UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

CHRISTOPHER ROBERTS, and THOMAS P. FISCHER, Plaintiffs, v. THE FEDERAL HOUSING FINANCE AGENCY, in its capacity as Conservator of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, MELVIN L. WATT, in his official capacity as Director of the Federal Housing Finance Agency, JACOB J. LEW, in his official capacity as Secretary of the Treasury, and THE DEPARTMENT OF THE TREASURY, Defendants.	Civil Action No. 1:16-CV-02107

DEPARTMENT OF THE TREASURY AND TREASURY SECRETARY JACOB J. LEW'S MEMORANDUM IN SUPPORT OF THEIR MOTION TO DISMISS THE AMENDED COMPLAINT

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INTRODUCTION

As was the case with the numerous lawsuits that preceded it, the claims in this suit fail for lack of jurisdiction and, further, fail to state a claim. The plaintiffs in this case are shareholders in the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, "the GSEs"). They seek to challenge the actions taken by the United States Department of the Treasury ("Treasury") and the Federal Housing Finance Agency ("FHFA") to stabilize the GSEs, two financial institutions that are essential to the nation's economy. Plaintiffs here assert claims materially identical to those that other district courts have already considered, and rejected, in disposing of ten earlier-filed, coordinated lawsuits in the District of Columbia and an eleventh lawsuit in the Southern District of Iowa challenging the same actions by Treasury and FHFA. *See Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 228-29 (D.D.C. 2014), *appeals docketed*, Nos. 14-5243, 14-5254, 14-5260, 14-5262 (D.C. Cir. Oct. 8, 2014); *Cont'l W. Ins. Co. v. FHFA*, 83 F. Supp. 3d 828, 840 n.6 (S.D. Iowa 2015). This complaint fails on the same grounds that those lawsuits failed, and, for several independent reasons, this suit should also be dismissed.

Plaintiffs' claims fail for the reasons articulated in the Joint Motion to Dismiss Memorandum submitted by Treasury and FHFA. HERA's sweeping jurisdiction-withdrawal provision, 12 U.S.C. § 4617(f), precludes a court from taking "any action to restrain or affect the exercise of powers or functions of [FHFA] as a conservator or a receiver." The Seventh Circuit, like every other circuit to consider the issue, has held that a materially identical provision of the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") deprives courts of subject matter jurisdiction over challenges to the actions of a conservator or receiver. *See Veluchamy v. FDIC*, 706 F.3d 810, 817 (7th Cir. 2013)*; Courtney v. Halleran*, 485 F.3d 942, 948 (7th Cir. 2007) ("[S]ection [1821(j)] prohibits a court from taking any action either to restrain or affect the FDIC's exercise of its powers as a receiver, unless authorization can be found elsewhere in the section"). In addition, HERA's transfer-of-shareholder-rights provision, 12 U.S.C. § 4617(b)(2)(A)(i), bars plaintiffs' suit. Under HERA, the conservator succeeded to "all rights, titles, powers, and privileges of the [GSEs], and of any stockholder[.]" *Id.* This provision "plainly transfers shareholders' ability to bring derivative suits—a 'right[], title[], power[], [or] privilege'—to FHFA." *Kellmer v. Raines*, 674 F.3d 848, 850 (D.C. Cir. 2012).

Plaintiffs' claims against Treasury fail for still other reasons. First, plaintiffs' claims challenging the original Senior Preferred Stock Purchase Agreements (the "PSPAs"), are time barred, as the six year statute of limitations applicable to APA claims has long since run. Second, Plaintiff cannot evade the jurisdiction-withdrawal provision of HERA by naming Treasury as well as FHFA as a defendant. An injunction against either party would "restrain or affect" the exercise of the conservator's powers, and HERA's jurisdiction-withdrawal provision applies to plaintiffs' claims against Treasury. Moreover, the Third Amendment did not constitute an improper purchase of new securities, as plaintiffs claim; rather, Treasury acted within the scope of its authority under HERA. Indeed, recent legislation confirms as much.

Even assuming that jurisdiction over plaintiffs' claims exists, plaintiffs' fiduciary duty claim under the APA is baseless. Finally, plaintiffs' claims are derivative in nature and thus barred under the doctrine of issue preclusion. Derivative claims have already been resolved against the GSEs' shareholders in earlier litigation, and that result requires dismissal of the derivative claims in this case.[1]

LEGAL STANDARD

Defendants move to dismiss all claims pursuant to Rule 12(b)(1) of the Federal Rules of Civil Procedure. Where, as here, a motion to dismiss for lack of jurisdiction is limited to a facial attack on the pleadings, it is subject to the same standard as a motion brought under Rule 12(b)(6). *See Silha v. ACT, Inc.*, 807 F.3d 169, 174 (7th Cir. 2015) (holding "that when evaluating a facial challenge to subject matter jurisdiction under Rule 12(b)(1), a court should use *Twombly-Iqbal*'s 'plausibility' requirement, which is the same standard used to evaluate facial challenges to claims under Rule 12(b)(6).") Under this standard, "[t]o assess whether a complaint states a plausible claim of relief, . . . a court (1) first identifies the well-pleaded factual allegations by discarding the pleadings that are 'no more than conclusions' and (2) then determines whether the remaining well-pleaded factual allegations 'plausibly give rise to an entitlement of relief.'" *Id.* (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009)).

I. PLAINTIFFS' CHALLENGE TO THE PSPAS IS TIME BARRED

Plaintiffs challenge Treasury and FHFA's decision to enter into several provisions of the PSPAs under various theories. *See* Am. Compl. ¶ 192(f) (Prayer for Relief).[2]

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[1] Treasury respectfully refers the Court to the Background section of FHFA and Treasury's Joint Motion, *see Joint Mot.* at 3-9.

[2] Documents incorporated within a complaint by reference are considered part of the pleadings, and may be cited in this Motion to Dismiss, which raises a facial challenge to whether the complaint has stated any claim over which this Court has subject-matter jurisdiction. *Albany Bank & Tr. Co. v. Exxon Mobil Corp.*, 310 F.3d 969, 971 (7th Cir. 2002). Additionally, courts may take judicial notice of Securities and Exchange Commission ("SEC") filings. *See Deicher v. City of Evansville, Wis.*, 545 F.3d 537, 541 (7th Cir. 2008) ("[A] court can take judicial notice of matters of public record."); *Horizon Asset Mgmt. Inc. v. H&R Block, Inc.*, 580 F.3d 755, 761 (8th Cir. 2009) (in resolving a motion to dismiss, courts "may take judicial notice of . . . public SEC

Because more than six years have elapsed between the time FHFA and Treasury entered into the PSPAs and the instigation of this lawsuit, however, plaintiffs' claims are time-barred by the statute of limitations applicable to APA actions.

Although the APA itself does not contain a statute of limitations, 28 U.S.C. § 2401(a) establishes a general six-year statute of limitations applicable to civil actions against the United States. *Solid Waste Agency of N. Cook Cty. v. U.S. Army Corps of Eng'rs*, 191 F.3d 845, 853 (7th Cir. 1999), *vacated on other grounds*, 531 U.S. 159 (2001). This six-year statute of limitations "applies to lawsuits brought pursuant to the APA." *Id.*; *Polanco v. U.S. Drug Enf't Admin.*, 158 F.3d 647, 652 (2d Cir. 1998); *Sierra Club v. Slater*, 120 F.3d 623, 631 (6th Cir. 1997); *see also Vill. of Elk Grove Vill. v. Evans*, 997 F.2d 328, 331 (7th Cir. 1993) (recognizing cases holding the same). "Compliance with the limitations period is a condition of federal court jurisdiction;" unlike an ordinary statute of limitations, "§ 2401(a) is a jurisdictional condition attached to the government's waiver of sovereign immunity, and as such must be strictly construed." *Chenault v. McHugh*, 968 F. Supp. 2d 268, 272 (D.D.C. 2013) (citations omitted).

As plaintiffs concede, Treasury and FHFA entered into the PSPAs on September 7, 2008, Am. Compl. ¶ 56. Plaintiffs did not bring this suit until February 10, 2016, more than seven years following the Agreement. *See* Compl. (ECF 1). "The statute of limitations under 28 U.S.C. § 2401(a) begins to run when the right of action first accrues, which, under the APA, is generally the time of the final agency action." *Heartwood, Inc. v. U.S. Forest Serv.*, 73 F. Supp. 2d 962, 970-71 (S.D. Ill. 1999), *aff'd*, 230 F.3d 947 (7th

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filings").

Cir. 2000). In assessing whether a particular agency action is final, "[t]he core question is whether the agency has completed its decisionmaking process, and whether the result of that process is one that will directly affect the parties." *Id.* (citation omitted). Other courts have described the analysis in even stricter terms, explaining that "[a] cause of action . . . 'first accrues,' within the meaning of § 2401(a), as soon as . . . the person challenging the agency action can institute and maintain a suit in court.". *Spannaus v. Dep't of Justice*, 824 F.2d 52, 56 (D.C. Cir. 1987) (cited in *Historic Eastern Pequots v. Salazar*, 934 F. Supp. 2d 272, 279 (D.D.C. 2013).

Under either analysis, the applicable statute of limitations has run. Plaintiffs are effectively challenging the existence of contractual rights under the terms of the PSPAs, which became final once they were agreed to by FHFA and Treasury in September of 2008. Am. Compl. ¶ 192(f) (Prayer for Relief) (challenging PSPAs sections 5.1-5.6 and 5.8). Although Three Amendments followed the initial PSPAs, *see* Joint Mot. at 8, the contractual provisions plaintiffs challenge have not changed. Accordingly, there is no basis upon which to argue that subsequent amendments restarted the clock for purposes of the statute of limitations.

In addition, the PSPAs undoubtedly "directly affect[ed] the parties," *Heartwood*, 73 F. Supp. 2d at 970-71: FHFA and Treasury entered into a binding contract under which Treasury committed to advance funds to either GSE for each quarter in which that company's liabilities exceeded its assets. *See generally*, Ex. A, Amended and Restated Preferred Stock Purchase Agreements. And, plaintiffs could have instituted and maintained their claims challenging the PSPAs as early as September 2008, such that the cause of action first accrued at that time. Plaintiffs' challenge to the PSPAs is time-barred and must be dismissed for lack of subject matter jurisdiction.

II. HERA'S JURISDICTION-WITHDRAWAL PROVISION BARS PLAINTIFFS' CLAIMS

For the reasons articulated in Treasury and FHFA's Joint Motion, HERA's jurisdiction-withdrawal provision, 12 U.S.C. § 4617(f),[3] effects a sweeping ouster of judicial authority to grant equitable remedies, and FHFA plainly acted within the scope of its statutory authority when it entered into the Third Amendment. *See* Joint Mot. at 13-14. For the reasons articulated below, Section 4617(f) likewise applies to plaintiffs' claims against Treasury, and Treasury did not exceed its statutory authority when it entered into the Third Amendment to the PSPAs.

A. HERA's Jurisdiction-Withdrawal Provision Applies to Plaintiffs' Claims Against Treasury

In Counts II and III, plaintiffs challenge Treasury's conduct in agreeing to the Third Amendment, asserting that Treasury acted outside its statutory authority under HERA. Am. Compl. ¶¶ 170-179; *id.* ¶¶ 180-191. However, Section 4617(f), HERA's jurisdiction-withdrawal provision, does not permit plaintiffs to set aside FHFA's actions by naming Treasury, as well as FHFA, as a defendant. Plaintiffs ask the Court to enter an injunction against Treasury to "return to Fannie and Freddie all dividend payments made pursuant to the Net Worth Sweep" or "recharacteriz[e] such payments as a pay down of the liquidation preference," *see* Am. Compl. ¶ 192(b) (Prayer for Relief), and to "[v]acat[e] and set[] aside the Net Worth Sweep," *id.* ¶ 192(c). But this relief would obviously also "restrain or affect" FHFA, the conservator, as it would effectively set

[3] U.S.C. § 4617(f) provides that "[e]xcept as provided in this section or at the request of the Director, no court may take any action to restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver."

aside an agreement to which the conservator agreed. As the *Perry Capital* court held, "there can be little doubt that enjoining Treasury from partaking in the Third Amendment would restrain FHFA's uncontested authority to determine how to conserve the viability of the GSEs." *Perry Capital*, 70 F. Supp. 3d at 222-23.

Courts applying the Financial Institutions Reform, Recovery, and Enforcement Act's ("FIRREA") analogous jurisdiction-withdrawal provision have reached the same common-sense conclusion, holding that the provision "precludes a court order against a third party which would affect the FDIC as receiver, particularly where the relief would have the same practical result as an order directed against the FDIC in that capacity." *Hindes v. FDIC*, 137 F.3d 148, 160-61 (3d Cir. 1998); *see also Dittmer Props., LP v. FDIC*, 708 F.3d 1011, 1017 (8th Cir. 2013) ("Even though the FDIC has apparently already sold the note in question, if plaintiffs such as Dittmer are allowed to attack the validity of a failed institution's assets by suing the remote purchaser, such actions would certainly restrain or affect the FDIC's powers to deal with the property it is charged with disbursing."); *Telematics Int'l, Inc. v. NEMLC Leasing Corp.*, 967 F.2d 703, 707 (1st Cir. 1992).[4]

B. Treasury Did Not Exceed its Authority Under HERA When it Entered into the Third Amendment to the PSPAs.

[4] The presumption in favor of judicial review does not apply in this case. Section 4617(f) expressly precludes judicial review of agency actions where such review would "restrain or affect" FHFA's exercise of its conservatorship powers, and Congress enacted the emergency investment provisions of 12 U.S.C. § 1719(g) and 12 U.S.C. § 1455(l) as part of the same statute. Because an order invalidating Treasury's contractual agreement with the conservator would "restrain or affect" the conservator, review under the APA is unavailable. Section 4617(f)'s prohibition "qualifies as a reliable indicator of congressional intent to preclude review of non-monetary APA claims brought against both FHFA and Treasury." *Perry Capital*, 70 F. Supp. 3d at 221.

As explained in Treasury and FHFA's Joint Motion, HERA's preclusion of judicial review where such review would "restrain or affect" the conservator requires the dismissal of plaintiffs' claims seeking injunctive relief against Treasury. *See* Joint Mot. at 10-12. In addition, those claims fail as a matter of law. HERA vested Treasury with the authority "to purchase any obligations and other securities" issued by Fannie Mae and Freddie Mac, "on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine." 12 U.S.C. § 1719(g)(1)(A) (Fannie Mae); *id.* § 1455(l)(1)(A) (Freddie Mac).[5] HERA further granted Treasury the authority to, "at any time, exercise any rights received in connection with such purchases." 12 U.S.C. § 1719(g)(2)(A). Treasury may also "hold" or "sell" any securities it acquires, subject to a limitation created by recent legislation, providing that Treasury may not sell its senior preferred stock before January 1, 2018, unless Congress first passes legislation instructing Treasury to do so. 12 U.S.C. § 1719(g)(2)(D); Consolidated Appropriations Act of 2016, H.R. 2029, 114th Cong. § 702(b) (2015) (enacted Dec. 18, 2015). Treasury's authority to purchase new securities from the GSEs expired on December 31, 2009. 12 U.S.C. § 1719(g)(4). Its authority to "exercise any rights received in connection" with earlier purchases, as well as its authority to hold or sell securities, does not expire at any time. *See Id.* § 1719(g)(2)(D).

Plaintiffs are incorrect in asserting that the Third Amendment constituted a "purchase" of new "securities." Treasury obtained no new shares of the GSEs' stock as a result of the Third Amendment. *See Isquith by Isquith v. Caremark Int'l, Inc.*, 136 F.3d 531, 534-536 (7th Cir. 1998) (plaintiffs did not "buy or sell securities" where they "did

[5] For ease of reference, this memorandum will cite to the relevant portions of Fannie Mae's charter, but the statutory language is identical in both charters.

not buy or sell shares" in the relevant companies). Nor did it commit any additional taxpayer funds to the GSEs. As the *Perry Capital* court explained, the Third Amendment merely altered "the compensation structure" of the securities Treasury *already* owned. *Perry Capital*, 70 F. Supp. 3d at 224 . HERA's share-acquisition sunset provision bars only Treasury's purchase of "obligations" or "securities issued by the" GSEs, but does not bar contract amendments or "other non-security-purchasing activities otherwise permitted under an already agreed-upon, pre–2010 investment contract with the GSEs." *Id.* at 223-24 (internal citations omitted). Implying such a restriction would be inappropriate when the amendment plainly falls within Treasury's authority to "hold" or "sell" the securities it owns or to "exercise" previously secured rights.

In the absence of an actual purchase of securities, plaintiffs' complaint adverts to an argument that the Third Amendment "fundamentally changed" Treasury's preferred stock. Am. Compl. ¶¶ 113, 174. The "fundamental change" doctrine, adopted in some securities fraud cases, is an "esoteric and dubious judge-made doctrine" whose ongoing validity has been questioned. *Isquith by Isquith*, 136 F.3d at 535-36. The Seventh Circuit has explained that it "very much doubt[s] that the doctrine retains any validity in any class of case." *Id*. Some courts of appeals have expressly declined to adopt it, *see Katz v. Gerardi*, 655 F.3d 1212, 1221 (10th Cir. 2011), and even those which have accepted it have acknowledged that it "does not cut a wide swath," *Jacobson v. AEG Capital Corp.*, 50 F.3d 1493, 1499 (9th Cir. 1995). It is implausible that Congress intended to incorporate such an "esoteric and dubious" doctrine into HERA's definition of "purchase." *See Perry Capital*, 70 F. Supp. 3d at 224 (declining to apply the "fundamental change" doctrine to HERA's definition of "purchase").[6]

Additionally, even if it were properly before the Court, plaintiffs' claim that Treasury's conduct was arbitrary and capricious because Treasury did not make an emergency determination prior to agreeing to the Third Amendment is also baseless. Am. Compl. ¶¶ 175, 184. The emergency determination and considerations apply "in connection with exercising the authority contained in this paragraph," 12 U.S.C. § 1719(g)(1)(C). "[T]his paragraph" refers to paragraph 1, which sets forth Treasury's authority to purchase securities. But, again, the Third Amendment was not a purchase of securities. Treasury's authority to "hold, exercise any rights received in connection with, or sell" its investment in the GSEs is the subject of a separate statutory provision, which is paragraph 2 of the relevant provisions. 12 U.S.C. § 1719(g)(2)(D).

Finally, plaintiffs' claim that Treasury acted contrary to 12 U.S.C. § 4617(a)(7) by supervising or controlling FHFA fails as a matter of law. *See, e.g.*, Am. Compl. ¶¶ 14, 25, 86, 133, 157, 163, 177. The fact that Treasury and FHFA are counter-parties to a contract explicitly contemplated by Congress does not establish supervision or control. *See Gail C. Sweeney Estate Marital Tr. ex rel. Fed. Nat'l Mortgage Ass'n v. U.S. Treasury Dep't*, 68 F. Supp. 3d 116, 123 (D.D.C. 2014) ("Moreover, it is particularly significant to this analysis that Treasury and the FHFA are counterparties to a contract

[6] In any event, the doctrine is inapplicable on its own terms. It applies "where a defendant's fraud results in a fundamental change in the nature of the plaintiff[s'] investment without the plaintiff[s'] consent." *Katz*, 655 F.3d at 1221 (citation omitted); *Jacobson*, 50 F.3d at 1499 (The fundamental change doctrine is a "narrow" doctrine that applies to "shareholders who, without any say, find themselves fraudulently forced-out of their securities."). Plaintiffs do not claim that the Third Amendment was a change made without Treasury's consent. Treasury and FHFA bargained for the changes and freely consented to those changes. Further, the doctrine could only apply if Treasury were claiming to be defrauded, which it is not

that was authorized by Congress in the HERA statute."). Nor does one party supervise or control another party by engaging in negotiations over the terms of an agreement. *See Perry Capital*, 70 F. Supp. 3d at 227 ("Undoubtedly, many negotiations arise from one party conjuring up an idea, and then bringing their proposal to the other party.").

C. Recent Legislation Confirms that Treasury and FHFA Acted Within the Scope of their Authority Under HERA.

Recent federal legislation provides strong confirmation that both Treasury and FHFA acted within the scope of their authority under HERA and the original PSPAs when they entered into the Third Amendment. It is well established that "an agency's interpretation of a statute may be confirmed or ratified by subsequent congressional failure to change that interpretation." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 45 (1983). Where Congress amends a statute fully aware of an agency's construction, but takes no steps to halt the agency action, then "presumably the legislative intent has been correctly discerned." *N. Haven Bd. of Educ. v. Bell*, 456 U.S. 512, 535 (1982) (citation omitted).

Here, in the Consolidated Appropriations Act, H.R. 2029 § 702 ("the Act"), Congress legislated with respect to the PSPAs between Treasury and the GSEs, giving particular attention to Treasury's authority to exercise its rights received in connection with the PSPAs. The Act defines the PSPAs between Treasury and the GSEs to include both:

> (A) "the Amended and Restated Senior Preferred Stock Purchase Agreement, dated September 26, 2008, as such Agreement has been amended on May 6, 2009, December 24, 2009, and August 17, 2012, respectively, and as such Agreement may be further amended and restated," H.R. 2029 § 702(a)(2)(A); and
> (B) "any provision of any certificate in connection with such Agreement creating or designating the terms, powers, preferences, privileges, limitations, or any other conditions of the Variable Liquidation Preference Senior Preferred Stock of an

enterprise issued or sold pursuant to such Agreement," *id.* § 702(a)(2)(B).

While the Act confirms Treasury's ongoing authority to amend the original PSPAs, *see id.* § 702(a)(2)(A), and leaves in effect Treasury's rights under the stock certificates issued in connection with the Third Amendment, *see id.* § 702(a)(2)(B), the Act limits Treasury's authority under the PSPAs to sell or otherwise dispose of its preferred shares.[7] *Id.* § 702(b).

The statutory text thus makes clear that the amendments to the PSPAs, as well as the right to a variable dividend that Treasury received in connection with the Third Amendment, have "been fully brought to the attention of . . . Congress." *N. Haven Bd. of Educ.*, 456 U.S. at 535 (citation omitted). By expressly predicating parts of the new legislation on the Third Amendment, including the variable dividend that plaintiffs challenge here, Congress approved of the Third Amendment as consistent with Treasury's authority and the duties of the conservator under HERA. First, Congress expressly acknowledged Treasury's ongoing authority under HERA to amend the original PSPA. *See* H.R. 2029 § 702(a)(2)(A) (referring to Treasury's authority to "amend[] and restate[]" the PSPAs). Second, Congress indicated its view that the Third Amendment constituted a valid exercise of Treasury's ongoing authority to amend the original PSPAs. *See id.* (defining the PSPAs between Treasury and the GSEs to include the Agreement as amended on "August 17, 2012"). Third, Congress *expressly* incorporated into the Act Treasury's rights under the stock certificates issued in connection with the Third

[7] The Act directs that "until at least January 1, 2018, the Secretary may not sell, transfer, relinquish, liquidate, divest, or otherwise dispose of any outstanding shares of senior preferred stock acquired pursuant" to the PSPAs "unless Congress has passed and the President has signed into law legislation that includes a specific instruction to the Secretary regarding the sale, transfer, relinquishment, liquidation, divestiture, or other disposition of the senior preferred stock so acquired." *Id.* § 702(b).

Amendment. *See id.* § 702(a)(2)(B). It is clear that "Congress has acquiesced" in Treasury's interpretation of its authority under HERA. *See Basham v. Fin. Am. Corp*., 583 F.2d 918, 923 n.5 (7th Cir. 1978) (citing *Norwegian Nitrogen Prods. Co. v. United States*, 288 U.S. 294, 313 (1933); *Zemel v. Rusk*, 381 U.S. 1, 11 (1965)).

Similarly, the fact that Congress circumscribed Treasury's authority in one area but left Treasury's entitlement to the variable dividend intact, H.R. 2029 § 702(b), further confirms that Treasury and the Conservator acted within their statutory powers in executing the Third Amendment. *See United States v. Rutherford*, 442 U.S. 544, 554, n.10 (1979); *City of Gary, Ind. v. U.S. Dep't of Labor*, 793 F.2d 873, 875 (7th Cir. 1986) (citing *Texarkana Metro. Area Manpower Consortium v. Donovan*, 721 F.2d 1162, 1164 (8th Cir. 1983) (failure of Congress to indicate disapproval of Agency's practice "demonstrated congressional ratification"). And because Congress has specifically instructed Treasury *not* to sell the senior preferred stock until at least until 2018, unless Congress has first enacted legislation instructing Treasury to do so,[8] *see* H.R. 2029 § 702(b), the Act further undermines plaintiffs' assertion that FHFA is misusing its conservatorship powers by not immediately recapitalizing the GSEs and returning them to private control. *See, e.g.*, Am. Compl. ¶¶ 25–26, 102, 112, 157.

III. EVEN ASSUMING THAT JURISDICTION OVER PLAINTIFFS' CLAIM EXISTS, PLAINTIFFS' FIDUCIARY DUTY CLAIM UNDER THE APA IS BASELESS

For the foregoing reasons and for the reasons explained in Treasury and FHFA's Joint Motion, Section 4617(f), HERA's jurisdiction-withdrawal provision, as well as 12 U.S.C. § 4617(b)(2)(A)(i), HERA's transfer-of-shareholder-rights provision, deprive this

[8] In addition, the Act includes a "sense of Congress" provision declaring that: "[i]t is the Sense of Congress that *Congress should pass and the President should sign into law legislation determining the future of Fannie Mae and Freddie Mac*," and that the Secretary should not sell the Senior Preferred Stock until such legislation is passed. *Id*. § 702(c) (emphasis added).

Court of jurisdiction and bar plaintiffs' suit. *See* Joint Mot. at 21-24. However, even if plaintiffs were able to assert their APA claim alleging that Treasury breached its fiduciary duties as an alleged controlling shareholder under Delaware and Virginia law, *see* Am. Compl. ¶¶ 153, 186, 188, that claim would fail as a matter of law.

First, under the Supremacy Clause, state corporate law does not apply of its own force to the federal government. "Under the intergovernmental immunity component of Supremacy Clause jurisprudence, the states may not directly regulate the federal government's operations or property. . . [T]he Constitution itself specifies that Congress retains the '[p]ower to dispose of and make all needful Rules and Regulations respecting the . . . Property belonging to the United States.'" *Arizona v. Bowsher*, 935 F.2d 332, 334 (D.C. Cir. 1991) (citing U.S. Const., art. IV, § 3, cl. 2); *see also Hancock v. Train*, 426 U.S. 167, 179 (1976).

Congress did not create or incorporate a fiduciary duty that requires Treasury to place the interests of shareholders above those of the taxpayers. HERA imposes no fiduciary duties on Treasury; instead, it transfers shareholder rights and privileges to FHFA, and authorizes FHFA to act "in the best interests of [the GSEs] or the Agency." 12 U.S.C. § 4617(b)(2)(J)(ii). Treasury's duty under HERA is to assist in stabilizing the housing market and to protect the American taxpayer, and the "considerations" referenced in plaintiff's complaint are set forth "[t]o protect the taxpayers," 12 U.S.C. § 1719(g)(1)(C), not to promote the private interests of shareholders. Thus, even if state law could be applied to Treasury (and the Supremacy Clause ensures that it cannot), the imposition of state law fiduciary obligations on Treasury would upset the balance of policy considerations underlying Congress's authorization to extend funds to the GSEs.

Cf. Starr Int'l Co. v. Fed. Reserve Bank of N.Y., 742 F.3d 37, 42 (2d Cir. 2014) (holding that federal law preempted asserted fiduciary duty under Delaware law).

Second, Treasury is not a controlling shareholder within the meaning of state corporation law. A controlling shareholder of a corporation either owns a majority of the corporation's voting shares, or it exercises actual control over the corporation's affairs. *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987). Treasury is not and has never been a majority shareholder, nor does it have voting rights in the GSEs. Its rights as a senior preferred shareholder are entirely contractual.

That Treasury holds warrants to purchase common stock and contractual rights of refusal over the issuance of stock or debt does not establish control of the GSEs. An alleged "potential ability to exercise control" does not suffice to create a fiduciary duty; the plaintiff must instead plead and show, "the actual *exercise* of that ability." *In re Sea-Land Corp. S'holders Litig.*, Civ. A. No. 8453, 1987 WL 11283, at *5 (Del. Ch. May 22, 1987). Plaintiffs incorrectly allege that Treasury's contractual rights under the PSPAs make it a controlling shareholder. Am. Compl. ¶ 187. Even "a significant shareholder, who exercises a duly-obtained contractual right that somehow limits or restricts the actions that a corporation otherwise would take, does not become, without more, a controlling shareholder for that particular purpose." *Superior Vision Servs. v. ReliaStar Life Ins. Co.*, No. Civ. A. 1668-N, 2006 WL 2521426, at *5 (Del. Ch. 2006); *see also Starr Int'l Co. v. Fed. Reserve Bank of N.Y.*, 906 F. Supp. 2d 202, 221-25 (S.D.N.Y. 2012), *aff'd*, 742 F.3d 37 (2d Cir. 2014).

IV. PLAINTIFFS ARE BARRED BY THE DOCTRINE OF ISSUE PRECLUSION FROM PURSUING DERIVATIVE CLAIMS IN THIS CASE

The doctrine of issue preclusion, or collateral estoppel, "bars successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment, even if the issue recurs in the context of a different claim." *Taylor v. Sturgell*, 553 U.S. 880, 892 (2008) (citation omitted). Other shareholders, purporting to bring derivative actions on behalf of the GSEs, have already litigated the legal issues pertinent here, and lost on those issues in the *Perry Capital* case. The plaintiffs here bring a derivative action on behalf of the same GSEs, and are barred by the district court's determinations in *Perry Capital*.

In this Circuit, issue preclusion has four basic elements: (1) the issue sought to be precluded must be the same as the issue involved in the prior litigation; (2) the issue sought to be precluded must have been actually litigated in the prior litigation; (3) the determination of the issue in the prior litigation must have been essential to the final judgment; and (4) the party against whom estoppel is invoked must have been fully represented in the prior action. *Adams v. City of Indianapolis*, 742 F.3d 720, 736 (7th Cir. 2014) (citing *Matrix IV, Inc. v. Am. Nat'l Bank & Trust Co. of Chi.*, 649 F.3d 539, 547 (7th Cir. 2011)). All four elements are satisfied here.

A. Plaintiffs' Claims Are Derivative, and Thus the GSEs Are the Real Parties in Interest, Both Here and in *Perry Capital*

First, plaintiffs were fully represented in *Perry Capital* because, like plaintiffs here, the plaintiffs in *Perry Capital* brought derivative claims on behalf of the GSEs, the real parties in interest in both cases. "It is a matter of black-letter law that the plaintiff in a derivative suit represents the corporation [here, the GSEs], which is the real party in interest." *In re Sonus Networks, Inc., S'holder Derivative Litig.*, 499 F.3d 47, 63 (1st Cir. 2007) (citing *Clark v. Lacy*, 376 F.3d 682, 686 (7th Cir. 2004)). Accordingly, where a second shareholder derivative action follows the resolution of a prior shareholder derivative action, the corporation—and thus all of its shareholders—necessarily are bound by the issues decided in the first action, "even if different shareholders prosecute the suits." *Sonus*, 499 F.3d at 64; *see also id*. (observing that where "defendants have already been put to the trouble of litigating the very question at issue . . . the policy of repose strongly militates in favor of preclusion").[9]

In *Perry Capital*, the court addressed and dismissed avowedly derivative claims challenging the Third Amendment. *See* 70 F. Supp. 3d at 218 ("The class plaintiffs have brought . . . derivative claims of breach of fiduciary duty."). Accordingly, because plaintiffs' claims in the present case are also derivative, the GSEs are the real parties in interest in both cases, thereby satisfying the party representation requirement of issue preclusion.

"A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities." *Dole Food Co. v. Patrickson*, 538 U.S. 468, 474 (2003). Accordingly, shareholders generally lack standing to assert claims belonging to the corporation. *Franchise Tax Bd. of Cal. v. Alcan Aluminium Ltd.*, 493 U.S. 331, 336 (1990). In a derivative suit, any recovery flows to the corporate treasury; in a direct suit, it flows only to the individual plaintiff-shareholders. To the extent that funds rightfully belonging to the corporation are diverted to particular shareholders, the corporation has fewer resources available for its business and fewer assets available to satisfy the claims of its creditors. *See, e.g.*, *St. Clair Shores Gen. Emps. Ret. Sys. v. Eibeler*, 745 F. Supp.

[9] *See also Arduini v. Hart*, 774 F.3d 622, 633-34 (9th Cir. 2014) (similar); *Cottrell v. Duke*, 737 F.3d 1238, 1243 (8th Cir. 2013) (similar); *Respler ex rel. Magnum Hunter Res. Corp. v. Evans*, 17 F. Supp. 3d 418, 421 (D. Del. 2014) (similar); *Del. Cty. Emps. Ret. Fund v. Portnoy*, Civil Action NO. 13-10405-DJC, 2014 WL 1271528, at *7–8 (D. Mass. Mar. 26, 2014) (similar); *Hanson v. Odyssey Healthcare, Inc.*, Civil Action No. 3:04-CV-2751-N, 2007 WL 5186795, at *5 (N.D. Tex. Sept. 21, 2007) (similar).

2d 303, 311 (S.D.N.Y. 2010) ("Generally, when a corporation commits waste through overpayment, it is the corporation that is damaged directly and the shareholders suffer only derivative injury.").

The determination of whether federal-law claims, such as the APA claims asserted by plaintiffs, are direct or derivative is governed by federal law. *See* 7C CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE & PROCEDURE § 1821 (3d ed. 2015); *cf. Rifkin v. Bear Stearns & Co.*, 248 F.3d 628, 631 (7th Cir. 2001) ("[S]tanding to bring a federal claim in federal court is exclusively a question of federal law."). However, where standing turns on the "allocation of governing power within [a] corporation," federal law can look to state-law principles. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 99 (1991); *see also Strougo v. Bassini*, 282 F.3d 162, 168 (2d Cir. 2002) (addressing state law in determining shareholder standing under federal statute).

The principles for distinguishing direct from derivative claims are consistent across federal and state law. The analysis is 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] A claim is "direct" when "the duty breached was owed to the stockholder" and the shareholder "can prevail without showing an injury to the

[10] *Citigroup Inc. v. AHW Inv. P'ship*, No. 641, 2015, 2016 WL 2994902 (Del. May 24, 2016) does not undermine the conclusion that plaintiffs' APA claims are derivative in nature or that *Tooley* provides the relevant analytical framework. *AHW* simply recognizes that *Tooley* applies where: 1) there is a breach of fiduciary duty claim; or 2) the claim belongs to the Corporation. *AHW*, 2016 WL 2994902, at *2. Both conditions are present here. Plaintiffs have argued that Treasury breached its fiduciary duty to private shareholders, *see* Am. Compl. ¶¶ 153, 187, and under the shareholder standing rule applicable to APA claims, shareholders such as plaintiffs lack standing to assert claims belonging to the Corporation. *See Franchise Tax Bd. of Cal.*, 493 U.Sat 336. Accordingly, the claims belong to the GSEs, and *Tooley* plainly applies to the present case.

corporation." *Tooley*, 845 A.2d at 1039. A claim is "derivative" if the harm to the shareholder is the byproduct of some injury to the corporate body as a whole. *Id.*; *see also Rawoof v. Texor Petroleum Co.*, 521 F.3d 750, 757 (7th Cir. 2008) (observing direct claims are permitted only where the shareholder plaintiff "has suffered a direct, personal injury independent of the derivative injury common to all shareholders").

Thus, 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*, Civil Action No. 6555-VCG, 2012 WL 1580969, at *6 (Del. Ch. May 4, 2012). Further, "[w]here all of a corporation's stockholders are harmed and would recover *pro rata* in proportion with their ownership of the corporation's stock solely because they are stockholders, then the claim is derivative in nature." *Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008); *see also, e.g.*, *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006). Finally, "claims that [defendants] caused the company to enter into a series of 'unfair' transactions that have 'involved self-dealing' and 'diverting assets' are fundamentally claims belonging to the corporation and to [shareholders] only derivatively." *See Cowin v. Bresler*, 741 F.2d 410, 416 (D.C. Cir. 1984); *see also Pareto v. FDIC*, 139 F.3d 696, 699 (9th Cir. 1998) ("Pareto's allegations – that the directors breached their duties of care and loyalty by failing to safeguard Barbary Coast's assets and equity, mismanaging its operations, improperly placing it into voluntary receivership, and failing to exercise due diligence during merger attempts – describe a direct injury to the bank, not the individual stockholders.").

Plaintiffs' claims are derivative. To determine who suffered the alleged harm, the

Court need look no further than plaintiffs' own complaint, which alleges the Third Amendment harms the GSEs by "forcing" them to transfer their net worth to Treasury for no "meaningful consideration in return," thereby putting the GSEs "in a *worse* position." Am. Compl. ¶¶ 1, 17, 120, 146; *see also id.* ¶ 26 (alleging the Third Amendment "perversely pushes the Companies to the edge of insolvency by stripping the capital out of the Companies on a quarterly basis"). Indeed, plaintiffs' entire theory of the case is that the Third Amendment is allegedly arbitrary and capricious because it depletes the GSEs' assets. Because plaintiffs cannot "prevail without showing an injury to the corporation[s]"—indeed, they *allege* injury to the GSEs—Plaintiffs' claims are derivative. *Tooley*, 845 A.2d at 1036.

Further, the GSEs would receive the benefit of the remedies Plaintiffs seek; any benefit obtained by plaintiffs would be indirect and derivative. *See id.* (claim is direct only if the relief sought "flows directly to the stockholders, not to the corporation"); *Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC*, 922 A.2d 1169, 1179 (Del. Ch. 2006) (claim is direct only where "no relief flows to the corporation"). Plaintiffs ask that the Third Amendment be declared invalid and enjoined, so that future increases in net worth would be retained by the GSEs, and also request that the dividends Treasury has already received be returned to the GSEs. Am. Compl. ¶ 192(a)-(c) (Prayer for Relief). Such an order would not benefit plaintiffs directly. The relief sought, in Plaintiffs' view, would enrich the GSEs and therefore make plaintiffs' stock in the GSEs more valuable. Similarly, the harm that plaintiffs allege – the assertedly improper transfer of the GSEs' net worth to Treasury – was suffered by the GSEs. *See, e.g.*, Am. Compl. ¶ 26 ("the Net Worth Sweep requires the dissipation of assets by forcing the Companies to pay their net worth to Treasury every three months."). Plaintiffs' claims are thus quintessential derivative claims. *Tooley*, 845 A.2d at 1033, 1039; *Feldman*, 951 A.2d at 733.

Finally, that the Third Amendment will allegedly cause plaintiffs indirect harm as shareholders, such as a decline in the future value of their shares or a reduced likelihood of future dividends or liquidation payouts, does not transform their claims into direct claims. *See, e.g.*, *Tooley*, 845 A.2d at 1037 (claim is derivative where "the indirect injury to the stockholders arising out of the harm to the corporation comes about solely by virtue of their stockholdings").[11] Further, plaintiffs cannot transform their claims from derivative to direct by alleging that the reduced likelihood of future dividend payments or liquidation payouts somehow "confiscated the existing and potential value" of plaintiff's stock. Am. Compl. ¶ 110. That is merely "a veneer over a derivative claim." *Levin v. Miller*, 763 F.3d 667, 670 (7th Cir. 2014).

B. The Remaining Elements of Issue Preclusion Are Satisfied

In addition to satisfying the party representation element, plaintiffs' claims likewise satisfy the remaining elements of issue preclusion.

First, the issues here and in *Perry Capital* are the same and were actually litigated. The district court in *Perry Capital* considered explicitly derivative claims brought as part of a putative class action on behalf of GSE shareholders and concluded: (1) that section 4617(f) barred the equitable relief, including rescission, sought in the derivative claims;

[11] *See also Bixler v. Foster*, 596 F.3d 751, 758 (10th Cir. 2010) ("Because plaintiffs' injuries were based on the diminution of the value of their METCO shares, and not on direct injury to them, we conclude their [federal RICO] claims are derivative of the corporation's."); *Sax v. World Wide Press, Inc.*, 809 F.2d 610, 614 (9th Cir. 1987) ("Even if the defendants depleted [the company's] assets with the sole purpose of decreasing the value of [plaintiff's] stock and destroying his return on his investment, the action would nonetheless be derivative."). *Starr v. !Hey, Inc.*, No. 01 C 6087, 2003 WL 21212596, at *2 (N.D. Ill. May 23, 2003) (finding claim derivative where alleged injury "results from the diminution of the value of [plaintiff's] shares and [is] one that he has in common with other shareholders").

and (2) that section 4617(b)(2)(A) barred any derivative claims by shareholders concerning the PSPAs and that no "conflict of interest" exception to the application of § 4617(b)(2)(A) exists. 70 F. Supp. 3d at 229-39 & n.24. Issue preclusion bars plaintiffs from re-litigating those same issues in another derivative action. *See Taylor*, 553 U.S. at 892 ("Issue preclusion, in contrast, bars successive litigation . . . even if the issue recurs in the context of a different claim.") (citation omitted).

Second, the issues decided in *Perry Capital*—namely, the bar on equitable relief, the transfer of shareholder rights to the conservator, and the inapplicability of a conflict of interest provision, were all essential to the district court's judgment in *Perry Capital*. *See, e.g., Perry Capital*, 70 F. Supp. 3d at 221-39. Thus the "essential" to the prior judgment element is also met. *See Cont'l Western*, 83 F. Supp. 3d at 839-40. Further, the dismissal of the derivative actions in the District of Columbia was a "final judgment" for purposes of issue preclusion. It is irrelevant that the suits were dismissed for lack of subject matter jurisdiction. A dismissal for lack of jurisdiction carries preclusive effect "with respect to the jurisdictional ruling itself," and therefore, precludes a second cause of action plagued by the same jurisdictional defect. *Winters v. Taylor*, 333 F. App'x 113, 117 (7th Cir. 2009).[12]

In sum, because plaintiffs assert solely derivative claims, they are bound by the

[12] The pending appeal in *Perry Capital* judgment is irrelevant for these purposes. *See Cont'l Western*, 83 F. Supp. 3d at 840 ("Although *Perry Capital* has been appealed, it is still 'valid and final' for purposes of an issue preclusion analysis" because "[i]t is well established in the federal courts that the pendency of an appeal does not diminish the *res judicata* effect of a judgment rendered by a federal court.'") (internal citation omitted); *see also Prymer v. Ogden*, 29 F.3d 1208, 1213 n.2 (7th Cir. 1994) (citing *Kurek v. Pleasure Driveway & Park Dist. of Peoria*, 557 F.2d 580, 595 (7th Cir. 1977) (stating that the pendency of an appeal does not suspend the operation of a final judgment for collateral estoppel purposes), *vacated on other grounds*, 435 U.S. 992 (1978)).

district court's determinations in *Perry Capital*, the first derivative action.[13] Because the issues to be litigated with respect to the derivative claims would be the same "no matter which shareholder served as nominal plaintiff," and "defendants have already been put to the trouble of litigating the very question at issue, . . . the policy of repose strongly militates in favor of preclusion." *Sonus*, 499 F.3d at 64.

CONCLUSION

For the foregoing reasons, and for those stated in FHFA's motion and Treasury and FHFA's Joint Motion, the Court should dismiss the amended complaint with prejudice.

Dated: July 13, 2016

Respectfully submitted,

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[13] Indeed, the Court in *Continental Western* dismissed a Complaint containing materially identical allegations on issue preclusion grounds, determining that the plaintiff was in privity with a plaintiff from *Perry Capital*. *Cont'l Western*, 83 F. Supp. 3d at 834.

CERTIFICATE OF SERVICE

I hereby certify that on July 13, 2016, a copy of the foregoing Memorandum in Support of the Department of the Treasury and Secretary Jacob J. Lew's Motion to Dismiss the Amended Complaint was filed electronically. Notice of this filing will be sent by email to all parties by operation of the Court's electronic filing system. Parties may access this filing through the Court's CM/ECF System.

/s/ Caroline J. Anderson
Caroline J. Anderson