IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

TIMOTHY J. PAGLIARA, Plaintiff, v. FEDERAL NATIONAL MORTGAGE ASSOCIATION, Defendant.	C.A. No. 1:16-cv-00193

REPLY IN SUPPORT OF MOTION TO SUBSTITUTE THE FEDERAL HOUSING FINANCE AGENCY AS PLAINTIFF

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Permitting Plaintiff to inspect Fannie Mae's books and records would not only be intrusive, it would grant Plaintiff (in his capacity as a Fannie Mae shareholder) the power of inspection, investigation, and supervision over Fannie Mae. But federal law divested Plaintiff of that inspection power when FHFA placed Fannie Mae (and Freddie Mac, together the "Enterprises") into statutory conservatorship. Specifically, HERA transferred to FHFA "all rights, titles, ***powers***, and privileges" of Fannie Mae, its officers and directors, ***and its stockholders*** "with respect to [Fannie Mae]". 12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added). Because Plaintiff does not hold the purported powers he seeks to exercise here—*i.e.*, to inspect Fannie Mae's books and records for the purpose of challenging the propriety and legality of Enterprise operations—the Court should substitute the Conservator (which does hold those powers) in place of the current Plaintiff.

Congress imbued FHFA, when acting as Conservator, with "extraordinary" powers to conduct, direct, and oversee all aspects of Fannie Mae and Freddie Mac's operations, activities and affairs, free from judicial challenge and interference.[1] To accomplish this, Congress provided for the statutory transfer to FHFA, immediately upon the placement of Fannie Mae (or Freddie Mac) into conservatorship, of "all rights, titles, powers, and privileges of the regulated entity [in conservatorship], and of any ***stockholder***, officer, or director of such regulated entity with respect to the regulated entity and the assets of the regulated entity." § 4617(b)(2)(A)(i) (emphasis added). Congress also insulated from all judicial review the Conservator's exercise of the "rights, titles, powers, and privileges" to which it had succeeded by operation of law, prohibiting the courts from "tak[ing] any action to restrain or affect the exercise of [the

[1] *Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 225 (D.D.C. 2014), *appeal pending* No. 14-5243 (D.C. Cir. filed Oct. 8, 2014).

Conservator's] powers or functions." 12 U.S.C. §§ 4617(b)(2)(A)(i), (f).

Plaintiff's claim that his status as a Fannie Mae shareholder purportedly continues to authorize him to access and review Fannie Mae's books and records, even in the face of these unambiguously broad statutes, is meritless. Plaintiff relies on the language "with respect to the regulated entity and the assets of the regulated entity" as the basis for asserting that FHFA has succeeded to derivative but not direct claims. *See generally* Opp. (quoting § 4617(b)(2)(A)(i)). But Plaintiff's lengthy discussion about direct and derivative claims is irrelevant here. HERA explicitly transferred *all* shareholder rights, titles, powers, and privileges to FHFA as Conservator, regardless of how they are characterized. *See* § 4617(b)(2)(A)(i) (transferring to FHFA "all rights, . . . powers, and privileges . . . of any stockholder . . . of [Fannie Mae] with respect to [Fannie Mae]"). In addition, Plaintiff provides no support for limiting the scope of Section 4617(f) to actions interfering with FHFA's business judgment with respect to Freddie Mac.[2]

A. The Court Should Substitute FHFA as Plaintiff Because the Conservator Succeeded to "All Rights" of the Stockholders.

1. "All Rights" Means *All* Rights.

Though Plaintiff's Opposition is filled with charges (not now properly before the Court) of supposed "wrongful activity," this case presents a single, straightforward question of statutory

[2] Plaintiff is wrong in asserting, without citation, that "Fannie Mae was initially federally chartered, but subsequently incorporated in Delaware . . . ." Opp. 1. To the contrary, Fannie Mae is and has always been a federally-chartered corporation. *See, e.g., Delaware Cty. v. FHFA*, 747 F.3d 215, 219 (3d Cir. 2014); 12 U.S.C. § 1716, *et seq.* The certificate of incorporation Plaintiff attaches as Exhibit C to his Verified Complaint relates to a different company (Federal National Mortgage Association, Inc., not Fannie Mae). Fannie Mae's 2002 10K report (the first filed after Plaintiff claims Fannie Mae incorporated in Delaware) lists the company as a "Federally chartered corporation" and makes no mention of the company filing a certificate of incorporation in Delaware. Fannie Mae, Annual Report (Form 10-K) (2002). In any event, the Certificate of Incorporation Plaintiff relies upon was voided by the Delaware Secretary of State in 2004. *See* Certificate of Delaware Secretary of State (Mar. 14, 2016) (attached as Exhibit A).

interpretation: Does HERA's express transfer to the Conservator of "***all rights, titles, powers, and privileges of*** [Fannie Mae], and of any stockholder . . . with respect to [Fannie Mae]," 12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added), include a stockholder's power to inspect Fannie Mae's corporate books and records? Plainly it does. Plaintiff concedes that his claim is premised on a purported "right" of a stockholder to exercise the power to inspect Fannie Mae's books and records, and he admits that this purported inspection power is restricted to "shareholders" as a matter of law.[3] *See, e.g.*, Opp. 1, 17. These concessions are dispositive. HERA expressly and unambiguously transferred all shareholder rights and powers, including any right to inspect books and records, to FHFA during conservatorship. Accordingly, Plaintiff lacks standing to pursue that alleged right in this litigation.

Plaintiff improperly reads into the statute a word not included by Congress and, on this basis, proceeds to argue that the Conservator "has *not* succeeded to 'all'" stockholder rights, and instead has succeeded only to "*certain*" claims. Opp. 14 (emphasis added). Indeed, Plaintiff argues that the Conservator succeeded only to one specific shareholder right, *i.e.*, the right to pursue derivative claims on behalf of Fannie Mae. *See* Opp. 1-2, 10-14. Plaintiff is wrong, and he may not rewrite the statute—substituting the phrase "certain rights" where the statute plainly applies to "all rights." Simply put, "all rights, titles, powers, and privileges" means "*all* rights, titles, powers, and privileges"—not "*certain*" rights and claims. *See Hennepin Cty. v. Fed. Nat'l Mortg. Ass'n*, 742 F.3d 818, 822 (8th Cir. 2014) (holding, with respect to HERA's bar on "all taxation," that "'all' means all" (citation omitted)).

It would have been easy for Congress to state that the Conservator succeeds to ***only*** specific rights or claims of stockholders, such as derivative rights or claims, but Congress instead

[3] Fannie Mae does not concede that it has ever been subject to 8 Del. C. § 220. As noted above, Fannie Mae has never been incorporated in Delaware.

transferred to FHFA ***all*** stockholder rights and powers with respect to Fannie Mae. Nor is the breadth of Congress' transfer of all shareholder powers diminished by the statutory requirement that the powers be "with respect to the regulated entity"; rather, the opposite is true. That phrase should be interpreted broadly to mean "about or concerning" or "in relation to" Fannie Mae.[4] Plaintiff does not, and cannot, contest that his asserted shareholder right to inspect Fannie Mae's books and records relates to or concerns Fannie Mae; it obviously does.[5]

Further, the purported shareholder right Plaintiff seeks to invoke here—the power to inspect records of the current and ongoing relationship between the Conservator and Fannie Mae, and to sue if there is anything he does not like—is incompatible with the operational independence Congress intended for the Conservator. Plaintiff concedes that as "conservator, FHFA has the right and authority to operate Fannie Mae." Opp. 14. But if Plaintiff is permitted to exercise the power he no longer holds—the asserted power to inspect Fannie Mae's books and records while Fannie Mae is still in conservatorship—it would establish Plaintiff, through the invocation of this Court's jurisdiction, as a supervisor with judicial enforcement authority over the Conservatorship operations, in direct contravention of HERA. Plaintiff's argument runs

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[4] *See, e.g., Cal. Tow Truck Ass'n v. City and Cty. of San Francisco*, 807 F.3d 1008, 1021 (9th Cir. 2015) ("The cardinal canon of statutory construction is that Congress says in a statute what it means and means in a statute what it says . . . . [T]he phrase 'with respect to' is generally understood to be synonymous with the phrase 'relating to.' And, although the breadth of the words 'related to' does not mean the sky is the limit, the Supreme Court has reiterated that the ordinary meaning of the words 'related to' is a broad one, meaning 'having a connection with or reference to.'") (internal quotation marks, alterations, and citations omitted); *Merriam Webster Dictionary*, *available at* http://www.merriam-webster.com/dictionary/ with%20respect%20to (defining "with respect to" as meaning "about or concerning" or "in relation to").

[5] Plaintiff asserts that the fact that he still owns his Fannie Mae stock and maintains his right to sell that stock demonstrates that FHFA has not succeeded to "all" his rights as a shareholder. Opp. 14. But the reason for this is simple: Plaintiff's right to sell his Fannie Mae shares does not relate to Fannie Mae, which is indifferent as to who owns its stock and would not be affected by Plaintiff's sale of his stock. As such, it does not fall within the plain language of § 4617(b)(2)(A).

counter to the clear purpose of HERA, which is to give the Conservator broad authority to run the Enterprises free from outside interference.[6]

2. Fannie Mae's Bylaws Confirm that the Conservator Is the Only Party Authorized to Inspect Fannie Mae's Books and Records for Possible Misconduct.

Plaintiff tries to avoid HERA's broad assignment of shareholder rights to FHFA by asserting that Fannie Mae's bylaws choose to "follow the applicable corporate governance practices . . . of the Delaware General Corporation Law." Opp. 5.[7] But Fannie Mae has only *elected* to follow Delaware's corporate law "to the extent not inconsistent with [the Company's] Charter Act and other Federal law, rules, and regulations," Fannie Mae Bylaws § 1.05; Plaintiff fails to advise the Court that Fannie Mae's *post-conservatorship* Bylaws further provide that

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[6] Plaintiff is wrong in arguing that FHFA has not succeeded to the rights of Fannie Mae to elect its Board of Directors because it has instead succeeded "to the powers of the Board itself to manage Fannie Mae's business . . . ." Opp. at 17 n.8. As Plaintiff himself explains, FHFA selected a new Fannie Mae Board of Directors shortly after it became the Company's Conservator. *See* Opp. 8; *see also* Fannie Mae, Annual Report (Form 10-K) (2015), at 158-61, *available at* http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2015/10k_2015.pdf. (noting that immediately upon conservatorship, FHFA reconstituted the Fannie Mae Board of Directors, appointing nine Board members in addition to the Board Chairman).

[7] Plaintiff misleadingly cites to Fannie Mae's Bylaws as of January 1, 2003 for the proposition that inclusion of a provision in the Company's "Bylaws shall constitute inclusion in the corporation's 'certificate of incorporation' for all purposes of the Delaware General Corporation Law." Opp. 5. Pagliara does not mention that the preceding sentence in those Bylaws makes clear this is only true "to the extent not inconsistent with the Charter Act and other Federal law, rules, and regulations. . . ." Fannie May Bylaws (2003) § 1.05. Plaintiff also ignores the fact that the 2003 Bylaws to which he cites were not in place when he first purchased Fannie Mae stock in 2008 (*see* Complaint ¶ 21) and have long since been amended. The *2009* Bylaws Mr. Pagliara attaches as Exhibit B to his Verified Complaint have also been amended. The *current* Fannie Mae Bylaws, which are the relevant Bylaws here, treat only specifically identified bylaws (not including the corporate governance practices provision) as part of the Company's certificate of incorporation. Fannie Mae Bylaws (as amended through July 21, 2016), *available at* www.fanniemae.com/resources/file/aboutus/pdf/bylaws.pdf. Further, the current bylaws provide that "[n]othing in these Bylaws shall . . . affect the regulatory or conservatorship powers of [FHFA] under [HERA]." *Id.* art. 8. *See Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 962 (Del. Ch. 2013) (upholding use of recently-amended forum-selection clause of bylaws).

"[n]othing in these Bylaws shall be deemed to affect the regulatory or conservatorship powers of [FHFA] under [HERA]." Fannie Mae Bylaws, art. 8. This language forecloses Plaintiff's attempted reliance on the 2003 version of Fannie Mae's Bylaws to evade the legislative divestment of his purported power as a Fannie Mae shareholder to demand access to Fannie Mae's books and records.

3. Plaintiff's Cited Cases Do Not Support His Proposal to Limit the Conservator's Succession Rights.

None of Plaintiff's cited cases suggest any limitation to the Conservator's statutory rights of succession. Although several of those cases addressed overtly derivative claims (brought by shareholders on behalf of the company itself), the courts' finding that HERA transferred those claims to FHFA plainly was not what Plaintiff attempts to transform it into—a finding that derivative claims were the *only* shareholder rights and powers transferred.

For example, Plaintiff cites *In re Federal Home Loan Mortgage Corporation Derivative Litigation* for the purported notion that HERA only bars "derivative suits by shareholders of the affected companies." Opp. 12 (citing 643 F. Supp. 2d 790 (E.D. Va. 2009)). But in that case, the Court actually said that "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." 643 F. Supp. 2d at 795 (emphasis added); *see also Esther Sadowsky Testamentary Tr. v. Syron*, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009) (granting FHFA's motion to substitute, holding that "under the plain language of HERA, 'all rights, titles, powers, and privileges' of Freddie Mac's shareholders are now vested in the FHFA," and that these rights "***include*** the right to bring an action on Freddie Mac's behalf" (emphasis added)); *In re Fed. Nat'l Mortg. Ass'n Secs., Deriv. & ERISA Litig.*, 629 F. Supp. 2d 1, 4 (D.D.C. 2009) (granting defendants' motion for substitution as to derivative claims with no occasion to consider whether § 4617(b)(2)(A)

also transferred non-derivative rights, powers and claims).

Nor, contrary to Plaintiff's position, is there anything about *Kellmer v. Raines*, 674 F.3d 848, 850-51 (D.C. Cir. 2012), that should make this Court "skeptical" of Defendants' position here. *See* Opp. 13-14. That the Conservator, more than eight years ago, opted not to exercise its substitution rights in no way suggests FHFA did not have the right to seek substitution had it wished to do so. To the contrary, the *Kellmer* court noted that "nothing was missed" in HERA's substitution statute and that Congress "transferred everything it could to the [FHFA]." 674 F.3d at 851.

Plaintiff relies heavily on *Levin v. Miller*, 763 F.3d 667 (7th Cir. 2014). But in that case, the court addressed claims for money damages against former officers and directors based on alleged harm they had caused, requiring the court to assess whether such claims were derivative (*i.e.*, based on harm to the company) or direct (*i.e.*, based on harm to the individual shareholder plaintiff). *Id.* at 669-70. There are no such claims here—Plaintiff here demands to exercise a purported power to inspect Fannie Mae's books and records. Because the dispositive issue here is whether the Conservator succeeds to an asserted shareholder power to inspect, not whether (as in *Levin*) the Conservator succeeds to a claim against third parties for money damages based on harm to the company and/or its shareholders, *Levin* and Plaintiff's the other cases are irrelevant here.

In all events, the suggestion in *Levin* that a conservator's succession to "all rights" of a stockholder would not extend to direct claims was not at issue in that litigation, and the parties to that case had no occasion even to brief the issue. *See* 763 F.3d at 672.[8] The only judicial

[8] In *Lubin v. Skow*, 382 F. App'x 866, 871 (11th Cir. 2010), the court made a passing statement that "FIRREA would not be a bar to standing" if the shareholder had asserted a direct claim. But that position was not advocated by the parties and the statement was pure *dicta*:

exploration of the issue in *Levin* was Judge Hamilton's persuasively reasoned concurrence. As Judge Hamilton correctly concluded, FIRREA's succession language cannot be read as limited in application to derivative claims:

> It is not obvious to me that the language must be interpreted so narrowly, nor did the cases cited at page 2 of the opinion confront this issue or require that result. ***The FDIC [as conservator or receiver] can already pursue what would be a derivative claim because the claim really belongs to the failed depository institution itself.*** So what does the language referring to "the rights . . . of any stockholder" add to the meaning and effect of the statute? The doctrine that statutes should not be construed to render language mere surplusage is not absolute, but it weighs in favor of a broader reach that could include direct claims. If "rights . . . of any stockholder" was meant to refer only to derivative claims, it's a broad and roundabout way of expressing that narrower idea.

Id. at 673 (Hamilton, J., concurring) (emphasis added).

In sum, even if the present case involved a damages claim (like the direct/derivative cases on which Plaintiff relies), rather than a demand to exercise the supervisory powers of inspection and oversight, there is no "rule" in the case law—much less a "uniform" one—that the Conservator's succession to "all rights" of the stockholders counterintuitively includes *only* a single right, to pursue derivative claims.

4. The Doctrine of Constitutional Avoidance Provides No Basis to Limit the Conservator's Rights.

Nor can Plaintiff rely on the doctrine of constitutional avoidance to prevent substitution, for the simple reason that there is no constitutional issue to avoid here. *See* Opp. at 16-17. By

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(footnote continued)
specifically, the court held all of the claims were derivative, not direct, and were barred by FIRREA's succession provision. *Id*. at 871. Similarly, in *Barnes v. Harris*, 783 F.3d 1185, 1192 (10th Cir. 2015), *Pareto v. FDIC*, 139 F.3d 696, 699-700 (9th Cir. 1998), and *In re Beach First Nat'l Bancshares, Inc.*, 702 F.3d 772, 777 (4th Cir. 2012), the courts did not consider or address the issue of succession to direct claims, holding simply that FDIC as receiver had succeeded to nearly all of the shareholder's claims, which the courts found to be derivative.

moving to substitute, FHFA is not attempting to assert "ownership" over Plaintiff's stock, or to prevent him from selling his stock. *See id.* It is merely exercising one of the asserted stockholder powers to which it has succeeded during the conservatorship—the right to gain access to Fannie Mae's books and records—just as it has exercised other rights of officers, directors, and stockholders, including the right to re-constitute Fannie Mae's board of directors. Plaintiff does not even begin to explain how a purported statutory right to inspect corporate books and records could form the basis for any claim for the taking of "private property . . . without just compensation." U.S. Const., am. 5. There is thus no constitutional issue to avoid.[9]

B. 12 U.S.C. § 4617(f) Also Bars Plaintiff's Demand to Inspect.

The Court should also substitute FHFA as plaintiff for the independent reason that allowing Plaintiff to inspect Fannie Mae's books and records would "restrain or affect" the Conservator's exercise of its powers and functions in direct violation of HERA's anti-injunction bar. 12 U.S.C. § 4617(f). Plaintiff seeks an extensive review of Fannie Mae's records, including all documents within the relevant date range that constitute FHFA "directives and/or instructions to the Company." *See* Compl. Ex. A at 3. For example, Plaintiff seeks to inspect all board materials concerning "any report, analysis, or evaluation" of Fannie Mae's "solvency or insolvency"; concerning "the declaration and/or payment of dividends"; and concerning "the involvement of FHFA and/or Treasury in the management of [Fannie Mae's] business and affairs." *Id.* at 2-4 (Compl. Ex. A). Permitting Plaintiff's investigation into the Conservator's management and operation of Fannie Mae would necessarily "interfere with and potentially usurp precisely the powers granted to the FHFA by HERA." *Gail C. Sweeney Estate Marital Tr.*

[9] Moreover, the doctrine of constitutional avoidance counsels that "ambiguous statutory language" should be "construed to avoid serious constitutional doubts." *FCC v. Fox Tel. Stations, Inc.*, 556 U.S. 502, 516 (2009). Because § 4617(b)(2)(A) is clear and unambiguous, the doctrine of constitutional avoidance has no application here.

v. U.S. Treasury Dep't, 68 F. Supp. 3d 116, 125-26 (D.D.C. 2014) (The decision whether to bring suit arising from the sale of assets during conservatorship is the type of "decision Congress entrusted to the Conservator in HERA" and protected by Section 4617(f)) (citation omitted).

Plaintiff contends that § 4617(f) only bars interference with FHFA's exercise of business judgment. *See* Opp. 18-20. Even if § 4617(f) were so limited—and it is not—that is exactly the sort of interference threatened by Plaintiff's lawsuit. HERA gives FHFA, not Plaintiff, the exclusive right to operate Fannie Mae, enter contracts on its behalf, and to control any investigation into the actions or operations of Fannie Mae and its Directors, including with respect to contracts such as the Third Amendment.

CONCLUSION

For the foregoing reasons, the Court should substitute FHFA for the current Plaintiff.

Dated: August 15, 2016

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Exhibit A

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THAT THE CERTIFICATE OF INCORPORATION OF "FEDERAL NATIONAL MORTGAGE ASSOCIATION, INC.", WAS RECEIVED AND FILED IN THIS OFFICE THE TWENTY-FIRST DAY OF AUGUST, A.D. 2002.

AND I DO HEREBY FURTHER CERTIFY THAT THE AFORESAID CORPORATION IS NO LONGER IN EXISTENCE AND GOOD STANDING UNDER THE LAWS OF THE STATE OF DELAWARE HAVING BECOME INOPERATIVE AND VOID THE FIRST DAY OF MARCH, A.D. 2004 FOR NON-PAYMENT OF TAXES.

AND I DO HEREBY FURTHER CERTIFY THAT THE AFORESAID CORPORATION WAS SO PROCLAIMED IN ACCORDANCE WITH THE PROVISIONS OF GENERAL CORPORATION LAW OF THE STATE OF DELAWARE ON THE TWENTY-FIFTH DAY OF JUNE, A.D. 2004 THE SAME HAVING BEEN REPORTED TO THE GOVERNOR AS HAVING NEGLECTED OR REFUSED TO PAY THEIR ANNUAL TAXES.

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