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BY CM/ECF

The Honorable Gregory M. Sleet
U.S. District Court for the District of Delaware
U.S. Courthouse
844 North King Street
Wilmington, DE 19801

Re: *Jacobs v. Federal Housing Finance Agency*,
C.A. No. 15-708-GMS

Dear Judge Sleet:

I write on behalf of plaintiffs David Jacobs and Gary Hindes in response to the January 24, 2017 correspondence sent by defendant Federal Housing Finance Agency ("FHFA") and nominal defendants Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac," and together with Fannie Mae, the "Companies") regarding the United States District Court for the Southern District of Florida's recent decision in *Edwards v. Deloitte & Touche, LLP*, C.A. No. 16-21221 (S.D. Fla. Jan. 18, 2017) ("*Edwards*"). D.I. 57.

Defendants' arguments regarding *Edwards* miss the mark. The plaintiffs in *Edwards* did not bring claims against FHFA or the U.S. Department of the Treasury ("Treasury"), the Companies' conservator and controlling stockholder, respectively. Rather, the *Edwards* plaintiffs brought suit against Fannie Mae's third-party auditor for negligent misrepresentation and aiding and abetting breach of fiduciary duty based on a theory of accounting malpractice (*Edwards* at 2-3, 8). Indeed, in *Edwards*, the third-party auditor was the only named defendant and the only party from whom the plaintiffs sought relief. *See* Complaint, D.I. 1-1, *Edwards v. Deloitte & Touche, LLP*, C.A. No. 16-21221 (S.D. Fla. Apr. 6, 2016) ("*Edwards* Complaint"). Although the court in *Edwards* found that the claims brought in that case were derivative, such a result is irrelevant to this case given that the claims and allegations in *Edwards* are very different than those here.

The statutory and contract claims asserted in this case concern violations of rights held personally by, and breaches of duties owed directly to, the Companies' stockholders under the Delaware and Virginia corporation statutes, which are incorporated into the Companies' respective charters, or under the certificates of designation governing the Companies' preferred stock. In contrast, the third-party auditor in *Edwards* owed duties not to the stockholders, but

rather to Fannie Mae itself. It is unsurprising, then, that the Florida court found that Fannie Mae itself – and not its stockholders – suffered the harm alleged in *Edwards*. *Edwards* at 9 ("these alleged harms are premised on harms to Fannie Mae rather than the Plaintiffs independently"). In this case, FHFA and Treasury violated the rights of, and breached duties owed to, the Companies' stockholders. Consequently, *Edwards* is inapposite.

Given the nature of the allegations pled in the *Edwards* complaint – accounting malpractice and a resulting drop in the value of Fannie Mae's stock (*Edwards* at 2-3, 8-9) – it is likewise unsurprising that the Florida court found that the alleged wrongs harmed Fannie Mae's stockholders only indirectly, because, according to the Florida court, the loss of stock value was the result of harm to, and the consequent loss of value of, Fannie Mae itself. *Id.* at 9. But that finding is irrelevant to this case, in which Plaintiffs allege that the Companies' stockholders "have suffered a distinct injury caused by the expropriation of all the net worth of the Companies," separate from any injury to the Companies. *See* Plaintiffs' Brief in Opposition to Defendants' Motion to Dismiss (D.I. 23, "Opposition Brief") at 46. The harm Plaintiffs complain of in this case is recognized by the Delaware Supreme Court as "cash-value dilution" and such harm supports a direct claim. *See id.*; *In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 330 (Del. 1993). In *Tri-Star*, the Delaware Supreme Court held that claims are direct where a controlling stockholder "suffered no similar loss, but reaped substantial profit" at the sole expense of the minority stockholders. *Tri-Star*, 634 A.2d at 332. That is precisely the case here. For this and the reasons explained in Plaintiffs' Opposition Brief, Plaintiffs' claims are direct and therefore do not belong to FHFA. *See* D.I. 23 at 44-48. Further, with the minority stockholders' entire economic interest in their stock expropriated by the federal government and the Companies operating under conservatorship and thus controlled by the government, Delaware law's distinction between direct and derivative claims does not turn on whether the Net Worth Sweep involved "a dilution of voting power." *Edwards* at 10. *Edwards*, therefore, is, again, inapposite here.

Finally, the *Edwards* court's analysis adds nothing to the parties' prior briefing on whether HERA's succession provision bars derivative claims when FHFA has a manifest conflict of interest. *See* D.I. 23 at 50-53. The only two Courts of Appeals to consider this issue have allowed such claims to go forward. D.I. 23 at 51. And contrary to the *Edwards* court's suggestion, the fact that these rulings concerned FIRREA—and that Congress subsequently reenacted materially identical language in HERA—only strengthens the conclusion that the holdings in these appellate decisions are equally applicable in the context of HERA. *See Id.*

Respectfully,

Myron T. Steele (#000002)

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cc: Counsel of Record – by CM/ECF