ORAL ARGUMENT HELD ON APRIL 15, 2016

Nos. 14-5243 (L), 14-5254 (con.), 14-5260 (con.), 14-5262 (con.)

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

IN RE FANNIE MAE/FREDDIE MAC SENIOR PREFERRED STOCK PURCHASE AGREEMENT CLASS ACTION

On Appeal from the United States District Court
For the District of Columbia, No. 13-mc-01288
(Royce C. Lamberth, District Judge)

CLASS PLAINTIFFS' PETITION FOR PANEL REHEARING

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[*Additional Appearances on Inside Cover*]

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American European Insurance Company, Joseph Cacciapalle, John Cane, Francis J. Dennis, Marneu Holdings, Co., Michelle M. Miller, United Equities Commodities, Co., 111 John Realty Corp., Barry P. Borodkin and Mary Meiya Liao	Class Plaintiffs
Federal National Mortgage Association ("Fannie Mae) and Federal Home Loan Mortgage Corporation ("Freddie Mac")	Enterprises
United States Court of Appeals for the District of Columbia Circuit	Court
United States District Court for the District of Columbia (Lamberth, J.)	District Court
The Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008)	HERA
Perry Capital, LLC v. Mnuchin, No. 14-5243 (D.C. Cir. Feb. 21, 2017) (panel opinion)	Opinion or Op.
The Third Amendment to the Senior Preferred Stock Purchase Agreements between the United States Department of the Treasury and the Federal Housing Finance Agency, as conservator to Fannie Mae and Freddie Mac, dated August 17, 2012, and the declaration of dividends pursuant to the Third Amendment beginning January 1, 2013	The Third Amendment

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PRELIMINARY STATEMENT

Class Plaintiffs respectfully petition the Court for panel rehearing with respect to the paragraph that begins on page 68 and carries over onto page 69 of its Opinion in this case. Class Plaintiffs respectfully ask the Court to reconsider that paragraph because it: (a) addresses an issue the parties did not brief; (b) is not necessary to any holding by the Court, including the Court's decision to remand Class Plaintiffs' claims for breach of the implied covenant of good faith and fair dealing; (c) is unsupported by precedent; and (d) contradicts controlling and longstanding principles of contract law.

On pages 64-70 of the Opinion, the Court held that Class Plaintiffs' claim for breach of the implied covenant relating to shareholder dividend rights should be remanded to the District Court. In the course of discussing the standard to be applied to those claims on remand, the Court stated:

> We remand this claim, insofar as it seeks damages, for the district court to evaluate it under the correct legal standard, namely, whether the Third Amendment violated the reasonable expectations of the parties ***at the various times the class plaintiffs purchased their shares***.

Op. 68 (emphasis added). Based on this articulation of the "correct legal standard," *id.*, the Court then went on to state:

> The district court may need to redefine or subdivide the class depending upon what the various plaintiffs could reasonably have expected ***when they purchased their shares***. For those who purchased their shares after the enactment of the Recovery Act and

> the FHFA's appointment as conservator, the analysis should consider, *inter alia*, (1) Section 4617(b)(2)(J)(ii) (authorizing the FHFA to act "in the best interests of the [Companies] or the Agency"), (2) Provision 5.1 of the Stock Agreements, J.A. 2451, 2465 (permitting the Companies to declare dividends and make other distributions only with Treasury's consent), and (3) pertinent statements by the FHFA, *e.g.*, J.A. 217 ¶ 8, referencing *Statement of FHFA Director James B. Lockhart at News Conference Announcing Conservatorship of Fannie Mae and Freddie Mac* (Sept. 7, 2008) (The "FHFA has placed Fannie Mae and Freddie Mac into conservatorship. That 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 to operate the Enterprises until they are stabilized.").

Id. at 69 (emphasis added).

Class Plaintiffs respectfully submit that the legal standard set forth above, and in particular the emphasized language in the two quotes above, is incorrect. The relevant expectations for the breach of implied covenant claims are the expectations of the shareholders who purchased preferred or common shares in the Enterprises ***when those shares were issued***, not the subsequent expectations of shareholders who purchased shares in the secondary market. The parties do not dispute that the shareholder certificates are contracts, and these contracts were executed when the shares were first issued to the public. As a matter of longstanding contract law, the relevant intent and expectations are those in place at the time of that contract formation, not those that arose later when the contracts were assigned to different parties.

In addition, any possible dispute over this legal standard was not an issue that the parties briefed either before the District Court or on appeal, and was not necessary to any of the holdings in this case.

Class Plaintiffs therefore respectfully ask the Court to grant this petition and either: (a) amend its Opinion to remove this language and replace it with language articulating the correct legal standard (set forth below); or (b) amend its Opinion to remove this language, and to make clear that the issue of the time as of which to assess the reasonable expectations of the parties to shareholder contracts should be addressed in the first instance by the District Court on remand. *See Fox Television Stations, Inc. v. FCC*, 293 F.3d 537, 540 (D.C. Cir. 2002) (Ginsburg, J.) (granting in part motion for panel rehearing by modifying opinion to remove language resolving unbriefed issue and to replace with language making clear that the Court was declining to reach the issue).

ARGUMENT

As a matter of basic contract law, it is the intent of the parties ***at the time of contract formation*** that governs any dispute over the contract or the remedies owed due to a breach of the contract. As one leading authority on contract law has explained:

> In a dispute over contract interpretation, each party claims that the language should be given the meaning that that party attaches to it at the time of the dispute. However, the resolution of the dispute

> begins, not with these meanings, but with the meanings attached by each party ***at the time the contract was made***.

E. Allan Farnsworth, Farnsworth on Contracts § 7.9 (3d Ed. 2004 & Supp. 2016) (emphasis added). Both Delaware and Virginia law apply this established principle. *New Castle Cnty. v. Hartford Accident & Indem. Co.*, 778 F. Supp. 812, 820 (D. Del. 1991) (under Delaware law, contract interpretation focuses on "the meanings attached by each party *at the time the contract was made*.") (emphasis in original; quoting E. Allan Farnsworth, 2 Farnsworth on Contracts § 244 (1990)); *Eure v. Norfolk Shipbuilding & Drydock Corp., Inc.*, 561 S.E.2d 663, 668 (Va. 2002) ("her testimony consisted solely of her personal interpretation of the Agreement and did not reveal the intent of the parties ***at the time the Agreement was entered***. Accordingly, the parol evidence in favor of Mrs. Eure's interpretation of the Agreement was unrefuted at trial.") (emphasis added).

This Court expressly recognized this basic principle of contract law when it observed that "[w]hat is arbitrary or unreasonable depends upon 'the parties' reasonable expectations at the time of contracting.'" Op. at 68 (quoting *Nemec v. Shrader*, 991 A.2d 1120, 1126 (Del. 2010)). But this Court went astray in applying that principle when – without authority or discussion – it remanded the case to the District Court to "evaluate it under the correct legal standard, namely, whether the Third Amendment violated the reasonable expectations of the parties ***at the***

various times the class plaintiffs purchased their shares." Op. at 68 (emphasis added).

Class Plaintiffs respectfully submit that this Court erred in conflating "the time of contracting" and "the various times the class plaintiffs purchased their shares." Had the issue been briefed, the Court would have seen substantial authority for the proposition that what matters is the intent of the parties at the time the stock was originally issued and that aftermarket purchasers merely succeed to the extant contractual rights of their original predecessor-in-interest, rendering their own intent irrelevant. That promises to streamline this case on remand given that all Fannie Mae and Freddie Mac stock was issued before passage of HERA and therefore no Class Plaintiff could reasonably have expected the possibility of anything like the Third Amendment.

Delaware law governs the claims of the Fannie Mae shareholders (Op. 58 n.24), and Delaware case law holds that a claim of breach of the implied covenant depends upon the intent that the ***original parties*** had ***at the time of contract formation***, and not on the understanding of successor parties at the time that they succeed to the contract. *See ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 440 (Del. Ch. 2012) ("a court confronting an implied covenant claim asks whether it is 'clear from what was expressly agreed upon ***that the parties who negotiated the express terms of the***

contract would have agreed to proscribe the act later complained of as a breach of the implied covenant . . . .'") (quoting *Katz v. Oak Indus., Inc.*, 508 A.2d 873, 880 (Del. Ch. 1986)), *rev'd on other grounds*, 68 A.3d 665 (Del. 2013) (emphasis added).

ASB Allegiance held that this "temporal focus is critical." *Id.* It further held that an implied covenant claim:

> looks to the past. It is not a 'free-floating duty unattached to the underlying legal documents.' . . . It does not ask what duty the law should impose on the parties given their relationship at the time of the wrong, but rather what the parties would have agreed to themselves had they considered the issue ***in their original bargaining positions at the time of contracting***.

Id. (internal citation omitted; emphasis added); *see also Nemec*, 991 A.2d at 1127 (addressing implied covenant claim by supposing "the parties to the Stock Plan specifically addressed the issue ***at the time of the contract***") (emphasis in original).

Thus, when an implied covenant claim is brought by a party who purchased a contractual financial instrument in the secondary market, courts do not look at the intent and expectations of that secondary market purchaser when it made its purchase, but instead look at the expectations and intent of the original purchaser when the instrument was issued (*i.e.*, when the contract was executed). This is illustrated very clearly in a ruling by Delaware Supreme Court Chief Justice Strine (then Vice Chancellor) in *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020 (Del. Ch. 2006). In that case, a plaintiff who was not a party to the original

negotiable note contract acquired that note, and then brought a breach of implied covenant claim. *See id.* at 1026 ("The $10 Million Note . . . was later transferred to Allied."). The court did not look to the expectations of the plaintiff (*i.e.*, the transferee noteholder), but looked instead to the intent and expectations of the original party to the note (*i.e.*, plaintiff's predecessor-in-interest). *See id.* at 1035 ("The original parties to the $10 Million Note were sophisticated players . . . . At oral argument, Allied conceded the obvious: that SunSub, the original creditor on the $10 Million Note, used a large law firm to negotiate the detailed 15-page single-spaced promissory note . . . . The implied covenant is not a fall-back position to be argued when you now wish your predecessor-in-interest had done a better job of negotiating the contract in the first place.").

Accordingly, in assessing implied covenant claims brought on a class-wide basis, the Delaware courts have focused solely on the "hypothetical original bargaining position" of the parties drafting the original governing documents, without regard to any aftermarket transactions. *See In re Kinder Morgan, Inc. Corp. Reorganization Litig.*, No. 10093-VCL, 2015 WL 4975270, at *11 (Del. Ch. Aug. 20, 2015) (analyzing implied covenant claim brought by class of holders of publicly traded Master Limited Partnership based on "hypothetical original bargaining position" of the parties), *aff'd sub nom. The Haynes Family Tr. v. Kinder Morgan G.P., Inc.*, 135 A.3d 76 (Table) (Del. 2016); *Allen v. El Paso*

Pipeline GP Co., L.L.C., No. 7520-VCL, 2014 WL 2819005, at *17 (Del. Ch. June 20, 2014) (same).

We have found no contrary authority from the Virginia courts.[1] There is therefore no basis for concluding that Virginia would do anything other than apply the standard rule that the intent that governs a contract is the intent of the parties who entered the contract at the time that contract was executed. To the contrary, a decision from this Court, while noting the relative paucity of Virginia cases expressly discussing the implied covenant, confirms that the implied covenant reflects basic principles of Virginia contract law. *See Tymeshare, Inc. v. Covell*, 727 F.2d 1145, 1151-52 (D.C. Cir. 1984) (Scalia, J.) (although "neither of the parties has cited, nor have we been able to find, particularly pertinent Virginia authority on the existence of a generally applicable 'duty to perform in good faith' . . . . [That duty] is simply a rechristening of fundamental principles of contract law well established in Virginia and elsewhere.").

Indeed, in *Tymeshare*, this Court focused its inquiry on the intent of the parties at the time of contracting. *See, e.g., id.* at 1153 ("[T]he object of our inquiry is whether it was reasonably understood by the parties to this contract that there were at least certain purposes for which the expressly conferred power to adjust quotas could not be employed."); *id.* at 1154 ("Where what is at issue is the

[1] All parties agree that Virginia law should govern Class Plaintiffs' common law claims regarding Freddie Mac. *See* Op. at 58 n.24.

retroactive reduction or elimination of a central compensatory element of the contract – a large part of the *quid pro quo* that induced one party's assent – it is simply not likely that the parties had in mind a power quite as absolute as appellant suggests.").

The uniform trend in other States provides ample additional reason to believe that Virginia law is in accord with that of Delaware on this fundamental issue of contract law. Although Delaware law is particularly well-developed on the issue, other States that have addressed the issue likewise focus on the expectations and intent of the original contracting parties at the time of the original contract formation.[2]

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[2] *See, e.g., Wilson v. Career Educ. Corp.*, 729 F.3d 665, 675 (7th Cir. 2013) (under Illinois law, "the implied covenant of good faith is used as a construction aid to assist the Court in determining whether the manner in which one party exercised its discretion under the contract violated ***the reasonable expectations of the parties when they entered into the contract***.") (emphasis added); *Wilson v. Amerada Hess Corp.*, 773 A.2d 1121, 1130 (N.J. 2001) (under New Jersey law, looking to "***the expectations of the parties at the formation of a contract***") (emphasis added); *Cross & Cross Props., Ltd. v. Everett Allied Co.*, 886 F.2d 497, 502 (2d Cir. 1989) (applying New York law, "[t]he boundaries set by the duty of good faith are generally defined by the parties' ***intent and reasonable expectations in entering the contract.***") (emphasis added); *Flood v. ClearOne Commc'ns, Inc.*, 618 F.3d 1110, 1122 (10th Cir. 2010) (Gorsuch, J.) (under Utah law, "the covenant is about securing to the parties the sort of good faith performance that . . . they reasonably thought they were securing ***at the time they entered into the bargain***.") (emphasis added); *Market St. Assocs. Ltd. P'ship v. Frey*, 941 F.2d 588, 595 (7th Cir. 1991) (Posner, J.) (under Wisconsin law, "[t]he concept of the duty of good faith . . . is a stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to their dispute."); *Best v. U.S. Nat'l Bank of Or.*, 739 P.2d 554, 559 (Or. 1987) (under Oregon law, looking at

In this case, the implied covenant claims are not based on the relationships between each individual class member and Fannie Mae or Freddie Mac at the time those class members bought stock in the secondary market. Instead, the claims are based on the intent and expectations of the parties to the share agreements at the time the preferred and common shares were first issued – *i.e.*, as of the time the contracts were executed. To the extent the original purchasers of the preferred and common stock sold their shares in the secondary market, those sales transferred all rights associated with the shares – including the right to bring breach of contract claims based on the original contracting intent and expectations. Shareholder rights to assert breach of contract or breach of implied covenant claims are property rights that travel with the shares when they change hands.[3] The transfer

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banking fees in effect at time of contracting in determining whether defendant bank's subsequently set fees were beyond the reasonable expectations of customers for purposes of implied covenant claim); *White Stone Partners, LP v. Piper Jaffray Cos.*, 978 F. Supp. 878, 883 (D. Minn. 1997) (under Minnesota law, "the proper inquiry is what was reasonably understood by the parties regarding the discretion granted in the agreement and whether the actions alleged were implicitly envisioned by the contract."); *Hanaway v. The Parkesburg Grp., LP*, 132 A.3d 461, 474-75 (Pa. Super. 2015) (under Pennsylvania law, assessing implied covenant claim by determining the reasonable expectations of the parties at the time of contracting), *review denied*, 138 A.3d 608 (Pa. 2016).

[3] *See Schultz v. Ginsburg*, 965 A.2d 661, 667 (Del. 2009) ("As a matter of law, a Charter Violation claim transfers to a later purchaser because the injury is to the stock and not the holder."); *In re Dole Food Co., Inc. Stockholder Litig.*, No. 8703-VCL, 2017 WL 624843, at *5 (Del. Ch. Feb. 15, 2017) ("[T]he Delaware law claims that provided the principal basis for the settlement were property rights associated with the shares. As shares changed hands, these property rights traveled with the shares."); *In re Activision Blizzard, Inc. Stockholder Litig.*, 124 A.3d

of those contractual claims does not in any way change the nature of the claims, which remain based on the contractual intent and expectations of the parties at the time of contract formation.

Indeed, it is well-established that the assignment of a contractual right does not change the nature of the right, but merely puts the assignee "in the shoes of the assignor." *Fox-Greenwald Sheet Metal Co., Inc. v. Markowitz Bros., Inc*., 452 F.2d 1346, 1357 n.69 (D.C. Cir. 1971) ("an assignee stands in the shoes of his assignor") (citing 3 S. Williston, Contracts § 432 (3d ed. 1960); Restatement of Contracts § 167(1) (1932)); *Fed. Fin. Co. v. Hall*, 108 F.3d 46, 48 (4th Cir. 1997) (applying Virginia law) ("the common law speaks in a loud and consistent voice: *An assignee stands in the shoes of his assignor*" (emphasis in original) (quoting *FDIC v. Bledsoe*, 989 F.2d 805, 810 (5th Cir. 1993), and citing 6 Am. Jur. 2d Assignments § 102 (1963) and Restatement (Second) of Contracts § 336 cmt. b, illus. 3 (1979)). This means that shareholders who purchased Fannie Mae or

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1025, 1043-44 (Del. Ch. 2015) (with respect to each of the "Delaware corporate law claims that Lead Counsel pursued and which formed the basis for the Settlement . . . , the right to assert the claim and benefit from any recovery is a property right associated with the shares. By default, that property right travels with the shares."); 6 Del. Code Ann. § 8-302(a) ("a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer"); VA Code § 8.8A-302(a)(2016) ("a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer"); *R.A. Mackie & Co., L.P. v. Petrocorp Inc.*, 329 F. Supp. 2d 477, 507 (S.D.N.Y. 2004) (interpreting identical UCC § 8-302; "'rights in the security' includes rights 'vis-à-vis the issuer and vis-à-vis other potential holders,' and . . . rights against the issuer include contract rights").

Freddie Mac preferred or common shares "stand in the shoes" of the shareholder from whom they made those purchases, stretching back continuously to the original purchasers of the shares at the time of issuance.

Accordingly, as the cases discussed above recognize, the proper focus of the implied covenant inquiry in this case is on the intent and expectations of the shareholders and Enterprises as to the shares at the time those shares were first issued, and is not based on the expectations held by shareholders who later purchased shares in the secondary market.

CONCLUSION

Class Plaintiffs respectfully request that this Court modify its Opinion to accord with applicable law by directing the District Court, on remand, to focus its reasonable expectations inquiry solely upon the reasonable expectations of the original contracting parties at the time the shares were issued. All of the preferred and common shares of both Fannie Mae and Freddie Mac were issued before HERA was enacted in July 2008. The contractual expectations that attached to all shares were therefore expectations that were ***not*** informed by HERA, and ***not*** informed by anything that could have provided notice that a future conservator could first enter into a senior preferred stock agreement with one set of terms, and then could amend those terms with those set forth in the Third Amendment. Thus, the application of the correct legal standard to the implied covenant claim would

have the salutary effect of streamlining this aspect of the lawsuit, likely avoiding the need for sub-classes.

Alternatively, Class Plaintiffs respectfully request that the Court modify the Opinion by removing the paragraph at issue to allow the District Court full scope to consider the correct legal standard following full briefing in the first instance. Under similar circumstances, this Court granted panel rehearing in order to remove a portion of its opinion addressing an issue that, while it had been raised in passing by one party, "was not fully briefed" and was "not necessary" to the Court's decision to vacate one FCC rule and remand another in order to allow the Commission to consider the issue in the first instance. *See Fox Television Stations, Inc.*, 293 F.3d at 540 (granting in part motion for panel rehearing by modifying opinion to remove language resolving unbriefed issue and to replace with language making clear that the Court was declining to reach the issue).

Dated: March 31, 2017

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 40(b)(1) and 35(b)(2)(A), I hereby certify that this brief complies with the type-volume limitation because it contains 3,533 words, excluding the parts exempted by Fed. R. App. P. 32(f). I further certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the typeface style requirements of Fed. R. App. P. 32(a)(6) because the brief was prepared in proportionally spaced typeface using Microsoft Word in 14-point Times New Roman font.

CERTIFICATE OF SERVICE

I hereby certify, pursuant to Fed. R. App. P. 25(c) and Cir. R. 25, that on March 31, 2017, the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system, which will send a notification to the attorneys of record in this matter who are registered with the Court's CM/ECF system.

DATED: March 31, 2017

/s/ *Hamish P.M. Hume*
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