IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF DELAWARE

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| TIMOTHY J. PAGLIARA,<br><br>Plaintiff,<br><br>v.<br><br>FEDERAL NATIONAL MORTGAGE ASSOCIATION,<br><br>Defendant. | C.A. No. 16-193-GMS |

**PLAINTIFF TIMOTHY J. PAGLIARA'S ANSWERING BRIEF IN OPPOSITION TO MOTION TO SUBSTITUTE THE FEDERAL HOUSING FINANCE AGENCY AS PLAINTIFF**

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Plaintiff Timothy J. Pagliara ("Stockholder"), a stockholder of defendant Federal National Mortgage Association ("Fannie Mae"), hereby opposes the motion by the Federal Housing Finance Agency ("FHFA") to substitute itself as Plaintiff (the "Motion") (D.I. 8).

## I. INTRODUCTION

Pursuant to Section 220 of the Delaware General Corporation Law ("DGCL"), the Stockholder brought this action in the Delaware Court of Chancery for an order permitting him to inspect and copy certain books and records of Fannie Mae (the "Action"). Fannie Mae was initially federally chartered, but subsequently incorporated in Delaware and expressly elected to follow the DGCL for purposes of corporate governance, except to the extent inconsistent with federal law. Section 220 of the DGCL gives the Stockholder "the right . . . to inspect for any proper purpose" Fannie Mae's books and records. 8 *Del. C.* § 220(b). The Stockholder seeks the books and records primarily for three purposes: (1) to investigate misconduct by the board of directors of Fannie Mae (the "Board"); (2) to communicate with other stockholders about the misconduct and (3) to value his investment in Fannie Mae.

In its Motion, FHFA effectively seeks dismissal of the Stockholder's Action by invoking two provisions of the Housing and Economic Recovery Act of 2008 ("HERA"). FHFA's reliance on HERA and its request for substitution are wrong.

FHFA relies first on HERA's succession provision, 12 U.S.C. § 4617(b)(2)(A)(i). That provision states that FHFA, as conservator of Fannie Mae, succeeds to "all rights, titles, powers, and privileges of the regulated entity, and of any stockholder . . . *with respect to the regulated entity and the assets of the regulated entity*." 12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added). Courts have applied the succession provision *only* to transfer a stockholder's right to bring *derivative* claims, which seek to enforce a right of the corporation itself—*i.e.*, a right "with respect to the regulated entity." Contrary to FHFA's position in its Motion, courts have held,

under a substantially identical succession provision, that *direct* claims, which seek to enforce stockholders' individual rights, are *not transferred*. *See Levin v. Miller*, 763 F.3d 667, 672 (7th Cir. 2014). FHFA itself has previously acknowledged that direct claims are not transferred under HERA. Indeed, an interpretation of the succession provision allowing FHFA to take over the Stockholder's direct claims would raise the specter of a taking without just compensation. Under Delaware law, a suit to inspect corporate records is a direct claim to enforce an individual right. Because HERA's succession provision applies only to derivative claims, FHFA has no right to take over the Stockholder's suit for inspection of corporate records.

Next, FHFA turns to HERA's anti-injunction provision, 12 U.S.C. § 4617(f). That provision prohibits a court from taking action "to restrain or affect the exercise of powers or functions of [FHFA] as a conservator[.]" *Id.* As with the succession provision, FHFA over-reads HERA. The anti-injunction provision has been interpreted to bar (1) restrictions on FHFA's exercise of its business judgment and (2) derivative suits. This case involves neither. Compliance with the non-discretionary statutory obligation to disclose the requested corporate records at issue in this case in no way "restrain[s] or affect[s]" FHFA's role as conservator.[1]

[1] FHFA's contention that HERA's succession provision "contains no 'conflict of interest' exception" is incorrect. (D.I. 9 at 9 (FHFA's Memorandum of Law in Support of Motion) (cited hereinafter as "OB").) Two circuit court decisions considering the materially-identical succession provision in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") support the proposition that, if a federal receiver or conservator is subject to a manifest conflict of interest, a shareholder can maintain a derivative suit despite otherwise being barred from doing so. *See Delta Sav. Bank v. United States*, 265 F.3d 1017, 1022-24 (9th Cir. 2001); *First Hartford Corp. Pension Plan & Tr. v. United States*, 194 F.3d 1279, 1283 (Fed. Cir. 1999). And at least one court has suggested that this exception may apply to HERA. *See In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 795, 797 (E.D. Va. 2009) (analyzing facts to determine whether conflict of interest exists), *aff'd sub nom. La. Mun. Police Emps. Ret. Sys. v. FHFA*, 434 F. App'x 188 (4th Cir. 2011). Given FHFA's relationship with Fannie Mae, and the role that FHFA assumed in entering a blatantly unfair transaction between Fannie Mae and its controlling stockholder (*see infra* § IV.E.), a manifest conflict of interest would exist if FHFA were permitted to prosecute derivative claims challenging the transaction.

FHFA asks this Court to depart from the rulings of other courts to have considered these issues and adopt an unprecedented expansion of FHFA's powers under HERA. FHFA gives this Court no basis to do so. For those reasons and the reasons below, the Motion should be denied.

## II. NATURE AND STAGE OF THE PROCEEDINGS

The Stockholder incorporates the Nature and Stage of Proceedings from his pending Motion to Remand to the Delaware Court of Chancery (D.I. 11) and further states:

On July 18, FHFA filed with this Court the instant Motion, improperly seeking to substitute itself for the Stockholder as Plaintiff. (D.I. 8.)

On August 1, the Stockholder moved to remand this Action to the Court of Chancery, on the ground that the Action arises only under state law and the Court therefore lacks federal jurisdiction. (D.I. 10.) The Court should resolve the threshold jurisdictional issue that the motion to remand presents before addressing the instant Motion. *Campbell v. Sussex Cty. Fed. Credit Union*, C.A. No. 10-710-RBK/AM, 2011 WL 2532403, at *2 (D. Del. June 24, 2011) ("[L]ack of jurisdiction itself precludes the court from asserting judicial power[;] a court may take no further action in a matter once it determines that it lacks jurisdiction. . . . Thus, jurisdiction is a threshold issue that must be resolved before the court can take any further action in the case."); *see also Coardes v. Chrysler Corp.*, 785 F. Supp. 480, 482 (D. Del. 1992) ("[L]ack of jurisdiction would make any decree in the case void and the continuation of the litigation in federal court futile . . . ." (quoting *Abels v. State Farm Fire & Cas. Co.*, 770 F.2d 26, 29 (3d Cir. 1985))).

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But it is unnecessary for the Court to determine whether such a conflict exists because the Stockholder brings only a direct claim, which remains with him.

## III. SUMMARY OF THE ARGUMENT

1. FHFA's Motion seeking substitution must be denied because contrary to FHFA's arguments, HERA does not provide any basis for divesting the Stockholder of his individual right to bring a direct claim to inspect Fannie Mae's books and records.

2. FHFA's interpretation of HERA's succession provision, 12 U.S.C. § 4617(b)(2)(A)(i), contradicts relevant case law and ignores the plain language of the statute. This succession provision states that FHFA, as Fannie Mae's conservator, succeeds to "all rights, titles, powers, and privileges of the regulated entity, and of any stockholder . . . *with respect to the regulated entity and the assets of the regulated entity*." (emphasis added). As FHFA has previously acknowledged, this provision transfers to FHFA only a stockholder's right to bring *derivative* claims *on behalf* of Fannie Mae. It does not transfer a stockholder's right to bring *direct* claims *against* Fannie Mae. The Stockholder brings only a direct claim to enforce his individual right to inspect Fannie Mae's books and records, and that claim remains with the Stockholder.

3. FHFA over-reads HERA's anti-injunction provision, 12 U.S.C. § 4617(f), which prohibits a court from taking action "to restrain or affect the exercise of powers or functions of [FHFA] as a conservator[.]" This provision has been interpreted to bar (1) restrictions on FHFA's exercise of its business judgment and (2) derivative suits. This case involves neither. In all events, compliance with the non-discretionary statutory obligation to disclose the requested books and records at issue in this case in no way "restrain[s] or affect[s]" FHFA's role as conservator.

## IV. STATEMENT OF FACTS

### A. Fannie Mae Is a Privately Owned, Publicly Traded Corporation Governed by Delaware Law.

Originally created as a government entity, Fannie Mae was privatized by Congress through federal statutes between 1954 and 1970. (D.I. 1 Ex. A (the "Complaint" or "Compl.") ¶¶ 26, 28, 33, 36.) Since 1970, Fannie Mae has been a private corporation, with private stockholders and publicly traded stock. (*Id.* ¶¶ 2, 36, 103.) The Stockholder is a private owner of publicly traded preferred stock in Fannie Mae. (*Id.* ¶ 21.)

In 2002, Fannie Mae's then-regulator, the Office of Federal Housing Enterprise Oversight, directed Fannie Mae to choose, within 90 days from August 5, 2002, to be governed by one of three alternative bodies of corporation law, one of which was the DGCL. 12 C.F.R. § 1710.10 (2002). Promptly thereafter, on August 21, 2002, Fannie Mae filed a certificate of incorporation in Delaware. (Compl. Ex. C.) Fannie Mae's bylaws as of January 21, 2003 (the "Bylaws") state, "The inclusion of provisions in these Bylaws shall constitute inclusion in the corporation's 'certificate of incorporation' for all purposes of the Delaware General Corporation Law." (D.I. 12 Ex. A § 1.05.)

The Bylaws further state that 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" to the extent not inconsistent with federal law. (*Id.*) Since 2002, Fannie Mae therefore has been governed by the DGCL, including Section 220, except to the extent inconsistent with federal law.

### B. The Conservatorship

On September 7, 2008, at the height of the 2007-09 financial crisis, Fannie Mae's new regulator, FHFA, placed Fannie Mae into temporary conservatorship ("Conservatorship") with

FHFA as conservator. (Compl. ¶ 65, 71.) FHFA did so ostensibly under the authority of HERA.

HERA specified the extent of FHFA's powers as conservator. Under HERA, FHFA as conservator succeeded to "all rights, titles, powers, and privileges of [Fannie Mae], and of any stockholder, officer, or director of [Fannie Mae] with respect to [Fannie Mae] and the assets of [Fannie Mae]." 12 U.S.C. § 4617(b)(2)(A)(i); *see U.S. ex rel Adams v. Aurora Loan Servs., Inc.*, 813 F.3d 1259, 1261 (9th Cir. Feb. 22, 2016) (slip op.) (HERA's succession provision "places FHFA in the shoes of Fannie Mae and Freddie Mac, and gives the FHFA *their* rights and duties, not the other way around.") (internal citations omitted). FHFA's powers therefore are limited to the pre-existing powers of Fannie Mae and its stockholders, Board and management, *with respect to Fannie Mae and its assets*. As the powers of Fannie Mae and its stockholders, Board and management are constrained by Delaware law, so too are FHFA's powers. (Compl. ¶ 61).

Contrary to FHFA's position now, when the Conservatorship was announced, FHFA and its then-Director, James Lockhart, admitted that FHFA's succession to the rights of Fannie Mae did not include each and every right of its stockholders. Fannie Mae's common and preferred stock continue to be publicly traded, and FHFA acknowledged that "stockholders will continue to retain all rights in the stock's financial worth; as such worth is determined by the market." (FHFA Fact Sheet, at 3 (Sept. 7, 2008) (Ex. A)).[2] Director Lockhart also assured Congress that Fannie Mae's "shareholders are still in place; both the preferred and common shareholders have an economic interest in the companies." (Compl. ¶ 74 n.29.)

FHFA's exercise of its finite powers as conservator is also limited by the statutory purpose of conservatorship. At the start of the Conservatorship, FHFA acknowledged that "conservatorship is the legal process in which a person or entity is appointed to establish control

[2] The Exhibits referenced herein shall be the Exhibits attached to the Declaration of Adam W. Poff in Support of this answering brief in opposition to the Motion, submitted herewith.

and oversight of a Company to put it in a sound and solvent condition." (*See* Ex. A; Statement of FHFA Director Lockhart at 5-6 (Sept. 7, 2008) (Ex. B) (Conservatorship is "a statutory process designed to stabilize a troubled institution with the objective of returning the entities to normal business operations. FHFA will act as the conservator . . . until [Fannie Mae is] stabilized.").) This language comported with the language of HERA itself, which authorizes FHFA to exercise conservator powers 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*." 12 U.S.C. § 4617(b)(2)(D) (emphasis added).

**C. The Senior Preferred Stock Purchase Agreement**

On the same day that the Conservatorship was imposed, also under authority provided by HERA, the United States Department of the Treasury ("Treasury") entered into a Preferred Stock Purchase Agreement (the "PSPA") with Fannie Mae and invested in senior preferred stock (the "Senior Preferred Stock") of Fannie Mae. (D.I. 12 Ex. D.) HERA required that any such 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 Treasury] without mutual agreement between the Secretary and [Fannie Mae]." 12 U.S.C. § 1719(g)(1)(A). The Senior Preferred Stock entitled Treasury to receive a cumulative cash dividend of 10% per annum of the Senior Preferred Stock's liquidation preference or, if the dividends were paid in kind, 12% per annum, until all cumulated dividends were paid in cash. (D.I. 12 Ex. E § 2(c) (Certificate of Designation).) Also, under the PSPA, Fannie Mae issued Treasury a warrant to purchase 79.9% of Fannie Mae's common stock for nominal consideration. (D.I. 12 Ex. D §§ 1, 3.1 (PSPA).) The PSPA further gave Treasury the right to veto an extensive list of corporate actions. (*Id.* § 5.)

**D. FHFA Reconstituted and Delegated Authority to Fannie Mae's Board.**

On November 24, 2008, having succeeded to the Board's powers and executed the PSPA, FHFA reconstituted Fannie Mae's Board and delegated responsibility to which it had succeeded back to the new Board. (Compl. ¶ 76.) Among other authority, FHFA specifically empowered the Board to "review and approve matters related to . . . paying dividends or other distributions on or repurchasing Fannie Mae equity securities[.]" (*Id.* ¶ 77 & n.30.)

Because the Board's corporate powers that FHFA succeeded to as conservator are governed by Delaware corporate law, the powers FHFA delegated back to the new Board likewise are governed by Delaware law. (*See id.* ¶ 77.) Under the structure that FHFA established, certain Board actions were subject to FHFA approval. (*Id.* ¶ 78.) But FHFA could not make the Board take or approve any action. (*Id.*)

**E. The Third Amendment and Net Worth Sweep**

On August 17, 2012, less than two weeks after Fannie Mae announced positive net income of $5.1 billion for the second quarter of 2012, Fannie Mae entered into an amendment (the "Third Amendment") to the PSPA. (*See* Compl. ¶¶ 104, 117.) By the Third Amendment, and for zero return consideration, Fannie Mae and Treasury (Fannie Mae's controlling stockholder) agreed to increase the dividend on the Senior Preferred Stock from 10% in cash (12% if paid in kind) to the *entirety of Fannie Mae's future net worth in perpetuity* (the "Net Worth Sweep"). (*See* Compl. Ex. D § 3 (Third Amendment).)

Fannie Mae has paid the Net Worth Sweep dividends for every quarter since the Third Amendment took effect. (Compl. ¶ 141.) After the reversal in early 2013 of about $50 billion of the prior write-off of deferred tax assets, Fannie Mae paid Treasury a dividend of $59.4 billion for only the second quarter of 2013 (as compared to a pre-existing dividend of $2.9 billion per

quarter at the 10% rate). (Compl. ¶ 124.) Since the Third Amendment, the total increase in dividends has been $78.2 billion. (*See id.*; D.I. 12 Ex. H.) And there is no end in sight.

### F. The Inspection Demand

On January 19, 2016, pursuant to Section 220 of the DGCL, counsel for the Stockholder served a demand for books and records on Fannie Mae (the "Demand"). (Compl. Ex. A.) The Demand sought information primarily concerning the Board's actions and omissions in the Third Amendment, the payment of Net Worth Sweep dividends and Fannie Mae's investment of tens of millions of dollars in a common mortgage security offering to be shared with Fannie Mae's competitors. (*Id.* § I.) On January 27, 2016, Fannie Mae through FHFA, rejected the Demand. (Compl. Ex. H, G.) Due to Fannie Mae's rejection of the Demand, Section 220 of the DGCL entitled Plaintiff to commence a summary proceeding in the Delaware Court of Chancery for the inspection of books and records of Fannie Mae. 8 *Del. C.* § 220(c). Plaintiff therefore commenced this Action on March 14, 2016 in the Delaware Court of Chancery.

## V. ARGUMENT

FHFA offers two theories why the Stockholder cannot bring a claim for the inspection of corporate records under DGCL § 220: (1) HERA's succession provision has transferred his claim to FHFA; and (2) HERA's anti-injunction provision bars such a suit. Although framed differently, both theories turn on the same mistaken belief that HERA strips shareholders of all rights and claims of any kind relating to a company in conservatorship, including the stockholders' individual rights and their direct claims to enforce them. No court has ever adopted that over-reading of the statute. This Court should not depart from the rulings of other courts to have considered these issues and hand FHFA the wide-ranging new authority it seeks.

### A. HERA's Succession Provision Does Not Strip the Stockholder of His Direct Claims.

FHFA first argues that HERA's succession provision, 12 U.S.C. § 4617(b)(2)(A)(i), transfers the Stockholder's claim to FHFA. It repeatedly contends that the statute transfers to FHFA "all rights" of Fannie Mae's shareholders, full stop. (*See, e.g.*, OB at 1, 3, 6, 8.) The text of the statute, FHFA asserts, is "clear," "unequivocal, "unambiguous[]," and the like. (*E.g.*, *id.* at 3, 6, 8). But FHFA overlooks, or otherwise ignores, the final and crucial clause. The full succession provision states:

> 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*.

12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added). The full provision transfers not "all rights" without qualification, but only those rights "*with respect to the regulated entity and the assets of the regulated entity*." The critical "with respect to" qualification undercuts FHFA's singular reliance on the term "all rights." FHFA urges the Court to "read the statute." (OB at 7.) The Stockholder agrees. He respectfully requests that the Court read all of the relevant statutory provision, along with the case law interpreting the entire relevant provision and the substantially identical language in FIRREA.

There are two possible readings of the "with respect to" qualification. The first, and the one that Fannie Mae and FHFA presumably adopt, is that the succession provision transfers all stockholder claims *that relate in any way to Fannie Mae*. The second, and the correct one that the Stockholder adopts, is that the succession provision transfers all stockholder claims *that are brought on behalf of Fannie Mae and its assets*. A unanimous and ever-growing group of courts has adopted the latter reading of the statute: As conservator, a government agency like FHFA succeeds to *derivative* claims that stockholders might otherwise assert on behalf of the

corporation. Accordingly, FHFA does not take ownership of an individual stockholder's stock, and it does not succeed to *direct* claims that an individual stockholder might bring on his or her own behalf to enforce individual rights. The inspection claim that the Stockholder asserts here is a textbook example of a direct claim that remains with the stockholder. Thus, as explained below, the succession provision is no bar to his claim for inspection of corporate records.

**1. HERA Only Transfers Derivative Claims.**

**a. Courts Analyzing Succession Provisions Have Uniformly Distinguished Between Direct and Derivative Claims.**

FHFA fails to confront the unanimous case law against its position. Instead, FHFA suggests that courts have "routinely" adopted its preferred interpretation of HERA. (*See* OB at 4; *see also id.* at 6 (purporting there are "multiple" supportive decisions).) This is not correct. In fact, every case that FHFA cites either affirmatively endorses the distinction between derivative and direct claims or adheres to that rule without comment.

For decades, courts have interpreted what FHFA itself contends is a "materially-identical" succession provision in FIRREA. (OB at 4, 6.)[3] Those courts have established a uniform rule that FIRREA's succession provision bars stockholders from bringing derivative claims, but not direct claims. *See, e.g.*, *Barnes v. Harris*, 783 F.3d 1185, 1192-95 (10th Cir. 2015); *Levin v. Miller*, 763 F.3d 667, 672 (7th Cir. 2014); *In re Beach First Nat'l Bancshares, Inc.*, 702 F.3d 772, 778-81 (4th Cir. 2012); *Pareto v. FDIC*, 139 F.3d 696, 699-700 (9th Cir. 1998); *Lubin v. Skow*, 382 F. App'x 866, 870-72 (11th Cir. 2010). As the Seventh Circuit

[3] *See* 12 U.S.C. § 1821(d)(2)(A)(i) (FDIC "shall, as conservator or receiver, and by operation of law, immediately succeed to . . . all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution *with respect to the institution and the assets of the institution*[.]") (emphasis added).

observed in *Levin* two years ago, "No federal court has read the statute" to bar direct stockholder claims. 763 F.3d at 672. That remains true today. Judge Easterbrook explained why in *Levin*:

> At oral argument the court asked counsel whether § 1821(d)(2)(A)(i) should be understood . . . to transfer to the FDIC *all* claims held by any stockholder of a failed bank—even claims that . . . do not depend on an injury to the failed bank. No federal court has read the statute that way, however, and counsel for all of the litigants declined to adopt that understanding. Section 1821(d)(2)(A)(i) transfers to the FDIC only stockholders' claims "with respect to . . . the assets of the institution"—in other words, those that investors (but for § 1821(d)(2)(A)(i)) would pursue derivatively on behalf of the failed bank. This is why we have read § 1821(d)(2)(A)(i) as allocating claims between the FDIC and the failed bank's shareholders rather than transferring to the FDIC every investor's claims of every description. Any other reading of § 1821(d)(2)(A)(i) would pose the question whether . . . stockholders would be entitled to compensation for a taking; our reading of the statute (which is also the FDIC's) avoids the need to tackle that question.

*Id.* (emphasis in original). *Levin* therefore held that FIRREA's succession provision transfers *only* derivative claims, not *direct* claims. *Id.* Consistent with *Levin*'s guidance, the court in *Lubin* aptly explained that "FIRREA grants the FDIC ownership over all shareholder *derivative claims* . . . . The question then becomes *whether the claims [at issue] are derivative claims*." 382 F. App'x at 870 (emphasis added).

Courts have used this well-established construction of FIRREA's succession provision to interpret HERA's "materially-identical" provision. For example, the D.C. Circuit relied on decisions from the "three circuits to have interpreted" FIRREA's "virtually identical language" to conclude that HERA "plainly transfers shareholders' ability to bring derivative suits." *Kellmer v. Raines*, 674 F.3d 848, 850 (D.C. Cir. 2001). Similarly, the Eastern District of Virginia was "persuaded by" FIRREA decisions in holding that "HERA bars derivative suits by shareholders of the affected companies." *In re Fed. Home Loan Mortg. Corp. Deriv. Litig.*, 643 F. Supp. 2d 790, 795 (E.D. Va. 2009), *aff'd sub nom, La. Mun. Police Emps. Ret. Sys. v. FHFA*, 434 F. App'x 188 (4th Cir. 2011). Several other courts have come to the same conclusion. *Perry*

*Capital LLC v. Lew*, 70 F. Supp. 3d 208, 232 (D.D.C. 2014) ("HERA's plain language bars shareholder derivative suits[.]"); *Esther Sadowsky Testamentary Tr. v. Syron*, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009) (granting motion to substitute in a derivative "action on Freddie Mac's behalf"); *In re Fed. Nat'l Mortg. Ass'n Sec., Derivative, & ERISA Litig.*, 629 F. Supp. 2d 1, 4 (D.D.C. 2009) (granting motion to substitute "for the shareholder derivative plaintiffs"). FHFA cites each of these HERA decisions, as well as *Pareto*'s FIRREA analysis, but without acknowledging that not a single one permitted a conservator to commandeer, under either HERA or FIRREA, a stockholder's direct claims.

In fact, contrary to FHFA's position in its Motion, the FDIC (under FIRREA) and FHFA (under HERA) have both previously followed the distinction between direct and derivative claims, just as the Stockholder asks the Court to do here. In *Levin*, for example, the FDIC conceded that the plaintiff retained ownership of certain direct claims, which had not been transferred to the agency. *See* 763 F.3d at 670, 672.[4] Similarly, FHFA moved to substitute in the *Kellmer* litigation "only with respect to the derivative claims asserted by Fannie Mae shareholders," and FHFA did not dispute that a shareholder plaintiff could continue to pursue claims for disclosure violations under federal securities laws, brought "in his individual capacity." (*See Kellmer v. Raines*, C.A. No. 07-1173, D.I. 68 at 1 n.1 (D.D.C. 2009) (Ex. C (motion)); *see also* C.A. No. 08-1093, D.I. 1 (D.D.C. 2008) (Ex. D (complaint consolidated with

[4] While the FDIC conceded that the plaintiff retained ownership of certain direct claims, the direct/derivative rule nevertheless remained an issue before the Seventh Circuit in *Levin*. The lower court had dismissed all seven claims asserted by the plaintiff, holding that all were derivative claims and "belong to the FDIC." *Levin*, 763 F.3d at 670. The plaintiff appealed, arguing that certain of its claims were direct. While the FDIC did not dispute on appeal that two of the claims "belong to [the plaintiff]" (*i.e.*, were direct), the other defendants did and asked the Seventh Circuit to affirm the lower court's decision that they were barred by the succession provision. *Id.* The *Levin* court vacated the lower court's dismissal of those two claims, finding that the claims were direct and not barred by the succession provision. *Id.* at 672.

*Kellmer*)).)[5] The fact that the federal government has in the past taken a much narrower view of the succession provisions in FIRREA and HERA makes FHFA's position in this case all the more questionable.

In determining what rights a conservator obtains by succession, the well-established distinction between derivative and direct claims makes perfect sense. As conservator, FHFA has the right and authority to operate Fannie Mae, which includes succession to the rights that the shareholders have to make decisions for the corporation and to bring certain claims on the corporation's behalf. But FHFA does not need the Stockholder's individual rights as a stockholder to perform its statutory duties as conservator, and FHFA does not succeed to those individual rights. The Stockholder still owns his stock, and he remains free to sell his stock or buy more shares in Fannie Mae without FHFA's permission. Plainly then, FHFA has not succeeded to "all" of the Stockholder's rights as FHFA would have the Court rule. FHFA is the conservator of *Fannie Mae*, not the conservator of *the Stockholder personally*. FHFA cannot take over his individual claims and prevent him from suing to protect his individual rights as a stockholder.[6]

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[5] FHFA cites *Kellmer* for the proposition that "HERA's unequivocal succession language applies to all claims 'fairly described as [relating to] a right[] or power[] of owning stock.'" (OB at 6 (internal quotations omitted).) Neither *Kellmer's* holding, nor the statement actually quoted, was so broad. The full sentence quoted by FHFA actually confirms the court's analysis was limited to derivative claims: "But regardless of its origins, a shareholder's ability to sue *derivatively* given certain conditions is fairly described as a 'right[]' or 'power[]' of owning stock." *Kellmer*, 674 F. 3d at 851 (emphasis added).

[6] To the extent FHFA attempts to rely on dicta from the case law indicating that the shareholder rights to which FHFA succeed "include" derivative claims, that language would still not support its position. *See, e.g.*, *In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 795 (E.D. Va. 2009) ("As the FHFA argues, the plain meaning of the statute is that all rights previously held by Freddie Mac's stockholders, *including* the right to sue derivatively, now belong exclusively to the FHFA." (emphasis added)). It is unsurprising that a court would contemplate the potential succession of other rights beyond derivative claims; this does not imply that those other rights include direct claims. In fact, no court has taken that position. No

**b. FHFA's Statutory Construction Arguments Are Unavailing.**

FHFA proposes two statutory construction arguments as to why this Court should reject the direct/derivative rule, departing from well-established case law and FHFA's prior position that HERA does not transfer a shareholder's direct claims. Neither argument is persuasive.

*First*, FHFA argues that the direct/derivative rule is an attempt by the Stockholder to "rewrite HERA," and that the rule "cannot survive HERA's plain language." (OB at 6-7.) This argument depends on FHFA's blinkered view of the statute. Because FHFA stops reading the succession provision after "all rights," it is no surprise that it views the direct/derivative rule as an attempt at an extra-textual limitation. But the subsequent qualification in the text itself—"with respect to the regulated entity and the assets of the entity"—does important work. That qualification limits the succession provision to those claims "that investors (but for [the succession provision]) would pursue derivatively on behalf of" Fannie Mae. *Levin*, 763 F.3d at 672. Again, the Stockholder still owns his stock, and FHFA cannot prevent him from suing to protect his individual rights as a stockholder.

*Second*, FHFA contends that the canon against superfluity demands that the succession provision transfer direct claims. (OB at 8.) Under its theory, HERA's succession provision would be meaningless if limited to derivative actions because derivative actions already belong to the corporation and thus to FHFA as conservator. (*Id*.) In other words, because FHFA immediately succeeded to Fannie Mae's rights, succeeding only to a stockholder's right to bring a derivative claim on behalf of the company "would add nothing." (*Id.*) There is a glaring flaw in this argument. Derivative claims always *belong to* the company; nevertheless, they are always *brought by* a stockholder. (*See, e.g., id.* at 8 (citing *Ross v. Bernhard*, 396 U.S. 531, 538 (1970)).

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court has invoked the succession provision under FIRREA or HERA to bar a direct claim. *See supra* at 12-15.

Without the succession provision, Fannie Mae stockholders could still bring derivative claims on Fannie Mae's behalf—notwithstanding the fact that those claims ultimately belong to Fannie Mae or its conservator. With the succession provision, stockholders cannot. Thus, under the Stockholder's interpretation, and applying the direct/derivative rule, the succession provision is in no way superfluous.

Instead, it is *FHFA's* reading of the statute that renders a key provision superfluous, providing yet another reason to reject its interpretation. FHFA's reading of the statute would give virtually no meaning to the qualification "with respect to the regulated entity and the assets of the regulated entity." The qualification provision is there, just as *Levin* holds, in order to make the direct/derivative distinction.

**c. Constitutional Avoidance Requires the Stockholder's Interpretation of HERA.**

Even if FHFA and the Stockholder had offered "competing plausible interpretations" of HERA, this Court must presume "that Congress did not intend the alternative which raises serious constitutional doubts." *Clark v. Martinez*, 543 U.S. 371, 381 (2005). FHFA's interpretation raises a serious constitutional question under the Takings Clause of the Fifth and Fourteenth Amendments. After all, a direct claim is, by its very nature, the Stockholder's individual property. *See* 8 *Del. C.* § 220(b) (affording inspection rights to individual stockholders); *see also, e.g.*, *All. of Descendants of Tex. Land Grants v. United States*, 37 F.3d 1478, 1481 (Fed. Cir. 1994). If HERA were construed to strip the Stockholder of his property and to transfer that property to a government agency without just compensation, the statute would violate the Takings Clause.[7] By contrast, construing HERA to leave direct claims

[7] Any taking would be the result of HERA's succession provision and attributable to Congress, a state actor, as the body that enacted HERA. *See Lugar v. Edmondson Oil Co.*, 457

untouched "avoids the need to tackle that [Takings-Clause] question." *Levin*, 763 F.3d at 672. For that reason, too, this Court should reject FHFA's interpretation of the succession provision.

**2. The Stockholder's Claim for Inspection of Corporate Records Is a Direct Claim.**

The sole question, then, is whether the Stockholder's claim for inspection of corporate records is direct or derivative. As FHFA does not dispute, the Stockholder's claim is a direct claim. *See, e.g. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, C.A. No. 1456-N, 2006 WL 2588971, at *11 (Del. Ch. Sept. 1, 2006), *aff'd*, 930 A.2d 92 (Del. 2007) (A direct claim is a claim on "which the stockholder can prevail without showing an injury or breach of duty to the corporation, and one in which no relief flows to the corporation."). FHFA's argument that the nature of the claim is irrelevant because the Stockholder has been divested of his "underlying right" to inspect is nothing more than a repackaging of its prior, incorrect succession argument. (*See* OB at 9.) The Stockholder's direct claim to inspect Fannie Mae's books and records has not been transferred to FHFA, and substitution is therefore improper.[8]

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U.S. 922, 937 (1982) (the state actor inquiry asks whether "the conduct allegedly causing the deprivation of a federal right [can] be fairly attributable to the State").

[8] In support of a similar motion to substitute pending before the United States District Court for the Eastern District of Virginia, FHFA argues that its supposedly undisputed succession to the direct right of stockholders to elect a board demonstrates that FHFA must have succeeded to all rights of stockholders, whether direct or derivative. (*See Pagliara v. Federal Home Loan Mortgage Corp.*, C.A. No. 16-337-JCC/JFA, D.I. 37 at 5-6.) Of course, this is not correct because, as explained in the text, FHFA clearly has not succeeded to all rights of stockholders. The contention is wrong also for two additional reasons: *First*, FHFA has not succeeded, undisputedly or otherwise, to the rights of stockholders to elect Fannie Mae's Board. It rather has succeeded – absent some manifest conflict – to the powers of the Board itself to manage Fannie Mae's business (and it has delegated that authority to a board of its choosing). During the Conservatorship, there would therefore be little for a board elected by the stockholders to do. *Second*, even if, *arguendo*, FHFA could have succeeded to one direct right, this would not suggest that it succeeded to all such rights, much less a right, such as the right to books and records, which does not involve the management of Fannie Mae's business or even any discretionary decision by Fannie Mae. As the Stockholder retains economic interests in Fannie Mae (*see supra* at 7), he must retain the ability to value his economic interests by way of

**B. HERA's Anti-Injunction Provision Does Not Bar the Requested Relief.**

Finally, FHFA argues that permitting the inspection of Fannie Mae's corporate records would violate HERA's anti-injunction provision, 12 U.S.C. § 4617(f). (*See* OB at 11-12.) The anti-injunction provision states that "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." 12 U.S.C. § 4617(f). According to FHFA, the Stockholder's exercise of his statutorily guaranteed right to review corporate documents would somehow "restrain or affect" FHFA's power to act as a conservator. (*See* OB at 10-11.)

Not so. The relevant case law addressing the anti-injunction provision makes clear that Section 4617(f) prohibits courts from interfering with FHFA's ability to exercise its business judgment. A stockholder request to inspect corporate documents for a proper purpose does absolutely nothing to diminish FHFA's power as conservator. FHFA claims that "multiple decisions" have invoked the anti-injunction provision to bar a shareholder from continuing an action without the conservator's substitution (OB at 11), but FHFA ignores that none of these decisions involved a direct books and records claim. No court has applied the anti-injunction provision to bar claims like the one at issue in this Action.

Instead, courts have applied HERA's anti-injunction provision in two contexts—both in which a private suit might "restrain or affect" the exercise of FHFA's business judgment. In the first set of cases, the plaintiffs expressly sought to prohibit or compel specific business decisions by a conservator. For example, the Ninth Circuit recently rebuffed a challenge to FHFA's directive that the Federal Home Loan Mortgage Association (a/k/a "Freddie Mac") discontinue

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inspecting corporate books and records. *See Jefferson v. Dominion Holdings, Inc.*, C.A. No. 8663-VCN, 2014 WL 4782961, at *2 (Del. Ch. Sept. 24, 2014) (explaining plaintiff's "desire to value his shares provides a genuine and proper purpose" for a Section 220 books and records inspection).

purchasing certain risky assets. As the court explained, Section 4617(f) barred the suit because "the ability to decide which mortgages to buy is an inherent component of FHFA's charge[.]" *Cty. of Sonoma v. FHFA*, 710 F.3d 987, 993 (9th Cir. 2013). The Second Circuit likewise applied Section 4617(f) to block a challenge to the same FHFA directive, explaining that FHFA has the power to take "protective measures against perceived risks" without judicial intervention. *Town of Babylon v. FHFA*, 699 F.3d 221, 227 (2d Cir. 2012). In the analogous FIRREA context, courts have similarly applied the statute's anti-injunction provision to forbid courts from imposing restrictions on the FDIC's ability to dispose of property as it sees fit. *See, e.g.*, *Bank of Am. Nat'l Ass'n v. Colonial Bank*, 604 F.3d 1239, 1244 (11th Cir. 2010) (listing cases).

The second set of cases—including each of the cases FHFA relies upon—involves unauthorized *derivative* suits. *See Gail C. Sweeney Estate Marital Tr. v. U.S. Treasury Dep't*, 68 F. Supp. 3d 116, 117, 125-26 (D.D.C. 2014); *In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d at 792, 797; *Sadowsky*, 639 F. Supp. 2d at 350-51; *In re Fed. Nat'l Mortg. Ass'n Sec., Derivative, & ERISA Litig.*, 629 F. Supp. at 4 n.4. Because such derivative suits are brought on Fannie Mae's behalf, they may encroach upon FHFA's authority over Fannie Mae's business decisions. *See Sweeney*, 68 F. Supp. 3d at 126.

Neither category covers the suit here. The Stockholder's inspection claim does not seek to impose any restriction on the exercise of FHFA's business judgment as conservator; Fannie Mae (and FHFA as conservator) has no discretion in responding to the inspection demand. *See* 8 *Del. C.* § 220(c). Nor is this a derivative claim brought on behalf of Fannie Mae. Enforcement of the individual right to inspect Fannie Mae's corporate records thus will not "restrain or affect" FHFA's "exercise of powers or functions" as conservator. In circumstances like these, no court has ever suggested that the anti-injunction provision applies. *See In re Fed. Nat'l Mortg. Ass'n*

*Sec., Derivative, & ERISA Litig.*, 725 F. Supp. 2d 147, 155 (D.D.C. 2010) ("All [Section 4617(f)] means is that [a court] cannot affect FHFA's power and authority to manage Fannie Mae or to act on its behalf."). Courts permit such direct claims to proceed. *See, e.g.*, *Levin*, 763 F.3d at 672 (allowing direct claims to proceed despite FIRREA's anti-injunction provision).

HERA's anti-injunction provision, like its succession provision, therefore poses no obstacle to the Stockholder's suit or the relief he seeks.

## VI. CONCLUSION

For the foregoing reasons, the Stockholder respectfully requests that the Motion be denied.

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DATED: August 4, 2016

**CERTIFICATE OF SERVICE**

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