonstrated by Fannie Mae's 10-K for 2012.

109. Although Fannie Mae did not reverse the write-off of the deferred tax assets until early 2013, Fannie Mae, FHFA and Treasury knew by mid-2012 that Fannie Mae would soon effectuate the reversal. The 2008 write-off of the deferred tax assets had been predicated upon the theory that Fannie Mae would not return to profitability and therefore would never be able to use the tax assets. As Fannie Mae had returned to profitability by mid-2012, it began using its deferred tax assets. It was only a matter of time before the entire write-off of tax assets would be reversed.

110. Fannie Mae considered reversing the write-off in 2012. As it explained in its 10-K for 2012: "Our determination not to release the valuation

allowance on our deferred tax assets as of December 31, 2012 was a complicated decision. . . . Using reasonable but different estimates and assumptions, or assigning weight to various factors in reasonable but differing amounts, could have resulted in a decision to release the valuation allowance as of December 31, 2012." Fannie Mae went on to state, "[A]lthough we have not completed the analysis, we believe that, after considering all relevant factors, we may release the valuation allowance as early as the first quarter of 2013" – the immediately following quarter.

111. Due to the ongoing improvements in the credit quality of its portfolio, Fannie Mae also expected an additional massive increase in net worth from the reversal of its increased provisions for credit losses. It reduced the provision for credit losses by $12.7 billion in 2012. It went on to reduce the provision by $14.1 billion in 2013, $7.9 billion in 2014 and $8.5 billion in 2015 for a total four-year reduction of $43.2 billion.

A. Treasury faced its own cash crisis

112. In 2012, while Fannie Mae was generating and anticipating enormous profits and increases in net worth, Treasury faced a looming budgetary crisis. The federal government is, by law, subject to a debt ceiling that limits the amount that it can owe. The government was predicted to reach that ceiling by the end of 2012, absent (1) an increase in the debt ceiling, (2) sharp cuts to federal programs, or

(3) a massive influx of revenue. As Treasury explains, collision with the debt ceiling "would have catastrophic economic consequences."[43]

113. Republicans blocked the first path out of the crisis. As reported by Fox News, Republicans took the position that "[a]ny debt limit increase would require cuts and reforms of a greater amount."[44] The House Majority Leader at the time, Eric Cantor, described the Republicans' ultimatum in a floor debate: "if we are going to increase [the debt ceiling], we better be decreasing the other side of the ledger so we don't continue to increase and mount that debt."[45]

114. Democrats blocked the second path out of the crisis. President Obama took the position that: "If Congress in any way suggests that they're going to tie negotiations to debt ceiling votes and take us to the brink of default once again as part of a budget negotiation -- which, by the way, we had never done in our history until we did it last year -- I will not play that game."[46]

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[43] Treasury, *Debt Limit*, https://www.treasury.gov/initiatives/Pages/debtlimit.aspx (last visited Mar. 14, 2016).

[44] *Obama, Boehner Meet Amid Hard Bargaining Over Tax Hikes, Debt Ceiling*, Fox News (Dec. 17, 2012), http://www.foxnews.com/politics/2012/12/17/obama-boehner-meet-amid-bargaining-over-tax-hikes-debt-ceiling.html.

[45] 158 Cong. Rec. H6782, at H6786 (daily ed. Dec. 13, 2012) (statement of Rep. Cantor).

[46] President Barack Obama, *Opening Remarks by the President to the Business Roundtable* (Dec. 5, 2012), *available at* https://www.whitehouse.gov/the-press-office/2012/12/05/opening-remarks-president-business-roundtable.

115. Absent an unseen path around this political stalemate, Treasury's only solution to the crisis was to find a massive influx of revenue somewhere.

116. Despite its assurances in 2008, when Fannie Mae was placed into conservatorship, that Fannie Mae would ultimately be returned to operation for the benefit of its stockholders, in 2012, Treasury began declaring that "every dollar of earnings that Fannie Mae . . . generate[s] will be used to benefit tax-payers[.]"[47]

B. Treasury seized Fannie Mae's net worth through the Third Amendment

117. On August 17, 2012, Treasury caused Fannie Mae to enter the Third Amendment to the Restated PSPA, thereby seizing Fannie Mae's entire net worth on an ongoing basis.

118. Prior to the Third Amendment, Treasury had been entitled to receive a 10% cumulative dividend on the liquidation preference of its Senior Preferred Stock. If the dividends had not been paid, they would have cumulated at the rate of 12% annually added to the liquidation preference, until fully paid in cash.

119. Under the Third Amendment, Treasury is entitled to indefinitely receive, on a quarterly basis, "cumulative cash dividends" in an amount equal to

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[47] Press Release, Treasury, *Treasury Department Announces Further Steps to Expedite Wind Down of Fannie Mae and Freddie Mac* (Aug. 17, 2012), *available at* https://www.treasury.gov/press-center/press-releases/Pages/tg1684.aspx.

the entire net worth of Fannie Mae minus a decreasing capital reserve amount which is scheduled to equal zero on January 1, 2018.

120. The Third Amendment specifically provides as follows:

> For each Dividend Period from January 1, 2013, holders of outstanding shares of Senior Preferred Stock shall be entitled to receive, ratably, when, as and if declared by the Board of Directors, in its sole discretion, out of funds legally available therefor, *cumulative cash dividends in an amount equal to the then-current Dividend Amount*. . . .
>
> For each Dividend Period from January 1, 2013, through and including December 31, 2017, the "Dividend Amount" for a Dividend Period means the amount, if any, by which *the Net Worth Amount at the end of the immediately preceding fiscal quarter, less the Applicable Capital Reserve Amount, exceeds zero*. For each Dividend Period from January 1, 2018, the "Dividend Amount" for a Dividend Period means the amount, if any, by which the Net Worth Amount at the end of the immediately preceding fiscal quarter exceeds zero. In each case, "Net Worth Amount" means (i) the total assets of the Company (such assets excluding the Commitment and any unfunded amounts thereof) as reflected on the balance sheet of the Company as of the applicable date set forth in this Certificate, prepared in accordance with GAAP, less (ii) the total liabilities of the Company (such liabilities excluding any obligation in respect of any capital stock of the Company, including this Certificate), as reflected on the balance sheet of the Company as of the applicable date set forth in this Certificate, prepared in accordance with GAAP. "Applicable Capital Reserve Amount" means, as of any date of determination, for each Dividend Period from January 1, 2013, through and including December 31, 2013, $3,000,000,000; and for each Dividend Period occurring within each 12-month period thereafter, $3,000,000,000 reduced by an equal

> amount for each such 12-month period through and including December 31, 2017, so that for each Dividend Period from January 1, 2018, the Applicable Capital Reserve Amount shall be zero.

Third Amendment § 3 (emphasis added) (Exhibit D hereto).

121. The Third Amendment provides no end date for Fannie Mae's obligation to pay Treasury its net worth on a quarterly basis. The Net Worth Sweep is therefore perpetual.

122. The Third Amendment could not have been effectuated in the absence of Treasury's control of Fannie Mae. Neither the Board nor FHFA could have wanted the Third Amendment. As it resulted in a massive depletion of Fannie Mae's value, it was inconsistent with the Board's fiduciary duty to act only in Fannie Mae's best interests and also inconsistent with FHFA's statutory directive to "preserve and conserve" Fannie Mae's assets. In consenting to the Third Amendment, the Board and FHFA simply acceded to Treasury's control.

X. The Third Amendment Is Unfair to Fannie Mae

123. The Third Amendment was egregiously unfair to Fannie Mae. For no consideration whatsoever, Fannie Mae gave its entire residual value to Treasury. When the Third Amendment was adopted, the Board was well aware of Fannie Mae's return to profitability and impending massive increase in net worth. It therefore knew that the pre-existing 10% cash dividend (or 12% stock dividend) would be dwarfed by a dividend of Fannie Mae's entire future net worth. The

Board knew that the Third Amendment would massively increase the dividends to Treasury.

124. In the years since it was adopted, the Third Amendment has indeed resulted in a massive increase in dividends. After the reversal in early 2013 of approximately $50 billion of the write-offs of deferred tax assets, Fannie Mae paid a $59.4 billion dividend to Treasury for only the second quarter of 2013 (as compared to a pre-existing dividend at the 10% rate of $2.9 billion per quarter). Absent the Third Amendment, assuming no redemptions, Fannie Mae would have paid $66.5 billion in dividends on the Senior Preferred Stock to date. Instead, due to the Third Amendment, Fannie Mae has paid $144.7 billion in dividends on the Senior Preferred Stock to date, without redeeming any of the Senior Preferred Stock. For no consideration whatsoever, Fannie Mae increased its dividends to Treasury by $78.2 billion – thus far.

125. When the Third Amendment was adopted, the Board also knew that Fannie Mae received nothing in return for this increase. The Third Amendment did not eliminate any potential risk to Fannie Mae's solvency or ongoing operations. There was no such risk because, in the absence of the Third Amendment, if Fannie Mae did not have sufficient funds to pay the dividends at 10% in cash, it need not have paid them; the dividends would simply have cumulated at 12%. The accumulation of dividends could not have affected Fannie

Mae's solvency or net worth. All the accumulation could do was to increase Treasury's interest in Fannie Mae's net worth relative to other stockholders.

A. The Board approved, or failed to protect Fannie Mae from, the Third Amendment

126. Despite the public information available about the terms of the Third Amendment and its cost to Fannie Mae, the Stockholder cannot determine from that information whether the Board affirmatively approved the Third Amendment or abdicated its responsibility with respect to the Third Amendment. The Board resolutions sought by the Demand will show whether the Board approved the Third Amendment, whether the Board simply did not resolve against the Third Amendment or whether the Board failed to exercise any oversight with respect to the Senior Preferred Stock.

127. In all events, it is clear that the Board was supine in the face of Treasury's demand for the Third Amendment. For example, the Board did not publicly oppose it. Nor did the Board initiate legal proceedings to declare it invalid or enjoin it. As detailed below, there were ample meritorious legal grounds to challenge the Third Amendment. Among other grounds, it constituted an unfair transaction with Fannie Mae's controlling stockholder. It also violated various provisions of the DGCL.

128. Similarly, the documents sought through the Demand will confirm that the internal information available to the Board, when agreeing to or

acquiescing in the Third Amendment, mirrored the public information demonstrating how detrimental the Third Amendment was theoretically and would be as a practical matter for Fannie Mae.

129. Although opposing or suing to enjoin the Third Amendment would have put the Board at odds with its controlling stockholder, Treasury, boards frequently oppose actions of controlling stockholders. The Board's situation would have been much like that of any board opposing the inequitable or unlawful action of any other controlling stockholder. As detailed below, boards are required to oppose actions of a controlling stockholder when in the best interests of the corporation and its stockholders.

B. Since 2012, the Board has made no effort to eliminate the Third Amendment or the Net Worth Sweep

130. After the Third Amendment was entered on August 17, 2012, over seven months passed before the first sweep of Fannie Mae's net worth on March 29, 2013. During this time, the Board took no action to avoid the first dividend under the Net Worth Sweep. It has taken no action since to protect Fannie Mae and its stockholders from any subsequent dividend under the Net Worth Sweep.

131. The Third Amendment is void or voidable for multiple reasons, as detailed below. The Board therefore could have simply repudiated the Third Amendment. Alternatively, the Board could have initiated legal proceedings to

have it declared invalid. Nonetheless, despite the enormous impending harm, the Board lay supine in the face of Treasury's desire for Fannie Mae's value.

132. Even if the Third Amendment were valid, Fannie Mae had and retains the ability to redeem Treasury's Senior Preferred Stock and thereby eliminate the Net Worth Sweep by paying the liquidation preference of $117.1 billion.

133. The Senior Certificate specifically states that Fannie Mae can redeem the Senior Preferred Stock:

> If after termination of the Commitment [Fannie Mae] pays down the Liquidation Preference of each outstanding share of Senior Preferred Stock in full, such shares shall be deemed to have been redeemed as of the date of such payment, and the dividend that would otherwise be payable for the Dividend Period ending on the pay down date will be paid on such date.

Senior Certificate § 3(c) (Sept. 27, 2012) (Exhibit E hereto).

134. The PSPA between Fannie Mae and Treasury, even as modified through the Third Amendment, does not eliminate Fannie Mae's ability to redeem Treasury's Senior Preferred Stock. It states:

> From the Effective Date until such time as the Senior Preferred Stock shall have been repaid or redeemed in full in accordance with its terms:
>
> 5.1 *Restricted Payments*. Seller shall not, and shall not permit any of its subsidiaries to, in each case without the prior written consent of Purchaser . . . directly or indirectly redeem, purchase, retire or otherwise acquire for value any of Seller's Equity Interests (*other than the*

> *Senior Preferred Stock* or the Warrant), or set aside any amount for any such purpose.

PSPA § 5.1 (emphasis added) (not modified by Restated PSPA, First Amendment, Second Amendment or Third Amendment).

135. To the extent that redemption would require Treasury to waive any provisions of the PSPA or the Senior Certificate, the Board should readily be able to obtain such waivers. The provisions were designed to protect Treasury's investment in Fannie Mae. Treasury would not have had any further need for such protection upon the full repayment of its investment. It therefore could not reasonably have denied requests for waivers to permit redemption.

136. Upon information and belief, Fannie Mae has been able to refinance the Senior Preferred Stock since the end of 2012, at the latest. Fannie Mae's SEC filings demonstrate that it has been highly profitable since then, generating $84 billion in profits in 2013, $14.2 billion in profits in 2014, and $11 billion in profits in 2015. And, the reversal of the 2008 Accounting Losses alone, which occurred in early 2013, and could have occurred even earlier, added more than $50 billion to Fannie Mae's balance sheet.

137. Fannie Mae borrowed $85.7 billion in the second quarter of 2013, in large part to pay Treasury the dividends under the Net Worth Sweep for the second quarter of 2013. If Fannie Mae had simply undertaken this financing and financed another $30 billion at the end of 2012, it could have redeemed the Senior Preferred

Stock before the first dividend under the Net Worth Sweep and thereby avoided the Net Worth Sweep altogether.

138. To the extent that the DGCL's capital requirements presented an obstacle to redemption, Fannie Mae might have avoided any such obstacle by refinancing the Senior Preferred Stock with alternate equity.

139. Fannie Mae's Board however appears to have taken no action to redeem the Senior Preferred Stock. It lay supine in the face of Treasury's looting.

C. The Board apparently approved enormous and unnecessarily costly dividends under the Net Worth Sweep

140. After the Third Amendment, Fannie Mae need not have paid the dividends under the Net Worth Sweep. Under the DGCL, the Charter Act, and even the Third Amendment, whether the dividends under the Net Worth Sweep were actually declared and paid was left to the discretion of the Board. *See supra* ¶¶ 89-90, 120. As detailed below, the Third Amendment is void and voidable under the governing Delaware law. Finally, as detailed below, the dividend payments were apparently prohibited by Section 170 of the DGCL because Fannie Mae's capital for its preferred stock was impaired. *See infra* ¶¶ 198-99.

141. Nonetheless, the Board has apparently approved the payment of the dividend under the Net Worth Sweep for every quarter since the fourth quarter of 2012. Since the Third Amendment became effective, Fannie Mae has paid Treasury the following dividends:

Date	Amount Paid
March 29, 2013	$4.224 billion
June 28, 2013	$59.368 billion
September 30, 2013	$10.243 billion
December 31, 2013	$8.617 billion
March 31, 2014	$7.191 billion
June 30, 2014	$5.692 billion
September 30, 2014	$3.712 billion
December 31, 2014	$3.999 billion
March 31, 2015	$1.920 billion
June 30, 2015	$1.796 billion
September 30, 2015	$4.359 billion
December 31, 2015	$2.202 billion
Total:	$113.323 billion

142. In the absence of the Third Amendment, if Fannie Mae had paid Treasury the same $113.3 billion, with the payments applied first to the dividends at 10% per annum and then to the liquidation preference, the liquidation preference on the Senior Preferred Stock would now be only approximately $18.3 billion. Fannie Mae would nearly have redeemed the entirety of the Senior Preferred Stock. Due to the Third Amendment, however, all of Fannie Mae's $113.3 billion in payments has gone to dividends; the Senior Preferred Stock's liquidation preference remains $117.1 billion. Worse, Fannie Mae continues to pay the dividends under the Net Worth Sweep.

143. In approving or acquiescing to the payment of these dividends, the Board has left Fannie Mae at risk of insolvency after each quarterly sweep. FHFA Director Watt, himself, has acknowledged that the Net Worth Sweep has created a

serious risk for Fannie Mae: "based on the terms of the PSPAs, [Fannie Mae's] capital buffer is reducing each year," and Fannie Mae will have no capital reserve as of January 1, 2018. Without a capital reserve, Fannie Mae will have "no ability to weather quarterly losses . . . without making a draw against the remaining Treasury commitments under the PSPAs."[48]

144. To the extent that the demanded books and records show that the Board did not affirmatively approve the dividends paid under the Net Worth Sweep, it is clear that the Board did nothing to stop them. It has not publically opposed them. Nor has it sought judicial relief.

145. On January 19, 2016, the Stockholder sent a letter to the Board, alerting the Board to its fiduciary duties and to the ways in which the dividends paid pursuant to the Net Worth Sweep breached those fiduciary duties and Delaware statutory law (the "Dividend Letter").[49] The Dividend Letter urged the Board, despite its lack of independence, to clarify its role in the approval or authorization of these dividends and to stop payment of these unlawful dividends.

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[48] *Prepared Remarks of Melvin L. Watt Director of FHFA at the Bipartisan Policy Center* (Feb. 18, 2016), *available at* http://www.fhfa.gov/Media/PublicAffairs/Pages/Prepared-Remarks-Melvin-Watt-at-BPC.aspx.

[49] *See* Dividend Letter (Exhibit F hereto).

Fannie Mae, through FHFA, responded to the Dividend Letter on January 26, 2016, refusing to take the requested actions.[50]

XI. The CSP and Single Security

146. During the Conservatorship, Fannie Mae's Board also appears to have permitted Fannie Mae to make investments that were not intended to benefit Fannie Mae and its stockholders. On October 22 and November 9, 2012, Fannie Mae's CEO announced that "[t]he company is no longer run for the benefit of private shareholders."[51] He went on to state, "Instead, it is managed in the overall interest of taxpayers, which is consistent with the substantial public investment in the company."[52] Thereafter, he described Fannie Mae's "two equally important priorities" as "first, to support the housing recovery, and second, to help lay the foundation for a better housing finance system going forward."[53]

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[50] *See* Letter on behalf of Fannie Mae from Alfred M. Pollard, General Counsel, FHFA, to C. Barr Flinn (Jan. 27, 2016) (Exhibit G hereto).

[51] Timothy J. Mayopoulos, *Remarks Prepared for Delivery by Timothy J. Mayopoulos, President and Chief Executive Officer, Fannie Mae, at the MBA Annual Conference, Chicago, Il.* (Oct. 22, 2012), *available at* http://www.fanniemae.com/portal/about-us/media/speeches/2012/speech-mayopoulos-2012mba-annual-conference.html.

[52] *Id*.

[53] *Id.*; *see also* Timothy J. Mayopoulos, *Remarks Prepared for Delivery by Timothy J. Mayopoulos, President and Chief Executive Officer, Fannie Mae, at the National Association of REALTORS Conference, Orlando, FL* (Nov. 9, 2012), *available at* http://www.fanniemae.com/portal/about-

147. In furtherance of these priorities, Fannie Mae has spent substantial sums of money to remake the mortgage market in a manner expected to be detrimental to Fannie Mae.

148. *First*, as explained in Fannie Mae's 10-K for 2014, in October 2013, Fannie Mae and Freddie Mac formed and began funding CSS, a joint venture to develop and operate the CSP, the Common Securitization Platform. The CSP is intended to eventually replace elements of Fannie Mae's and Freddie Mac's separate, proprietary systems for securitizing mortgages and related associated back office and administrative functions, as well as to ultimately provide a common platform for other market participants.

149. A Fannie Mae news release describes the CSP as "an important milestone in FHFA's goal of building a new secondary market infrastructure."[54] According to FHFA, this infrastructure is intended to "support a competitive,

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us/media/speeches/2012/speech-mayopoulos-2012national-association-of-realtors-conference.html.

[54] News Release, Fannie Mae, *CEO, Board Members Named at Common Securitization Solutions, LLC* (Nov. 3, 2014), *available at* http://www.fanniemae.com/portal/about-us/media/corporate-news/2014/6187.html.

resilient, and liquid secondary mortgage market to the benefit of homeowners and renters[.]"[55]

150. Improving the value and profit of Fannie Mae – the necessary object of a private corporation and its board – is not identified as a goal of CSS or the CSP.

151. From 2012 to mid-2015, Fannie Mae and Freddie Mac spent approximately $146 million supporting CSS and the development of the CSP. In 2014 alone, Fannie Mae contributed $43 million to CSS, per Fannie Mae's 10-K for 2014. But, despite Fannie Mae's significant monetary contribution to the development of the CSP, when the CSP launches in 2016, only Freddie Mac will participate in it. It remains uncertain when—if ever—Fannie Mae will participate in the CSP.

152. *Second*, with either the approval or acquiescence of the Board, Fannie Mae has undertaken a joint initiative with Freddie Mac to bring additional liquidity and fungibility to the MBS market by developing the Single Security, a single mortgage backed security, to replace both Fannie Mae's and Freddie Mac's current MBS security offerings.

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[55] *2015 Scorecard for Fannie Mae, Freddie Mac and Common Securitization Solutions*, at 1 (Jan. 2015), *available at* http://www.fhfa.gov/aboutus/reports/reportdocuments/2015-scorecard.pdf.

153. Development of the Single Security will be indisputably detrimental to Fannie Mae. Currently, Fannie Mae's MBS offerings trade at a premium to those of Freddie Mac and every other MBS offeror. The Single Security, if developed, will eliminate this substantial market advantage. In fact, according to the National Association of Home Builders, "FHFA is hopeful [the Single Security] would eliminate the long-time price differential between Fannie Mae and Freddie Mac securities[.]"[56] Consistent with this statement, FHFA has stated that the Single Security "should reduce the trading value disparities between Fannie Mae and Freddie Mac securities."[57]

154. Fannie Mae's disclosures concerning the Single Security do not identify any anticipated benefits to Fannie Mae and its stockholders from the development of the Single Security.

155. It is unclear based on public filings and statements whether Fannie Mae's Board affirmatively approved Fannie Mae's investments in the CSS, CSP

[56] Letter from David L. Ledford, Senior Vice President, Housing Finance & Regulatory Affairs, National Association of Home Builders, to FHFA Office of Strategic Initiatives (Oct. 14, 2014), *available at* https://www.fhfa.gov/AboutUs/Contact/Pages/input-submission-detail.aspx?RFIId=286.

[57] FHFA, *The 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac*, at 17 (May 13, 2014), *available at* http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2014StrategicPlan05132014Final.pdf.

and the Single Security or simply abdicated its responsibility to safeguard the best interests of Fannie Mae by preventing these developments. There is no public evidence that Fannie Mae's Board took any steps to halt any of these expenditures or developments despite the clear detriments that they pose to Fannie Mae.

SATISFACTION OF SECTION 220'S FORMAL REQUIREMENTS

156. On January 19, 2016, counsel for the Stockholder served the Demand on Fannie Mae, Exhibit A hereto and incorporated herein by reference. The Demand requested that Fannie Mae provide the Stockholder, pursuant to his rights under the DGCL, the opportunity to inspect certain specified books and records during Fannie Mae's usual business hours.

157. The Stockholder has complied with the provisions of Section 220 relating to the form and manner of making his Demand to inspect books and records of Fannie Mae.

158. The Demand stated the Stockholder's status as a stockholder, was accompanied by evidence of beneficial ownership, and stated that such evidence was a true and correct copy of what it purported to be.

159. The Demand stated numerous proper purposes for the inspection, including:

> (a) to investigate potential breaches of fiduciary duty by directors and/or officers of the Company, by FHFA, and/or by Treasury . . . ;

> (b) to investigate FHFA's and/or Treasury's aiding and abetting breaches of fiduciary duty by directors and/or officers of the Company . . . ;
>
> (c) to investigate mismanagement, waste, wrongdoing, and/or violations of law by directors and/or officers of the Company, by FHFA, and/or by Treasury . . . ;
>
> (l) to communicate with other Company stockholders regarding matters of concern to such stockholders; and
>
> (m) to value the stock held by the Stockholder.

160. The Stockholder's purposes for the inspection as set forth in the Demand are reasonably related to the Stockholder's interests as stockholder of Fannie Mae and are proper purposes under Delaware law.

161. The books and records sought to be inspected are reasonably related to the Stockholder's purposes. Among other purposes, the books and records demanded are necessary to enable the Stockholder to better assess whether he should initiate litigation against Fannie Mae's current and former directors, FHFA and Treasury.

162. On January 27, 2016, Fannie Mae, through FHFA, rejected the Demand.[58] However, Fannie Mae's only stated basis for the rejection was the following incorrect assertion: According to Fannie Mae, under HERA (12 U.S.C.

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[58] *See* Letter from Brian Brooks, Executive Vice President, General Counsel and Corporate Secretary, Fannie Mae, to C. Barr Flinn (Jan. 26, 2016) (Exhibit H hereto); Letter on behalf of Fannie Mae from Alfred M. Pollard, General Counsel, FHFA, to C. Barr Flinn (Jan. 27, 2016) (Exhibit G hereto).

§ 4617(b)(2)(A)(i)), FHFA as conservator has "succeeded" to "all stockholder inspection rights," thus supposedly divesting the Stockholder of his statutory inspection rights.[59] In fact, under section 4617(b)(2)(A)(i), FHFA succeeds to the rights of stockholders only "with respect to the regulated entity and the assets of the regulated entity." HERA § 1367(b)(2)(A)(i), 12 U.S.C. § 4617(b)(2)(A)(i). When interpreting this section and the substantially identical language in the similar statute concerning the powers of the FDIC, courts have repeatedly held that this language bars a stockholder from pursuing only some derivative claims on behalf of the corporation and does not bar direct claims. As this action is asserted directly against Fannie Mae, Fannie Mae's basis for rejecting the Demand is wrong.

163. Although other cases have been commenced in other jurisdictions challenging the Net Worth Sweep, none asserts claims against any member of the Board, and none addresses all the issues that the Stockholder seeks to investigate by means of the Demand.

<u>THE PROPER PURPOSES OF THE DEMAND</u>

164. The Demand states proper purposes. *First*, it seeks books and records concerning apparent misconduct by the Board, FHFA and Treasury to better

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[59] Letter on behalf of Fannie Mae from Alfred M. Pollard, General Counsel, FHFA, to C. Barr Flinn (Jan. 27, 2016) (Exhibit G hereto).

evaluate legal claims against them. This is a proper purpose, provided that the Stockholder has a credible basis for the claims to be investigated. *See La. Mun. Police Empls.' Ret. Sys. v. Countrywide Fin. Corp.*, 2007 WL 2896540, at *10 (Del. Ch. Oct. 2, 2007) ("It is well settled under Delaware law that an investigation of corporate mismanagement, waste or wrongdoing is a proper purpose for a Section 220 inspection" as long as there is "some evidence of possible mismanagement," and the applicable "credible basis standard sets the lowest possible burden of proof.") (quotations omitted) (emphasis removed); *Robotti & Co., LLC v. Gulfport Energy Corp.*, 2007 WL 2019796, at *2-3 (Del. Ch. July 3, 2007) (finding, where the plaintiff presented "credible evidence" that "demonstrate[d] the possibility of a violation of fiduciary duty" by a corporate board and/or management, that the plaintiff had met its "burden under § 220 with respect to demonstrating the propose purpose of investigating mismanagement"). As detailed below, the Stockholder has such a credible basis.

165. *Second*, the Demand seeks books and records to advance the Stockholder's discussions with other stockholders concerning the apparent misconduct. This also is a proper purpose. *See Weiss v. Anderson*, 1986 WL 5970, at *2 (Del. Ch. May 22, 1986) ("To inform fellow shareholders of one's view concerning the wisdom or fairness . . . of a [transaction] and to encourage fellow shareholders to [take action], in light of one's own view of the merits of the

. . . transaction, states a purpose that relates to one's interest as a stockholder of the company and an interest that is arguably shared by all fellow shareholders."); *see also Credit Bureau Reports, Inc. v. Credit Bureau of St. Paul, Inc.*, 290 A.2d 691, 692 n.2 (Del. 1972) (permitting inspection of a corporation's stockholder list for the purpose, inter alia, "of communicating with said stockholders on matters relating to mutual interests as stockholders"); *Robotti & Co., LLC*, 2007 WL 2019796, at *2 ("Stockholders may use information about corporate mismanagement, waste, or wrongdoing in several ways[, including] . . . [to] seek an audience with the board of directors to discuss proposed reform . . . .").

166. *Finally*, the Demand seeks books and records to enable the Stockholder to better value his stock of Fannie Mae. This too is a proper purpose. *Ostrow v. Bonney Forge Corp.*, 1994 WL 114807, at *11 (Del. Ch. Apr. 6, 1994) ("The valuation of shares has long been recognized to be a 'proper purpose' within the meaning of Section 220.").

CREDIBLE BASES FOR CLAIMS

167. The Stockholder has credible bases to believe that the Board and others breached fiduciary, statutory and contractual duties in connection with both the Third Amendment and Net Worth Sweep and Fannie Mae's investments in CSS, the CSP and the Single Security.

I. The Third Amendment and Net Worth Sweep

168. The Stockholder has credible bases to believe that the Third Amendment and the dividend payments under the Net Worth Sweep breached fiduciary duties, Delaware corporation law and Fannie Mae's Junior Certificates. The Stockholder also has credible bases to believe that the Board may be responsible for such breaches and further breached its fiduciary duties, in failing to prevent the resulting harm.

A. The breaches of fiduciary duties and violations of statute

1. Breaches of fiduciary duties

169. The Third Amendment constituted a breach of fiduciary duty because it was between the corporation, Fannie Mae, and its controlling stockholder, Treasury, and was not entirely fair to Fannie Mae. It also constituted waste.

170. The Stockholder has credible bases to believe that Treasury has been Fannie Mae's controlling stockholder since the Conservatorship began. As detailed previously, Treasury, through FHFA, exercised actual control over Fannie Mae throughout the Conservatorship. *See supra* ¶¶ 5-6, 12, 29, 53-54, 65-69, 83-88, 92-97, 101-02, 105, 109, 112, 116-24, 127-31, 139, 141. This was demonstrated time after time by Fannie Mae's repeated self-sacrificing acts for Treasury's benefit. The information available indicates that Treasury's control trumped the Board's fiduciary duty to act in Fannie Mae's best interests.

171. Furthermore, Treasury's Warrant to acquire 79.9% of Fannie Mae's outstanding common stock at any moment and for nominal consideration ensures Treasury's control of Fannie Mae.

172. The Third Amendment was not entirely fair to Fannie Mae. As detailed above, it was expected to and did massively increase the dividends on the Senior Preferred Stock. Fannie Mae received nothing in return for the increase. It is difficult to conceive of a transaction more unfair than the forfeiture of a corporation's entire net worth in perpetuity for no consideration.

173. A transaction with a controlling stockholder is not subject to the protection of the business judgment rule. *See, e.g.*, *Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1239 (Del. 2012) ("When a transaction involving self-dealing by a controlling shareholder is challenged, the applicable standard of judicial review is entire fairness."). If it is not entirely fair to the corporation, it constitutes a breach of fiduciary duty and is voidable. *See Valeant Pharm. Int'l v. Jerney*, 921 A.2d 732, 752, 736 (Del. Ch. 2007) (holding that unfair transaction was "voidable as between the parties to the transaction," and director owed damages for "his breach of the duty of loyalty in voting to approve the unfair, self-interested bonuses.").

174. The Third Amendment also amounted to corporate waste because it cannot be attributed to any rational business purposes. It involved no return

consideration or benefit to Fannie Mae whatsoever. It was simply a gift to Treasury. A transaction constitutes corporate waste if it cannot be attributed to any rational business purpose. *See Calma on Behalf of Citrix Sys., Inc. v. Templeton*, 114 A.3d 563, 590 (Del. Ch. 2015) ("Under Delaware law, directors waste corporate assets when they approve a decision that cannot be attributed to any rational business purpose.") (quotations omitted).

2. Breaches of the DGCL and the Junior Certificates

175. As detailed below, the Third Amendment violated Sections 242(b)(2) and 151 of the DGCL and also breached the Junior Certificates. The Third Amendment's violation of the DGCL renders it void. *See, e.g.*, *Shintom Co. v. Audiovox Corp.*, 888 A.2d 225, 228 (Del. 2005) ("Preferred shares that do not comport with the statutory requirements of the Delaware General Corporation law are void.").

a) Section 242(b)(2) of the DGCL and Section 7(c) of the Junior Certificates

176. The Third Amendment violated Section 242(b)(2) of the DGCL and Section 7(c) of the Junior Certificates because it amended the rights of the holders of the junior preferred stock ("Junior Preferred Stock") in a manner adverse to them without their approving vote.

177. Both Section 242(b)(2) of the DGCL and Section 7(c) of the Junior Certificates prohibit the amendment of the rights, preferences and privileges of the holders of the Junior Preferred Stock in a manner adverse to them without their approving vote.

178. The Third Amendment adversely amended the rights of the holders of the Junior Preferred Stock by nullifying their dividend and liquidation preferences. Before the Third Amendment, the holders of the Junior Preferred Stock were entitled to dividend and liquidation preferences, after more senior stock and before more junior stock. The Third Amendment nullified these rights by granting the holder of the Senior Preferred Stock the entire residual value of the corporation, eliminating even the theoretical possibility of any distribution on any Junior Preferred Stock.

179. The Third Amendment was entered without any stockholder vote.

b) Section 151 of the DGCL

180. The Third Amendment breached Section 151 of the DGCL because the dividends under the Net Worth Sweep are neither payable at a "rate" nor in "preference to" or in "relation to" dividends on more junior stock.

181. Section 151 requires that preferred stock dividends be payable at "such rates" as are set forth in the appropriate documentation and in "preference to" or in "relation to" more junior stock. Section 151 specifically contemplates

that, after payment of dividends on preferred stock, a "dividend on the remaining class or classes or series of stock may then be paid out of the remaining assets of the corporation available for dividends . . . ."

182. The dividends under the Net Worth Sweep are not payable at a "rate" because there is no relationship between the amount of the dividends and the amount of principal, the liquidation preference, on which they are paid. Even if the liquidation preference had been paid down to $5.00, the dividends would still amount to Fannie Mae's entire net worth. Similarly, if the liquidation preference grew, the dividends would still fall if Fannie Mae's net worth fell.

183. The dividends under the Net Worth Sweep are not payable in "preference to" or "relation to" dividends on more junior stock because they are payable to the absolute and permanent exclusion of dividends on such stock. Once the Net Worth Sweep is paid each quarter, there necessarily will be no assets remaining in Fannie Mae for the payment of dividends on any other classes or series of stock regardless of how valuable or profitable Fannie Mae is or becomes.

3. Breaches of contract

184. The Third Amendment also breached the implied covenants of good faith and fair dealing in the Junior Certificates because it defeated the reasonable expectations of the holders of the Junior Preferred Stock, denying them the benefits of their bargains with Fannie Mae.

185. The Junior Certificates are contracts between Fannie Mae and the junior preferred stockholders. *Cohn v. Crocker Nat'l Bank*, 490 A.2d 569, 572 (Del. Ch. 1985) ("The Certificate is a contract between the corporation and the stockholder which provides the rights and preferences of the shares and must be construed as such."). They contain implied covenants of good faith and fair dealing. The implied covenants are breached when Fannie Mae takes action that frustrates the reasonable expectations of the holders of the Junior Preferred Stock. *Blue Chip Capital Fund II Ltd. P'ship v. Tubergen*, 906 A.2d 827, 833 (Del. Ch. 2006) ("[T]he implied covenant specifically functions to protect preferred stockholders' expectations that the company and the board will properly perform the contractual obligations under the certificate.").

186. The holders of the Junior Preferred Stock might have expected Fannie Mae to issue more senior preferred stock on market terms. They might therefore have expected Fannie Mae to issue more senior preferred stock with some level of dividends and liquidation preferences that must be paid before the Junior Preferred Stock.

187. But the holders of the Junior Preferred Stock could never have anticipated that Fannie Mae would issue senior preferred stock on unprecedented, non-market terms that would eliminate even the theoretical possibility of dividends and liquidation preferences for the Junior Preferred Stock. They could never have

anticipated that Fannie Mae would invert its own capital structure by giving senior preferred stock the return of the common stock: the entire residual value of the corporation. Thus, the Third Amendment's reallocation of Fannie Mae's entire residual value to the Senior Preferred Stock breached the covenant of good faith and fair dealing.

B. The Board's liability

188. The Board breached its fiduciary, statutory and contractual duties in at least three ways that render it liable to Fannie Mae and its stockholders.

1. The Third Amendment

189. If the Board approved the Third Amendment, it approved an unfair transaction with a controlling stockholder and is liable on this ground alone. *See In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 52 A.3d 761, 813 (Del. Ch. 2011) (holding that where defendant directors approved an unfair transaction with a controlling stockholder, "[b]ecause the deal was unfair, the defendants breached their fiduciary duty of loyalty"). Also, if the Board approved the Third Amendment, it approved violations of the DGCL and the Junior Certificates and is liable also on this ground. *See Grayson v. Imagination Station, Inc.*, 2010 WL 3221951, at *1, *3, *5-6 (Del. Ch. Aug. 16, 2010) ("Although the DGCL empowers corporate directors and officers to act for the corporation, the DGCL also imposes certain restraints on the use of this authority. If a corporate officer

acts in a manner that the DGCL prohibits, then the officer has violated this structural relationship . . . .”).

190. Even if the Board did not expressly approve the Third Amendment, it nonetheless acquiesced in it, thereby breaching the same fiduciary, statutory and contractual duties. *See Kohls v. Duthie*, 791 A.2d 772, 786 (Del. Ch. 2000) (finding claim for breach of fiduciary duties “against [defendant directors] who knowingly acquiesced in” another director’s misconduct).

191. A board may also be liable for breaches of statutory, fiduciary or contractual duties when it does not take action to oppose or prevent them. *Bennett v. Propp*, 187 A.2d 405, 411 (Del. 1962) (finding that a director breached his fiduciary duties by doing “nothing” to prevent controlling stockholder’s improper use of corporate funds to increase control, and noting that the director “could surely have called a directors’ meeting” to notify the other directors of the controller’s misconduct); *In re Emerging Commc’ns, Inc. S’holders Litig.*, 2004 WL 1305745, at *40 (Del. Ch. May 3, 2004) (finding a director liable for breaching duty of loyalty where director failed to “advocate that the board reject the [unfair] price” in a going-private merger and where the director also failed to “go[] on record as voting against the proposed transaction”); *AIG Ret. Servs., Inc. v. Barbizet*, 2006 WL 1980337, at *7 (Del. Ch. July 11, 2006) (holding that the allegation that “director defendants refused to authorize a lawsuit because they

were beholden to" an interested party, "even though they knew that bringing the lawsuit would be in the best interests of" the corporation, was "sufficient to support a claim for breach of fiduciary duty against the director defendants"); *La. Mun. Police Empls.' Ret. Sys. v. Fertitta*, 2009 WL 2263406, at *8 (Del. Ch. July 28, 2009) ("The failure to act in the face of an obvious threat to the corporation and the minority stockholders . . . supports a reasonable inference that the board breached its duty of loyalty . . . .").

192. A board also breaches its fiduciary duties when it stands idly by, permitting a controlling stockholder to raid the corporation's coffers. *Grace Bros. v. Uniholding Corp.*, 2000 WL 982401, at *12-13 (Del. Ch. July 12, 2000) (denying motion to dismiss because plaintiff pled facts sufficient to support inference that defendant directors were aware of a transaction that would benefit a controlling stockholder group to the detriment of minority stockholders and "stood by and did nothing to stop it"); *In re Infousa, Inc. S'holders Litig.*, 2007 WL 3325920, at *26 (Del. Ch. Aug. 13, 2007) (denying motion to dismiss where plaintiff sufficiently pled breach of fiduciary duties where "the board either collaborated in or stood by idly in the face of a garish collection of self-interested transactions, principally engineered by the CEO and largest shareholder").

193. As discussed above, the Board had multiple options to oppose the Third Amendment, but made use of none of them.

2. The response to the Third Amendment

194. After the Third Amendment, the Board further breached its fiduciary duties in failing to take action to prevent the Net Worth Sweep. A board breaches its fiduciary duty when it does not take action to prevent harm to the corporation. *See supra* ¶¶ 190-92. This is particularly true if it fails to take such action to benefit a controlling stockholder.

195. After the Third Amendment, the Board had ample time to prevent the harm from the Net Worth Sweep, including seeking judicial relief or redeeming the Senior Preferred Stock. The first dividend under the Net Worth Sweep would not occur for over seven months; the massive $59.4 billion dividend paid after the reversal of the Accounting Losses was not to be paid or cumulated for over ten months after entry into the Third Amendment. And, of course the Board has had years since then to take action to avoid the subsequent Net Worth Sweep dividends. The Board's failure to act can only be explained as surrender to its controlling stockholder.

3. Payment of the Net Worth Sweep

196. The Board breached both statutory and fiduciary duties in approving the dividends paid pursuant to the Net Worth Sweep or permitting their payment absent Board approval.

a) Violation of Section 170

197. The Board violated Section 170 of the DGCL in voluntarily declaring and paying the dividends under the Net Worth Sweep.

198. Based on the information available, Fannie Mae's capital in respect of its issued shares of preferred stock was impaired as of each of the dates for which dividends were paid under the Net Worth Sweep. The capital was impaired because Fannie Mae's net assets, which ranged between approximately $3.6 billion and approximately $62.4 billion, as of each of the relevant dates, fell short of the apparent capital in respect of the Senior and Junior Preferred Stock, which by default is the amount of cash consideration paid for the stock, an amount exceeding $129 billion, based on public records.[60]

199. Under Section 170, a corporation may not pay any dividend if the capital for its preferred stock is impaired. The dividends nonetheless were paid.

200. Upon information and belief, the Board approved the dividends under the Net Worth Sweep. As they were unlawful, the Board therefore may be personally liable for them under Section 174 of the DGCL. If the Board did not approve them, it nonetheless acquiesced in them and therefore is still liable. *See*

[60] It is possible that the Board declared that the Junior Preferred Stock or Senior Preferred Stock had capital lower than the amount paid for each. However, such a declaration would need to be made contemporaneously with the issuance and is unusual. Absent receipt of minutes of all relevant Board meetings, the Stockholder has no way to confirm the actual capital of Fannie Mae.

Dalton v. Am. Inv. Co, 1981 WL 7618, at *1 (Del. Ch. June 4, 1981) ("[U]nder 8 *Del. C*. [§] 174, absent a timely dissent entered on the books of the corporation, a director is liable for board action which violates . . . [§] 173.").

b) Breach of fiduciary duties

201. In approving the dividends under the Net Worth Sweep, the Board also breached its fiduciary duties: The Third Amendment is void or voidable based upon the statutory and fiduciary breaches described above. A board breaches its fiduciary duties when it approves dividends on stock that is void or voidable. *See Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997) (stating that "a transfer of corporate assets that serves no corporate purpose" constitutes waste); *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 139 & n.113 (Del. Ch. 2009) (finding that a complaint stated a claim for waste and explaining that "committing waste is an act of bad faith" such that directors likely would not be exculpated by a 102(b)(7) provision) (citations omitted). Also, in approving the dividends, the Board approved more unfair transactions with Fannie Mae's controlling stockholder.

202. To the extent that the Board did not approve the dividends, it nonetheless breached its fiduciary and statutory duties in failing to take action to oppose or prevent the dividends. The Board might have opposed them by any number of means, including by board resolution, public comment or court action.

A board may avoid liability for unlawful dividends only by opposing them. *See* 8 *Del. C.* § 174 ("Any director who may have been absent when the same was done, or who may have dissented from the act or resolution by which the same was done, may be exonerated from such liability by causing his or her dissent to be entered on the books containing the minutes of the proceedings of the directors . . . ."); *see also Dalton*, 1981 WL 7618, at *1 ("[U]nder 8 Del. C. [§] 174, absent a timely dissent entered on the books of the corporation, a director is liable for board action which violates . . . [§] 173.").

203. Since the dividends need not have been paid and were enormously harmful to Fannie Mae, the Board again could have had only one reason for standing down: to benefit Fannie Mae's controlling stockholder. As previously explained, a board breaches its fiduciary duty of loyalty when it permits harm to the corporation to benefit a controlling stockholder. *See supra* ¶¶ 190-92. It breaches its fiduciary duty of loyalty when it stands idly by, permitting a controlling stockholder to raid the corporation's coffers. *See supra* ¶ 192.

II. The CSP and Single Security

204. At the time that Fannie Mae's expenditures on CSS, the CSP and the Single Security took place, the Board knew that the expenditures were intended to harm, not benefit, Fannie Mae. Whether or not the expenditures furthered legitimate government policy objectives, Fannie Mae remains a private

corporation, run by its Board for the benefit of its stockholders. The Board is neither required – nor permitted – to gratuitously finance the federal government's initiatives.

205. It is unclear based on public filings and statements whether Fannie Mae's Board affirmatively approved Fannie Mae's investments in the CSP and Single Security or simply abdicated its responsibility to safeguard the best interests of Fannie Mae by failing to prevent these developments. There is no public evidence that Fannie Mae's Board took any steps to halt any of these expenditures or developments despite the clear detriments that they pose to Fannie Mae.

206. As previously stated, a board breaches its fiduciary duty if it approves or fails to take action to prevent transactions that are harmful to the corporation. A board breaches its fiduciary duty of loyalty if it does so while knowing that the transaction will be harmful to the corporation.

CLAIM FOR RELIEF

(Demand for Inspection Pursuant to 8 *Del. C.* § 220)

207. The Stockholder repeats and realleges the foregoing paragraphs as if fully set forth herein.

208. The Stockholder's Demand complies with all of the requirements under Section 220 concerning the form and manner for demanding inspection of books and records.

209. The Stockholder's purposes are proper under Delaware law.

210. The Stockholder has identified credible bases to suspect wrongdoing by the Board and others meriting investigation.

211. Fannie Mae has refused to produce documents in response to the Demand.

212. Pursuant to 8 *Del. C.* § 220, the Stockholder is entitled to an Order permitting him to inspect all of the documents demanded in the Stockholder's Demand.

WHEREFORE, the Stockholder prays for the following relief:

A. An order permitting the immediate inspection of all documents set forth in the Demand.

B. Such other relief as the Court deems just and appropriate.

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