UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

ANTHONY R. EDWARDS, *et al.*,

Case No.: 1:16-cv-21221-Scola

Plaintiffs,

v.

DELOITTE & TOUCHE, LLP,

Defendant.
_____/

PLAINTIFFS' REPLY TO DEFENDANT'S RESPONSE IN OPPOSITION TO PLAINTIFFS' MOTION FOR REMAND

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Introduction

Deloitte's characterization of HERA as the Government's response to "a financial crisis of historic proportion," Response, p. 2, does nothing to confer federal jurisdiction over state law claims that do not necessarily raise federal issues as essential elements of the claims. *See Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 125 S. Ct. 2363, 2367-68 (2005).[1] Instead, the Court must apply the *Grable* factors to each of Plaintiffs' claims, which demonstrate the claims do not necessarily raise substantial federal issues and should be remanded, especially given that any doubt must be resolved in favor of remand. *See Russell Corp. v. Am. Home Assur. Co.*, 264 F.3d 1040, 1050 (11th Cir. 2001).

I. HERA's Succession Clause is a Defense to the Merits of Plaintiffs' Claims.

Plaintiffs do not have to defeat the succession clause as an *essential element* of their claims. Rather, the succession clause provides a defense to the merits of Plaintiffs' claims, which is insufficient to confer federal jurisdiction.

Deloitte argues that HERA eliminated Plaintiffs' standing to pursue their claims. However, the standing element of Plaintiffs' claims is not difficult to meet and can be easily established without reference to federal law. Delaware law provides:

> The concept of "standing," in its procedural sense, refers to the right of a party to invoke the jurisdiction of a court to enforce a claim or redress a grievance. It is concerned only with the question of *who* is entitled to mount a legal challenge and not with the merits of the subject matter of the controversy. In order to achieve standing, the plaintiff's interest in the controversy must be distinguishable from the interest shared by other members of a class or the public in general.

Stuart Kingston, Inc. v. Robinson, 596 A.2d 1378, 1382 (Del. 1991) (citations omitted).

[1] Nor does the fact that other federal courts are presiding over claims brought by Fannie or Freddie shareholders against the United States Government. Response, p. 4, FN 2. A motion to remand is pending in one case cited by Deloitte, *Pagliara v. FNMA*, No. 16-193 (D. Del.) (Doc. 10).

Plaintiffs allege they own Fannie stock and were damaged individually by Deloitte's conduct. Complaint, ¶¶ 11, 111, 118. These allegations are sufficient to establish Plaintiffs' entitlement to mount a legal challenge and are all that are required under Delaware law to have standing to sue.

To the extent they are relevant, Plaintiffs also meet federal standing requirements. Generally, to satisfy the "case" or "controversy" requirement of Article III, a plaintiff must generally demonstrate that he has suffered "injury in fact," that the injury is "fairly traceable" to the actions of the defendant, and that the injury will likely be redressed by a favorable decision. *Bennett v. Spear,* 117 S. Ct. 1154, 1161 (1997). This Court recognizes that a shareholder of a company has standing to assert claims in which he or she has a direct, personal interest. *See Elandia Intn'l, Inc. v. Koy,* No. 09-20588, 2010 WL 2179770, at *6 (S.D. Fla. Feb. 22, 2010). As such, Plaintiffs have standing to press their direct claims.

Recently, the court in *Pagliara v. Federal Home Loan Mortgage Corp.,* 2016 WL 4441978 (E.D. Va. Aug. 23, 2016) directly addressed the issue of whether HERA's succession clause was a bar to standing or a merits-based inquiry. The court concluded that Freddie Mac's lack of standing argument was "better framed as a merits challenge to the existence of the right [plaintiff] asserts, rather than a question of his standing to pursue the right." *Id.* at *4. The court found that "Pagliara unquestionably seeks to assert his own right as a stockholder…" which "satisfies Pagliara's obligation regarding standing." *Id.* Likewise, "[o]nly if the Court accepts [Deloitte's] interpretation of HERA" would Plaintiffs no longer possess the rights they seek to enforce, which "goes to the merits…not to [their] jurisdictional allegations." *Id.*

Fannie itself has successfully argued on a motion to remand that HERA's succession clause was a defense predicated on an alleged lack of standing, and thus could not confer federal jurisdiction. *Federal Nat'l Mtg. Ass'n v. Palmer,* No. 1:11–cv–00238–EJL–CWD, 2011 WL

5910062, at *3 (D. Id. Nov. 29, 2011) (granting Fannie's motion to remand and rejecting argument that HERA's succession clause confers "arising under" jurisdiction").

Accordingly, the evaluation and determination of whether FHFA has succeeded to Plaintiffs' right to bring their claims concerns the merits of the case—not standing. *See Pitt Cty. v. Hotels.com, L.P.*, 553 F.3d 308, 312 (4th Cir. 2009) (The issue of whether a plaintiff had the right to relief under a statute, which required an evaluation of each party's interpretation of the statute, concerned the merits of a case rather than standing).

HERA did not take Plaintiffs' standing to sue Fannie's auditor, a right they seek to assert as stockholders. Because Deloitte's succession clause argument is "better framed as a merits challenge," *i.e., a defense,* and overcoming HERA's succession clause is not required to establish standing, a dispute about the scope of the clause is not related to an element of Plaintiffs' claims and is insufficient to confer federal jurisdiction. Whether the scope of the scope of the succession clause will be disputed or is a substantial issue is inconsequential because the issue fails to meet the first *Grable* prong—a federal issue is not necessarily raised by Plaintiffs' claims.

II. Plaintiffs' Aiding and Abetting Claims Do Not Confer Federal Jurisdiction.

Deloitte argues that Plaintiffs' aiding and abetting breach of fiduciary duty claims are three separate claims founded on the alleged fiduciary duties of Treasury, FHFA, and Fannie's directors and officers. Response, p. 10. Even if the claims are viewed separately, none of the fiduciary duties at issue are based on federal law. Further, the fiduciary duties of Fannie's directors and officers are plead alternatively to FHFA's duties.

A. Treasury's Alleged Fiduciary Duties are not Based on Federal Law.

Plaintiffs explained in their Motion to Remand why state law fiduciary duty standards govern the duties owed by Treasury to Plaintiff minority shareholders. In response, Deloitte

asserts that the court must consider a substantial federal issue and determine whether Treasury owes any fiduciary duty at all to minority shareholders. Response, pp. 11-12. Further, Deloitte contends that Treasury's alleged misconduct must be governed by HERA or federal common law—not state fiduciary law. *Id.* Deloitte's arguments lack merit because (1) Treasury's duties arise by virtue of it being a dominant shareholder in a Delaware corporation; and (2) Treasury's state-based fiduciary duties are in addition to its statutory responsibilities under HERA.

1. Treasury is a dominant shareholder and owes fiduciary duties measured by Delaware law.

Treasury became Fannie's dominant shareholder when it entered into the Preferred Stock Purchase Agreement with FHFA in 2008. It is in that capacity that Treasury owes a fiduciary duty to minority shareholders, which is measured by Delaware corporate law.

"Dominant shareholders" are those that "exercise[] control over the business affairs of the corporation," as demonstrated by "actual control of corporation conduct." *See Kahn v. Lynch Commc'n Sys. Inc.*, 638 A.2d 1110, 1113-14 (Del. 1994); *see also Frank v. Elgamal*, No. 6120-VCN, 2012 WL 1096090, at *8 (Del. Ch. Mar. 30, 2012) ("Delaware case law has recognized that a number of shareholders…can collectively form a control group where those shareholders are connected in some legally significant way–*e.g.*, by contract, common ownership, agreement, or other arrangement–to work together toward a shared goal"). Dominant shareholders owe fiduciary duties to minority shareholders. *Id.* In fact, any dealings between dominant control persons and the corporation must meet a rigorous test to ensure that the transaction was fair to the minority shareholders. *See Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983); *see also Kahn*, 638 A.2d at 1115.

Plaintiffs allege that when Treasury entered into the PSPA, it became a dominant shareholder, and therefore assumed the same duties and obligations that would apply to any other

dominant shareholder, including a dominant shareholder's fiduciary duty to minority shareholders. As such, in its capacity as a dominant shareholder, Treasury had a fiduciary duty to take Fannie's minority shareholders' interests into account before entering into the Net Worth Sweep. *See Kahn*, 638 A.2d at 1115; *Ivanhoe Partners v. Newmont Min. Corp.*, 535 A.2d 1334, 1344 (Del. 1987). Plaintiffs allege that Treasury owed fiduciary duties "as controlling stockholder" of Fannie, without reference to HERA. Complaint, ¶ 115. It is not for this Court to determine whether the claim presents a viable cause of action, only that, as plead, the claim does not necessarily hinge on a substantial federal question. *See Greaves v. McAuley*, 264 F.Supp.2d 1078, 1087 (N.D. Ga. 2003) (granting motion to remand).

2. Treasury's state-based fiduciary duties are in addition to its statutory duties under HERA.

Nothing in HERA dispels the state law duties of a dominant shareholder or suggests that Treasury's purported public mandate is mutually exclusive with fiduciary duties to shareholders. HERA nowhere authorizes or requires Treasury to take action that would violate its fiduciary duties to minority shareholders. Indeed, HERA's grant of temporary authority to Treasury to invest in Fannie's stock expressly requires Treasury to take into consideration the economic rights of the company's shareholders, including the company's plans "for the orderly resumption of private market funding or capital market access" and the "need to maintain [Fannie's] status as . . . private shareholder-owned company." 12 U.S.C. § 1719(g)(1)(C). Thus, requiring Treasury to comply with the same fiduciary duties that apply to any other dominant shareholder is fully consistent with Treasury's obligations under HERA.

In *Suess v. FDIC*, 770 F. Supp. 2d 32, 38 (D.D.C. 2011), the court explained that the FDIC had statutory responsibilities under FIRREA, and *in addition*, as receiver, had a fiduciary duty to shareholders. *Id.* Likewise, Treasury has fiduciary duties as a dominant shareholder, in

addition to any HERA-based responsibilities. *See also Deutsche Bank Nat'l Trust Co. v. FDIC,* 784 F. Supp. 2d 1142, 1165 (C.D. Cal. 2001) (distinguishing between statutory duties and fiduciary duties that arise from state law and apply to receivers for corporations).

The court in *Gibraltar Fin. Corp. v. Fed. Home Loan Bank Bd.*, No. 89-3489, 1990 U.S. Dist. LEXIS 19197; 1990 WL 394298, at *4 (C.D. Cal. June 15, 1990) addressed an analogous scenario, although in the context of a conservator rather than a dominant shareholder, as follows:

> A more pertinent question is whether any duty arises where a governmental agency has assumed control of the day-to-day operations of a financial institution and has therefore ventured beyond its normal regulatory or supervisory role. The case law, and common sense, indicates that a duty does arise in such a circumstance.
>
> ….
>
> Notwithstanding the important public policy function served by FSLIC, nothing in the statutory or regulatory scheme would indicate the need to permit FSLIC to function in its capacity as conservator with impunity, leaving all shareholders in a financial institution bereft of the protections provided by the fiduciary duties imposed upon those who control such institutions.

Id. at *5-6; 9-10 (finding a shareholder may assert a claim against a conservator for breach of fiduciary duty).

Deloitte cites *Robinson v. FHFA*, No. 15-cv-109-KKC-EBA, 2016 WL 4726555, at *4, n.3 (E.D. Ky. Sept. 9, 2016)—a case in which the plaintiff brought only equitable claims under the Administrative Procedure Act—for the proposition that state fiduciary duty law does not apply to Treasury as a dominant shareholder. Besides being *dicta* in a footnote relating to an issue that was only "briefly" argued, the court's statement that "there is no evidence of Congressional intent to graft state fiduciary duties onto the Treasury's responsibilities under HERA," is supported only by *Hancock v. Train*, 426 U.S. 167, 179 (1976). But *Hancock* merely stands for the proposition that a state has no authority to enforce administrative regulations against the property or instrument of the United States. Here, Fannie is not the property or instrument of the United States and Plaintiffs' stock certainly still belongs to them, despite the

value taken by the entry of the Net Worth Sweep.

The precedent established by *O'Melveny & Myers v. F.D.I.C.,* 512 U.S. 79, 85 (1994)—that "matters left unaddressed in a [comprehensive statutory] scheme are presumably left subject to the disposition provided by state law" is consistent with the holdings of *Gibralter and Suess*, provides far better support that the matter of determining state-based fiduciary duty standards of controlling shareholders is not a federal issue and may be resolved by the state court. Accordingly, because Treasury assumed a dominant and controlling function in the operation of Fannie, it owed fiduciary duties arising out of state law. Plaintiffs may prove that Treasury violated those duties strictly by reference to ordinary state law standards.

B. FHFA's Alleged Fiduciary Duties are not Based on Federal Law.

Under Delaware law, officers and directors of a corporation owe the corporation's shareholders fiduciary duties of due care, good faith, and loyalty. *Gantler v. Stephens*, 965 A.2d 695, 708-09 (Del. 2009). When FHFA elected to exercise its powers and put Fannie into conservatorship, it assumed those duties by stepping into the shoes of Fannie's officers and directors. *see Herron v. Fannie Mae.*, 857 F. Supp. 2d 87, 94 (D.D.C. 2012) (finding "…FHFA when it serves as conservator step[s] in the shoes of the private corporation, Fannie Mae") (internal quotations omitted). The *Herron* court's analysis of post-conservatorship Fannie demonstrates that FHFA's fiduciary duties, assumed from Fannie's officers and directors, are based on state rather than federal law:

> As described above, a conservator or receiver steps into the shoes of the private entity—it assumes the private status of the entity. Fannie Mae was a private entity; when FHFA took over as conservator of Fannie Mae, it stepped into Fannie Mae's private role. In sum, FHFA as conservator of Fannie Mae is not a government actor…

Id. at 96 (internal citations omitted).

Because FHFA stepped into Fannie's shoes in the context of it being a private company governed by Delaware law, it follows that FHFA assumed Fannie's officers' and directors' duties rooted in Delaware corporate law. *See Gibraltar,* 1990 WL 394298, at *4 (finding conservator owed *the same fiduciary duties* as the officers and directors); *see also Deutsche Bank Nat'l Trust Co.*, 784 F. Supp. at 1165. If FHFA were not bound by the same duties and obligations as any other officer and director of a company, then Plaintiffs would be deprived of a fundamental protection for which they bargained when purchasing shares of the company and exposed to significant risk. *See Gibraltar,* 1990 WL 394298, at *9-10.

Plaintiffs' allegations as they relate to FHFA are based upon FHFA's conduct in its assumed role as officer and director of Fannie. As such, the same Delaware state laws that create the duties and obligations owed by any other officer or director apply to FHFA and are the only laws that this Court needs to consider.

C. Fannie's Directors' and Officers' Fiduciary Duties are Plead as a Separate Theory, Not a Separate Claim, and are not Based on Federal Law.

Plaintiffs allege that the "directors and officers of Fannie Mae owed fiduciary duties…" and that "[b]y imposing a conservatorship over Fannie Mae, through which FHFA assumed the powers of its officers and directors, FHFA assumed fiduciary duties…" *See* Complaint, ¶¶ 113, 114. As described above, FHFA stepped into the shoes of Fannie's officers and directors and assumed the duties they previously owed. The duties themselves do not change whether they are owed by Fannie's officers and directors or FHFA. Thus, the theory of liability against the officers and directors is an alternative one because Plaintiffs need not prevail on different factual and legal questions. *See Christianson v. Colt. Indus. Operating Corp.*, 108 S. Ct. 2166, 2174-75 (1988).

Further, under Delaware law, officers and directors of a corporation owe the

corporation's shareholders fiduciary duties of due care, good faith, and loyalty. *Gantler*, 965 A.2d at 708-09; *see also Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Raines*, 534 F.3d 779, 789 (D.C. Cir. 2008) (measuring Fannie's officers' and directors' fiduciary duties by Delaware law). For the same reasons that FHFA's fiduciary duties are not based on federal law, Fannie's officers' and directors' are not.

III. Plaintiffs' Alternative Causation Theories Do Not Each Raise a Substantial Federal Issue.

Deloitte argues that Plaintiffs' causation theories (a) require construction of HERA regarding when the conservatorship may end and (b) turn on PCAOB standards. Response, pp. 19-20. But a review of the Complaint shows Plaintiffs plead multiple causation theories that do not implicate federal law and, thus, this Court does not have jurisdiction. *See Christianson*, 108 S. Ct. at 2174.

Without authority, Deloitte argues that HERA must control the termination of the conservatorship. In fact, HERA says nothing about when Fannie may exit the conservatorship. FHFA publicized that: "Upon the [FHFA] Director's determination that the Conservator's plan to restore the Company to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship." *See* FHFA, "Fact Sheet: Questions and Answers on Conservatorship," at 2 (Sept. 7, 2008). http://www.treasury.gov/press-center/press-releases/Documents/fhfa_consrv_faq_090708.pdf. As such, FHFA, and not HERA, determines when Fannie may exit the conservatorship. As described above, FHFA owes fiduciary duties to Plaintiffs. Plaintiffs' causation theory may simply be premised on a violation of these state law duties in its decision-making causing Plaintiffs' damages.

Further, Plaintiffs allege alternative causation theories. First, Plaintiffs allege that Deloitte helped FHFA and Fannie to materially misstate Fannie's financial statements, including

falsely certifying non-cash accounting losses, causing harm to Plaintiffs' stock. Compl. ¶¶ 27-28. Second, Plaintiffs allege that the Net Worth Sweep would not have been possible without the assistance of Deloitte, ¶ 43, and that its implementation resulted in Plaintiffs losing the value of their stock. ¶ 32. Third, Plaintiffs allege that Deloitte's 2012 Audit Opinion omitted material information that should have been disclosed, ¶¶ 70, 76, 109, and that Plaintiffs' reliance on Deloitte's negligent audit reports resulted in substantial losses. ¶¶ 109, 110.

Finally, Plaintiffs' negligence claim does not necessarily turn on only PCAOB violations. Deloitte attempts to distinguish *Batchelor v. Deloitte & Touche, LLP*, No. 08-22686, 2009 WL 1255449 (S.D. Fla. Apr. 27, 2009) and the other cases cited by Plaintiffs by arguing that, unlike here, those cases alleged violations of state law auditing standards or other alternative theories of causation. But, just like in *Batchelor*, Plaintiffs bring a state law claim that is premised, in part, on Deloitte's violations of GAAP, its "public watchdog" duties, and its duties to only certify true financial statements. *See, e.g.*, Complaint, ¶¶ 75, 87, 98. State law creates the obligations for certified public accountants to tell the truth to the public. *See KPMG Peat Marwick v. National Union Fire Ins. Co.*, 765 So.2d 36, 38 (Fla. 2000) (explaining that certified public accountants like Deloitte here are the "public watchdog" under *Florida* law). Also, even if proof of a GAAS violation is required, Plaintiffs' claims are still state-based negligence claims. *See Hill v. Marston*, 13 F.3d 1548, 1550 (11th Cir. 1994) (reversing with directions to remand to state court, finding that a "violation of a federal standard as an element of a state tort recovery does not fundamentally change the state tort nature of the action"). Plaintiffs' alternative causation theories do not raise necessary or substantial federal issues.

Conclusion

For the foregoing reasons, and those set forth in the Motion for Remand, this Court does not have subject matter jurisdiction and should remand the case to state court.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on October 12, 2016, the foregoing document was filed with the Court's CM/ECF system, which will send electronic notice to all counsel of record.

/s/ Brad F. Barrios
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