IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA

ANTHONY R. EDWARDS, *et al.*, Plaintiffs, v. DELOITTE & TOUCHE, LLP, Defendant.	No. 1:16-cv-21221

THE FEDERAL HOUSING FINANCE AGENCY'S (A) JOINDER TO MOTION TO STAY AND (B) MOTION TO SUBSTITUTE AS PLAINTIFF AND SUPPORTING MEMORANDUM OF LAW

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April 12, 2016

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INTRODUCTION

The Federal Housing Finance Agency ("FHFA" or the "Conservator"), as Conservator of the Federal National Mortgage Association ("Fannie Mae"), hereby joins the motion of Defendant Deloitte & Touche LLP to stay (Doc. # 7). For the reasons explained in Deloitte's motion, FHFA believes it the most efficient and appropriate course to stay all proceedings in this action for a limited time, pending a determination by the U.S. Judicial Panel on Multidistrict Litigation ("JPML") as to whether this action should be transferred to become part of a proposed consolidated proceeding that involves other, closely-related actions. Indeed, courts have unanimously stayed all proceedings in four other cases being considered for transfer into the same consolidated proceeding.[1]

Should this Court deny the requested stay, however, FHFA respectfully moves, pursuant to Local General Rule 7.1, for an order substituting the Conservator in the place of the shareholder plaintiffs in this action. When it was appointed as Conservator, FHFA "immediately succeed[ed] to . . . all rights, titles, powers, and privileges of [Fannie Mae], *and of any stockholder*" of Fannie Mae. 12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added). In this case, Plaintiffs seek to assert their alleged rights as shareholders of Fannie Mae. But under the governing statutes, FHFA—not Plaintiffs—holds any and all such rights during conservatorship. As such, the Conservator is the only proper plaintiff, and the Court should grant FHFA's motion to substitute.

Plaintiffs' suit challenges the federal government's response to the most serious economic crisis in generations and Deloitte's alleged role in that response. FHFA was created by

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[1] *See* Minute Order, *Roberts v. FHFA*, N.D. Ill. No. 1:16-cv-2107 (Apr. 8, 2016); Order, *Saxton v. FHFA*, N.D. Iowa No. 1:15-cv-00047-LRR (April 4, 2016); Order, *Pagliara v. Fed. Nat'l Mortgage Ass'n*, D. Del. No. 1:16-cv-00193-GMS (April 4, 2016); Order, *Jacobs v. FHFA*, D. Del. No. 1:15-cv-00708-GMS (March 30, 2016).

Congress in the wake of a national crisis in the U.S. housing market in 2008 as an independent federal agency, to supervise and regulate Fannie Mae, the Federal Home Loan Mortgage Corporation ("Freddie Mac") and certain other government-sponsored enterprises. During the fall of 2008, FHFA concluded that Fannie Mae and Freddie Mac were at risk of failure. Given Fannie Mae and Freddie Mac's role in the national economy, and the systemic danger their potential collapse posed, FHFA's Director placed them into conservatorship on September 6, 2008. Soon thereafter, the Conservator and the U.S. Department of Treasury ("Treasury") entered into Preferred Stock Purchase Agreements ("PSPAs"), which made available to Fannie Mae and Freddie Mac a lifeline of hundreds of billions in capital.

Plaintiffs' complaint alleges Deloitte, acting as Fannie Mae's independent auditor, aided and abetted the Conservator and Treasury in breaching alleged fiduciary duties in connection with the operations of Fannie Mae in conservatorship undertaken pursuant to a federal statutory regime. In particular, Plaintiffs allege the Conservator and Treasury improperly amended the PSPAs in the so called Third Amendment, which exchanged a fixed 10% dividend and periodic commitment fee for a variable dividend equal to Fannie Mae's net worth. *See* Compl. ¶¶ 31-43. Plaintiffs allege the Third Amendment harmed Fannie Mae and Plaintiffs' interests as shareholders in Fannie Mae. *Id.* ¶¶ 31-32, 38-40.

Plaintiffs also allege that, from the earliest days of the conservatorship, the Conservator improperly wrote down the value of Fannie Mae's tax assets and loan loss reserves, forcing Fannie Mae to borrow money from Treasury and then pay larger dividends to Treasury, all with the alleged intent that FHFA and Treasury would use Fannie Mae's dividend payments "to bail out Wall Street banks." *Id.* ¶¶ 28, 61. Plaintiffs allege that the Conservator and Treasury could not have engaged in any of this alleged misconduct were it not for Deloitte's assistance. *Id.* ¶ 43.

Additionally, Plaintiffs allege that Deloitte violated federal auditing standards and prolonged the conservatorship in issuing its unqualified audit opinions on Fannie Mae's financial statements. *Id.* ¶¶ 44-99. According to Plaintiffs, Deloitte's misconduct harmed Fannie Mae and also Plaintiffs' interests as shareholders of Fannie Mae. *Id.* ¶¶ 37-38, 40-42. Further, Plaintiffs assert that, absent Deloitte's alleged misconduct, "Fannie Mae would have been able to exit the conservatorship," thus preventing the alleged harm to Plaintiffs. *Id.* ¶ 98.

Though the complaint is obviously premised upon a litany of alleged wrongdoing by the Conservator and Treasury, Plaintiffs have strategically elected not to sue those parties, but instead have asserted claims in this complaint solely against Deloitte.[2] But Plaintiffs' complaint, at its core, is a shareholder challenge to the Third Amendment, and it therefore raises factual and legal issues that are materially identical to the issues raised in myriad other lawsuits already filed by other Fannie Mae (and Freddie Mac) shareholders against the Conservator and Treasury that likewise challenge the Third Amendment. Those suits consistently have been dismissed. *See Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208 (D.D.C. 2014), *appeal pending* No. 14-5243 (D.C. Cir.); *Cont'l W. Ins. Co. v. FHFA*, 83 F. Supp. 3d 828, 840 n. 6 (S.D. Iowa 2015). And the remaining suits are currently the subject of a motion to transfer pending before the U.S. Judicial Panel on Multidistrict Litigation ("JPML"). FHFA and Deloitte likewise have requested the JPML transfer the present case to the proposed consolidated proceedings. *See infra* n.7.

In the event this Court denies a stay or the JPML denies consolidation, this Court should substitute FHFA as Conservator in place of the shareholder Plaintiffs. If the stay is granted,

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[2] Plaintiffs also have filed a nearly identical action against PricewaterhouseCoopers, LLP, the independent auditor for Freddie Mac. *See Edwards v. PricewaterhouseCoopers, LLP*, No. 1:16-cv-21224 (S.D. Fla.).

upon lifting of the stay, FHFA will renew its motion for substitution of FHFA in whichever district court in which the action will proceed.

STATEMENT OF FACTS AND PROCEDURAL HISTORY

A. Fannie Mae, Freddie Mac, and the Housing and Economic Recovery Act of 2008

Fannie Mae, along with Freddie Mac (together, the "Enterprises"), is a federally-created enterprise that facilitates liquidity and efficiency in the housing market by purchasing loans from mortgage lenders, thereby freeing up capital for additional mortgage lending. In July 2008, in the wake of a national crisis in the U.S. housing market, Congress enacted the Housing and Economic Recovery Act of 2008 ("HERA"), Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008); *see* Compl. ¶ 20. HERA created FHFA, an independent federal agency, to supervise and regulate Freddie Mac, Fannie Mae, and certain other government-sponsored enterprises. 12 U.S.C. § 4501 *et seq.*; HERA also granted FHFA's Director authority to place Freddie Mac and Fannie Mae in conservatorship or receivership in specific circumstances. *See* 12 U.S.C. § 4617(a).

B. FHFA is Appointed Statutory Conservator of Freddie Mac and Fannie Mae, Succeeding by Operation of Law to All Rights of the Enterprises and Their Shareholders

In September 2008, shortly after enactment of HERA and at a time when the national housing market was deteriorating, the Director of FHFA placed both of the Enterprises into conservatorships, "for the purpose of reorganizing, rehabilitating, or winding up the[ir] affairs." 12 U.S.C. § 4617(a)(2); *see also* Compl. ¶ 21. Today, both Enterprises remain in conservatorships.

As Conservator, FHFA, "by operation of law, immediately succeed[ed] to . . . all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director

of such regulated entity with respect to the regulated entity and the assets of the regulated entity." 12 U.S.C. § 4617(b)(2)(A)(i). The Conservator is responsible for the conduct of all aspects of each Enterprise's business and affairs, and HERA authorizes it to take such action as may be "necessary to put the regulated entity in a sound and solvent condition" and "appropriate to carry on the business of the regulated entity." *Id.* § 4617(b)(2)(D). FHFA as Conservator thus enjoys full authority to "operate the regulated entity" and "conduct all business of the regulated entity." *Id.* § 4617(b)(2)(B)(i). HERA bars courts from granting any relief that would "restrain or affect" conduct undertaken within the Conservator's expansive powers and functions. *Id.* § 4617(f).

Shortly after becoming Conservator, FHFA entered into the PSPAs with Treasury. *See* Compl. ¶ 22. Under the PSPAs, Treasury agreed to provide hundreds of billions of dollars for the Enterprises' continued operations. In exchange, the PSPAs granted Treasury a comprehensive package of rights, including: (1) an initial senior liquidation preference of $1 billion for each Enterprise; (2) warrants to acquire 79.9% of the Enterprises' common stock for a nominal payment; (3) payment from each Enterprise of a mandatory dividend in the amount of 10% per year of the total amount of funds Treasury provided; and (4) a periodic commitment fee ("PCF") "intended to fully compensate" taxpayers for the continuing Treasury commitment of hundreds of billions of dollars of taxpayer funds.[3]

Both Fannie Mae and Freddie Mac took their first Treasury draws shortly after their placement in conservatorships, and to date, they have drawn more than $187 billion in funds from Treasury to cure negative net worth positions and avoid mandatory receivership under

[3] The PSPAs and each of their amendments are publicly available on FHFA's website at www.fhfa.gov/conservatorship/pages/senior-preferred-stock-purchase-agreements.aspx.

HERA. Fannie Mae has drawn approximately $116 billion in funds from the Treasury commitment. *See* Compl. ¶ 27. Both Enterprises have also paid dividends to Treasury pursuant to the PSPAs. *Id.* ¶ 33.

On August 17, 2012, FHFA and Treasury executed a third amendment to the PSPAs ("the Third Amendment") to (1) replace the annual, fixed-rate 10% cash dividend with a variable quarterly dividend equal to the net worth of the Enterprises, minus a prescribed capital reserve, and (2) waive the PCF for so long as the variable dividend is in place. *See* Compl. ¶¶ 31-43. Thus, under the Third Amendment, Treasury agreed to accept the risk that the Enterprises' profits in any given year might be less than the fixed 10% dividend amount ($18.9 billion per year), plus the amount of the PCF (which was intended to fully compensate the taxpayers for Treasury's ongoing commitment to invest additional funds in the Enterprises, as necessary).

C. Plaintiffs File the Present Lawsuit

On February 29, 2016, Plaintiffs—a mixture of individual and institutional shareholders of Fannie Mae—filed the present complaint in the Circuit Court for the 11th Judicial Circuit in and for Miami-Dade County, Florida. Doc. # 1-1. The complaint asserts two claims on behalf of each plaintiff against Deloitte: (1) negligent misrepresentation, and (2) aiding and abetting alleged breaches of fiduciary duties by FHFA, Treasury, and Fannie Mae's directors and officers.[4] *See, e.g.*, Compl. ¶¶ 100-118.

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[4] Though Plaintiffs allege Fannie Mae's directors and officers breached fiduciary duties owed to Fannie Mae's shareholders (*see, e.g.*, Compl. ¶ 113), those directors and officers have acted only through the authority expressly delegated to them by the Conservator, which has succeeded to "all rights, titles, powers, and privileges" of "any . . . officer, or director" of Fannie Mae. 12 U.S.C. § 4617(b)(2)(A)(i). As Fannie Mae disclosed in its SEC filings: "Our directors serve on behalf of the conservator and exercise their authority as directed by and with the approval, where required, of the conservator. Our directors do not have any duties to any person or entity except to the conservator. Accordingly, our directors are not obligated to consider the interests of the company, the holders of our equity or debt securities or the holders of Fannie

(footnote continued on next page)

On April 6, 2016, Deloitte removed the action to this Court on the basis of federal question jurisdiction. *See* Notice of Removal (Doc. # 1).

D. FHFA's Pending Request That the JPML Transfer This and Other Third Amendment Cases for Coordinated Pretrial Proceedings

Fannie Mae and Freddie Mac shareholders have filed multiple actions in federal court seeking to challenge the Third Amendment. Accordingly, on March 15, 2016, FHFA filed a motion with the JPML to transfer four cases to the U.S. District Court for the District of Columbia for consolidated or coordinated pretrial proceedings pursuant to 28 U.S.C. § 1407.[5] Additionally, on March 28, 2016, FHFA advised the JPML of two related shareholder actions (styled as demands for inspection by shareholders of Fannie Mae and Freddie Mac) and requested that they be transferred to the MDL proceeding.[6]

Plaintiffs' present complaint is based on the same, central factual allegations and raises common and dispositive legal issues with these other cases, including jurisdictional issues that must be resolved at the outset of these cases. Thus, on April 7, 2016, FHFA further advised the JPML that the present suit is related to—and should be transferred to—that MDL proceeding.[7] At the same time, FHFA advised the JPML of the parallel case filed by Plaintiffs against

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(footnote continued)
Mae MBS unless specifically directed to do so by the conservator." Fannie Mae, Annual Report (Form 10-K) (2008), at 20, *available at* http://goo.gl/QxqVYi.

[5] *See In re: Federal Housing Finance Agency, et al. Preferred Stock Purchase Agreements Third Amendment Litigation*, MDL No. 2713 (J.P.M.L.). The four cases subject to the initial transfer motion are: *Saxton v. FHFA*, No. 1:15-cv-00047 (N.D. Iowa filed May 28, 2015); *Jacobs v. FHFA*, No. 1:15-cv-00708 (D. Del. filed Aug. 17, 2015); *Robinson v. FHFA*, No. 7:15-cv-00109 (E.D. Ky. filed Oct. 23, 2015); and *Roberts v. FHFA*, No. 1:16-CV-02107 (N.D. Ill. filed Feb. 10, 2016).

[6] *See* Notice of Related Actions, MDL No. 2713 (Doc. No. 9, filed Mar. 28, 2016).

[7] *See* Notice of Related Actions, MDL No. 2713 (Doc. No. 22, filed Apr. 7, 2016)

PricewaterhouseCoopers, independent auditor of Freddie Mac, and requested that it be transferred as well. *Id.*

On April 11, 2012, Deloitte moved to stay all proceedings in this case pending a determination by the JPML concerning whether this action should be transferred. Doc. # 7. As indicated above, FHFA joins in this request. Indeed, since FHFA filed the original motion to transfer in the JPML, three courts have granted identical motions to stay all proceedings in four other cases being considered for transfer into the same consolidated proceeding. For the reasons stated in Deloitte's motion to stay, this Court should follow suit and stay the present proceedings. If the Court denies a stay, however, the Court should grant FHFA's present motion to substitute the Conservator in place of the current Plaintiffs.

ARGUMENT

I. THE COURT SHOULD SUBSTITUTE FHFA, FANNIE MAE'S CONSERVATOR, IN PLACE OF THE SHAREHOLDER PLAINTIFFS

HERA unambiguously provides that, as Conservator, FHFA alone possesses all "rights, titles, powers, and privileges" of Fannie Mae's shareholders. 12 U.S.C. § 4617(b)(2)(A)(i). Accordingly, only the Conservator has standing to bring the shareholder complaint here.

A. HERA's Plain and Unambiguous Language Mandates Substitution of the Conservator as Plaintiff

HERA's succession provision is far-reaching and clear. During conservatorship, the Conservator "succeed[s] to . . . *all* rights, titles, powers, and privileges . . . of [Fannie Mae] and *of any stockholder* [of Fannie Mae]." *Id.* (emphasis added). By this provision, "Congress . . . transferred everything it could to the conservator." *Kellmer v. Raines*, 674 F.3d 848, 851 (D.C. Cir. 2012) (quoting *Pareto v. FDIC*, 139 F.3d 696, 700 (9th Cir. 1998)) (alteration omitted). "[T]he plain meaning of the statute is that *all* rights previously held by Freddie Mac's stockholders . . . now belong exclusively to the FHFA." *In re Fed. Home Loan Mortg. Corp.*

Deriv. Litig., 643 F. Supp. 2d 790, 795 (E.D. Va. 2009) ("*In re: Freddie Mac*"), *aff'd sub nom La. Mun. Police Emps. Ret. Sys. v. FHFA*, 434 F. App'x 188 (4th Cir. 2011) (emphasis in original). HERA's succession provision "clearly demonstrates Congressional intent to transfer as much control of [the Enterprises] as possible to the FHFA," *In re: Freddie Mac*, 643 F. Supp. 2d at 797, and serves to "assure the expeditious and orderly protection of all who are interested in [Fannie Mae] by placing the pursuit of its rights, protection of its assets, and payment of its liabilities firmly in the hands of a single, congressionally designated agency." *Pareto*, 139 F.3d at 700 (interpreting a materially-identical provision in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101–73, 103 Stat. 183).

In light of HERA's succession provision, courts consistently permit FHFA as Conservator to substitute itself in place of plaintiffs asserting claims based on their status as shareholders of Fannie Mae and Freddie Mac. *See Kellmer*, 674 F.3d at 850-51 (affirming FHFA's substitution in place of Fannie Mae shareholder asserting claims against former officers and directors and various third parties for, *inter alia*, aiding and abetting breach of fiduciary duty and negligence); *Gail C. Sweeney Estate Marital Tr. v. U.S. Treasury Dep't*, 68 F. Supp. 3d 116, 117 (D.D.C. 2014) (granting FHFA motion to substitute in place of a Fannie Mae shareholder asserting claims for breach of fiduciary duty, abuse of control, waste, and mismanagement); *Esther Sadowsky Testamentary Tr. v. Syron*, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009) (same, for Freddie Mac shareholder asserting similar claims). For example, in *In re Federal Home Loan Mortgage Corporation Derivative Litigation*, shareholders of Freddie Mac brought claims against, *inter alia*, PricewaterhouseCoopers LLP, Freddie Mac's independent auditor, for claims very similar to those asserted here: namely, aiding and abetting alleged breaches of fiduciary duties by Freddie Mac's officers and directors and also for professional malpractice. *In re:*

Freddie Mac, 643 F. Supp. 2d at 793.[8] Relying on HERA's succession provision, the Court granted FHFA's motion to substitute itself in place of these plaintiffs, observing that "the plain meaning of the statute is that *all* rights previously held by Freddie Mac's stockholders" can now be exercised only by the Conservator. *Id.* at 795. The Fourth Circuit affirmed. *See La. Mun. Police Employees Ret. Sys. v. FHFA*, 434 F. App'x 188 (4th Cir. 2011)

For the same reasons, courts also have dismissed shareholder claims for lack of standing in light of HERA's succession provision and FIRREA's materially-identical provision. *See Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 229 (D.D.C. 2014) (dismissing breach of fiduciary duty claims asserted by Fannie Mae and Freddie Mac shareholders for lack of standing in light of HERA's succession provision). For example, in *Lubin v. Skow*, the Eleventh Circuit interpreted FIRREA's succession provision to deprive shareholders of standing to assert derivative claims asserted by the shareholder-owner of a bank in receivership. 382 F. App'x 866, 871 (11th Cir. 2010); *see also Pareto*, 139 F.3d at 701 (affirming dismissal of claims asserted by shareholders of bank in receivership due to lack of standing).

In this case, Plaintiffs seek to assert their purported rights as shareholders of Fannie Mae—namely, the asserted rights to enforce alleged breaches of fiduciary duty committed by FHFA and Treasury (Compl. ¶¶ 112-118), and alleged misrepresentations by Deloitte (*id.* ¶¶ 100-111). Because FHFA has succeeded to "all rights, titles, powers, and privileges" of Fannie Mae and its shareholders—including Plaintiffs—during conservatorship, the FHFA as Conservator has succeeded to those rights Plaintiffs seek to assert through this suit. Accordingly,

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[8] The complaint that asserted claims against PricewaterhouseCoopers is available at *R.S. Bassman v. Syron*, No. 1:08-cv-1247 (E.D. Va.) (Doc. # 47 at ¶¶ 173-176)

the Court should grant FHFA's motion and order the FHFA as Conservator of Fannie Mae should be substituted in place of the shareholder Plaintiffs.

B. Congress's Grant of Authority Over "All" Shareholder Rights Is Not Limited To the Right to Bring Derivative Claims

Plaintiffs in other cases have opposed the Conservator's substitution by arguing—unsuccessfully—that HERA's succession provision applies only to *derivative* claims—*i.e.*, those claims asserted on behalf of the company—and not to *direct* claims—*i.e.*, those claims asserted on behalf of the shareholder itself. That argument fails.

By its plain text, HERA transfers "*all*" shareholder rights to the Conservator, not just the right to assert derivative claims. "It is well settled that the starting point for interpreting a statute is the language of the statute itself. When [a] statute's language is plain, the sole function of the courts ... is to enforce it according to its terms." *Montgomery Cty. Comm'n v. FHFA*, 776 F.3d 1247, 1255 (11th Cir. 2015) (internal quotation marks and citations omitted). Accordingly, the only interpretative tool needed to analyze HERA's succession provision is to adhere to Justice Frankfurter's admonition: "(1) Read the statute; (2) read the statute; (3) read the statute!" *Kellmer*, 674 F.3d at 850. The statute provides that FHFA as Conservator succeeded to "*all* rights . . . of any stockholder" with respect to Freddie Mac and its assets. "[A]ll rights" means just that—*all* rights. *See Montgomery Cty.*, 776 F.3d at 1255 (holding the "straightforward interpretation" of HERA's exemption from "all taxation" was that the Enterprises are "exempt from *all* state taxation"). Furthermore, "courts must not interpret one provision of a statute to render another provision meaningless." *Huff v. DeKalb County,* 516 F.3d 1273, 1280 (11th Cir. 2008). The Conservator already can pursue what would be derivative claims, as those claims belong to Fannie Mae, not any shareholder. *See* 12 U.S.C. § 4617(b)(2)(A)(i) (The Conservator "immediately succeed[s] to . . . all rights, titles, powers, and privileges of *the regulated entity*,

and of any stockholder . . . ") (emphasis added)); *Ross v. Bernhard*, 396 U.S. 531, 538 (1970) ("The claim pressed by the stockholder against directors or third parties is not his own but the corporation's.") (internal quotation marks and citation omitted)). Because creating a "direct claims" exception would render part of the statute meaningless, such an exception should be rejected.[9]

C. In All Events, Plaintiffs' Claims Are Derivative, Not Direct

While HERA's plain text resolves the issue of whether the Conservator's succession to "all" shareholder rights includes the right to assert direct claims, the Court need not even resolve that issue because the claims Plaintiffs assert are, in fact, derivative. The difference between direct and derivative claims is well-established and governed by two questions: "(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).[10] Here, Plaintiffs' claims are derivative on their face based on the harms they assert and relief they seek.

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[9] In advocating for a direct claims exception, Plaintiffs may also cite *Lubin v. Skow*, 382 F. App'x 866 (11th Cir. 2010), an unpublished Eleventh Circuit decision in which the court held a shareholder plaintiff lacked standing to assert derivative claims in light of FIRREA's succession provision. Although the court made a passing statement that "FIRREA would not be a bar to standing" if the shareholder had asserted direct claims, that statement was pure dicta: the court held all of the claims were derivative, not direct, and thus the court had no need to address FIRREA's impact on possibly direct claims. *Id.* at 871; *see also Pretka v. Kolter City Plaza II, Inc.*, 608 F.3d 744, 762 (11th Cir. 2010) (defining dicta to include statements "not necessary to the decision of an appeal given the facts and circumstances of the case"). "[D]icta is not binding on anyone for any purpose." *Edwards v. Prime, Inc.*, 602 F.3d 1276, 1298 (11th Cir. 2010).

[10] The Enterprises must comply with federal law and their federal charters, which were created by Congress. *See* 12 U.S.C. § 1716 *et seq.*; *id.* § 1451 *et seq.*; 12 C.F.R. § 1710.10(a). For issues not addressed by federal law or their charters, the Enterprises may follow the applicable corporate governance practices and procedures of Delaware law (or the law of the

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1. Plaintiffs' Aiding and Abetting Breach of Fiduciary Duty Claims Are Derivative

Plaintiffs allege that FHFA and Treasury breached fiduciary duties owed to Fannie Mae and its shareholders by executing the Third Amendment, and that Deloitte aided and abetted FHFA and Treasury in connection with their alleged breach. Compl. ¶¶ 31-43, 118.

Plaintiffs' aiding and abetting claims are derivative. To answer the first *Tooley* prong—which asks "who suffered the alleged harm (the corporation or the suing stockholders, individually)"?—the Court need look no further than Plaintiffs' own complaint, which alleges the Third Amendment was "detriment[al]" and "contrary to the best interests of Fannie Mae," "offered no benefits whatsoever to Fannie Mae," was "directly contrary" to putting Fannie Mae in a "sound and solvent condition," was "not entirely fair to Fannie Mae," and did not "further any valid business purpose of Fannie Mae." Compl. ¶¶ 37-38, 40-42. Indeed, Plaintiffs' theory is that the Third Amendment allegedly depletes Fannie Mae's assets, thereby leaving no money to distribute to shareholders via dividends and/or liquidation preferences. Allegations regarding the depletion of corporate assets assert a "classically derivative" injury. *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 771 (Del. 2006). Where, as here, Plaintiffs cannot "prevail without showing an injury to the corporation[s]"—indeed, they allege injury to the corporation—Plaintiffs' claims are derivative. *Tooley*, 845 A.2d at 1036.

(footnote continued)
jurisdiction in which the principal office of the Enterprise sits) but only to the extent that state law is not inconsistent with federal law or the charters. 12 C.F.R. § 1710.10(b). In its bylaws, Fannie Mae elected to follow the applicable corporate governance practices and procedures of Delaware law for such issues. *See* Fannie Mae Bylaws Section 1.05 (http://goo.gl/8md6Ru). Here, for purposes of the present motion only, FHFA assumes without conceding that Delaware law concerning whether a claim is direct or derivative is not inconsistent with federal law, and thus could apply here.

Further confirming Plaintiffs' claims are based on alleged harm to Fannie Mae is the fact the complaint is predicated on allegations that the purported breaches of fiduciary duty caused Plaintiffs' shares to lose "value." *See* Compl. ¶¶ 5, 6, 31-32, 38-40, 68, 71-72, 97, 109. It is well established that a reduction in stock value is an "indirect injury" that is derived from—and derivative of—an injury to the company itself; "[i]t does not arise out of any independent or direct harm to the stockholders, individually." *Tooley*, 845 A.2d at 1037. Accordingly, where, as here, alleged wrongdoing "deplete[d] corporate assets that might otherwise [have] be[en] used to benefit the stockholders, such as through a dividend," the claims are derivative because the wrongdoing "harms the stockholders only derivatively so far as their stock loses value." *Protas v. Cavanagh*, No. CIV.A. 6555-VCG, 2012 WL 1580969, at *6 (Del. Ch. May 4, 2012); *see also Perry Capital*, 70 F. Supp. 3d at 235 n.39 (claims alleging "damage to the price of their [Enterprise] shares, as valued by the market . . . are considered derivative under Delaware law"); *id.* 239 n.45 (claims alleging "present damage to the 'value' of the plaintiffs' investment . . . [are] considered derivative and barred under HERA").

Plaintiffs' claims also are derivative under the second *Tooley* prong, which provides that a claim is direct only if the relief sought "flows directly to the stockholders, not to the corporation." *Id.* The fact that Plaintiffs (wrongly) request direct money damages for their aiding and abetting claims does not transform those claims from derivative to direct. Instead, the court "should look to the nature of the wrong and to whom the relief *should* go." *Tooley*, 845 A.2d at 1039 (emphasis added); *see also Chrystall v. Serden Techs.*, 913 F. Supp. 2d 1341, 1362 (S.D. Fla. 2012) (holding breach of fiduciary duty claim seeking money damages based on "devaluation" of plaintiff's stock to be derivative); *In re Ionosphere Clubs, Inc.*, 17 F.3d 600, 605 (2d Cir. 1994) (holding claim derivative because "payment of damages directly to the

plaintiff-stockholders for the diminution in the value of their stock would be inappropriate"). Here, because the fundamental injury alleged constitutes harm to Fannie Mae—*i.e.*, the alleged improper "expropriation" of billions of dollars from Fannie Mae in the form of dividends to Treasury (Compl. ¶¶ 32-34)—the relief (if any) that would flow from such an alleged injury is a return of those dividends to Fannie Mae, not a direct payment to Plaintiffs.

2. Plaintiffs' Negligent Misrepresentation Claims Are Derivative

Plaintiffs also allege Deloitte acted negligently and made a variety of untrue statements (or failures to disclose) in its audit reports, and that Plaintiffs relied on those allegedly deficient reports to their detriment. Compl. ¶ 100-111. However, where—as here—a shareholder alleges that an auditor's (or other corporate representative's) negligence concerning the company's financial condition caused the shareholder to hold his stock, leading to alleged damages, such claims are derivative, not direct. For example, in *Stephenson v. PricewaterhouseCoopers, LLP*, 482 F. App'x 618, 621 (2d Cir. 2012), the Second Circuit, applying *Tooley*, held that a limited partner (akin to a shareholder) "lacks standing to assert a claim based on his decision to remain invested" in the company after receiving allegedly negligent statements by PwC, the company's independent auditor. This was because the limited partner "cannot prevail [on his holding claim] without showing injury to the [partnership as a whole]: his holding claim involves no harm to an individual partner and seeks no recovery for any individual partner, distinct from other partners." *Id.* The court thus found the claims were derivative, not direct. *Id.*[11]

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[11] *See also Smith v. Waste Mgmt., Inc.*, 407 F.3d 381, 385 (5th Cir. 2005) (holding shareholder claims of negligent misrepresentation that induced shareholder to hold stock were derivative); *Broyles v. Cantor Fitzgerald & Co.*, No. CIV.A. 10-857-JJB, 2013 WL 1681150, at *8 (M.D. La. Apr. 17, 2013) (holding claims that shareholders "held their shares . . . based on alleged misrepresentation . . . do not rise to a direct claim"); *In re Phar-Mor, Inc. Sec. Litig.*, 900 F. Supp. 777, 783-84 (W.D. Pa. 1994) (holding claim based on auditor's negligence to be

(footnote continued on next page)

That Plaintiffs also tack on the conclusory and imprecise allegation that they relied on Deloitte's alleged misrepresentations in "*purchasing or* holding" their stock does not render their claims direct. *See, e.g.*, Compl. ¶ 105, 124, 143 (emphasis added). For example, in *Ernst & Young Ltd. v. Quinn*, No. CIV.A. 09-CV-1164JCH, 2009 WL 3571573, at *6 (D. Conn. Oct. 26, 2009), investors asserted claims of negligent misrepresentation against Ernst & Young, the company's auditor, alleging that, absent Ernst & Young's alleged misrepresentations, the investors—much like Plaintiffs here—"would not have purchased, continued to purchase, or retained their . . . investment interests in the [company]." The court held that such a claim was derivative because it was dependent upon injury to the company in the first instance. *See id.*[12]

* * *

In sum, Plaintiffs' claims are derivative, not direct. But even if they are direct, the Court should nevertheless substitute the Conservator in place of Plaintiffs in light of HERA's plain and unambiguous language providing that the Conservator succeeds to "all" shareholder rights.[13]

(footnote continued)
derivative because it "resulted in, first and foremost, an injury to [the company], to-wit, a decline in corporate worth," and the shareholders' losses were "merely incidental to that decline")

[12] Additionally, to the extent Plaintiffs are attempting to assert claims based purely on a negligent inducement to purchase Fannie Mae stock, they have failed to plead such a claim by, *inter alia*, failing to allege the timing of any Plaintiff's purchase of Fannie Mae stock—*i.e.*, whether it was before or after the alleged misrepresentation, and based on which alleged misrepresentations. In fact, Plaintiffs allege that they all "were shareholders of Fannie Mae during all times relevant to this action." Compl. ¶ 11.

[13] Plaintiffs allege the Third Amendment was the result of a "manifest conflict of interest" by Treasury and FHFA. Compl. ¶¶ 39-40. To the extent Plaintiffs intend to ask the Court to create an exception to HERA's succession provision for a "manifest conflict-of-interest," such a request should also be rejected. As the District Court for the District of Columbia held: "HERA provides no qualification for its bar on shareholder derivative suits, and neither will this Court. . . . Therefore, the Court finds that HERA's plain language bars shareholder derivative suits, without exception." *Perry Capital*, 70 F. Supp. 3d at 231-32 (noting a conflict of interest exception "would swallow the rule").

D. Permitting Plaintiffs to Proceed With Their Claims Would Violate 12 U.S.C. § 4617(f)

Finally, permitting Plaintiffs to continue to prosecute this action, despite the Conservator's succession to "all rights" of the shareholders, would run afoul of HERA's jurisdiction-withdrawal provision, 12 U.S.C. § 4617(f), which provides that "no court may take any action to restrain or affect the exercise of powers or functions of the [FHFA] as a conservator." The decision whether to pursue any of Plaintiffs' claims against Deloitte would fall within the Conservator's powers and functions, which specifically include authority to "operate [Fannie Mae] with all the powers of the shareholders, the directors, and the officers," to "conduct all business of [Fannie Mae]," and to "perform all functions of [Fannie Mae] consistent with the appointment as conservator," *id.* §§ 4617(b)(2)(B) (i),(iii). *See Sweeney Estate Marital Tr.*, 68 F. Supp. 3d at 125-26 (observing that "whether or not to spend Fannie Mae's assets on a lawsuit against Treasury is plainly the type of business decision Congress entrusted to the Conservator in HERA"). Thus, "to permit plaintiff to bring an action which the conservator has declined to bring would interfere with and potentially usurp precisely the powers granted to the FHFA by HERA." *Id.* at 126 (internal quotation marks and citation omitted).

Indeed, in numerous decisions granting FHFA's motions to substitute in place of Fannie Mae or Freddie Mac shareholder plaintiffs, courts have held that Section 4617(f) also bars the shareholder from continuing the action. *See, e.g.*, *id.* at 119 (granting substitution in part because Section 4617(f) "suggests that the Court may not be empowered to authorize plaintiff to pursue litigation that the Conservator has declined to pursue"); *Sadowsky*, 639 F. Supp. 2d at 350 (Without substitution, suit would violate Section 4617(f) "since maintenance of this suit with the shareholders acting as Plaintiffs would be inconsistent with the Conservator's exercise of its statutory purposes."); *In re Fed. Nat'l Mortg. Ass'n Sec., Deriv., & "ERISA" Litig.*, 629 F. Supp.

2d 1, 4 n.4 (D.D.C. 2009) ("[A]llowing plaintiffs to continue to pursue derivative claims independent of FHFA would require this Court to take action that would 'restrain or affect' FHFA's discretion" in violation of § 4617(f).), *aff'd Kellmer*, 674 F.3d at 851; *In re: Freddie Mac*, 643 F. Supp. 2d at 797 (Section 4617(f) "clearly demonstrates Congressional intent to transfer as much control of Freddie Mac as possible to the FHFA, including any right to sue on behalf of the corporation."). So too here: denying FHFA's substitution and allowing Plaintiffs to continue prosecuting their claims would "be inconsistent with the Conservator's exercise of its statutory power" and thus would violate Section 4617(f). *Sadowsky*, 639 F. Supp. 2d at 350.

CONCLUSION

For the reasons stated in Deloitte's motion to stay, this Court should stay all proceedings pending a determination by the JPML concerning whether this action should be transferred. If the Court denies a stay or the JPML denies transfer, the Court should substitute FHFA as Conservator in place of the current Plaintiffs in this suit.

LOCAL RULE 7.1 CERTIFICATION

The undersigned certifies that counsel for the movant has conferred with counsel for plaintiffs in a good faith effort to resolve the issues raised in this motion, and plaintiffs do not agree with the relief requested.

Dated: April 12, 2016

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned certifies that, on April 12, 2016, a true and correct copy of the foregoing was filed electronically using the Court's CM/ECF system, causing a true and correct copy to be served on all counsel of record. I also served the following counsel of record via e-mail:

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