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.
_____/

REPLY TO THE FEDERAL HOUSING FINANCE AGENCY'S OPPOSITION TO PLAINTIFFS' RULE 59(e) MOTION

Plaintiffs point to manifest errors of law or fact in the Order Denying Motion to Remand and Granting Motion to Substitute (the "Order") (Doc. 50). Respectfully, in its Order, the Court did not consider the allegations of harm specific to Plaintiffs' claims for negligent misrepresentation against Defendant, Deloitte & Touche, LLP ("Deloitte"), or whether those negligence claims should be treated as direct claims not barred by the Housing and Economic Recovery Act of 2008 ("HERA"). The Court's omission illustrates its misapprehension of the nature of the claims, which is an error appropriately reconsidered under Rule 59(e). *E.g.*, *Z.K. Marine Inc. v. M/V Archigetis*, 808 F. Supp. 1561, 1563 (S.D. Fla. 1992).

This omission evidences a manifest error of law and fact. Indeed, whether the Federal Housing Finance Agency ("FHFA") may succeed to the rights of Fannie Mae's individual shareholders depends on whether the minority shareholders' claims are treated as direct, rather than derivative. *See Perry Capital LLC v. Mnuchin*, 2017 WL 677589, at *22-*24 (D.C. Cir. Feb. 21, 2017). FHFA, as conservator, succeeds only to the shareholders' right to bring

derivative suits – not direct suits. *Id*. at *22-23 (citing 12 U.S.C. § 4617(b)(2)(A)(i)).[1]

Curiously, in its opposition, FHFA omits any mention of *Perry Capital*, which was decided eight days beforehand on February 21, 2017. (*See* Doc. 58, at 1-13 (filed March 1, 2017).) Instead, FHFA continues to assert that "even if the Shareholders' claims [are] direct," substitution "still would be required because FHFA succeeded to 'all rights' of the Shareholders, not just the right to pursue derivative claims . . . ." (*Id*. at 12, n.7.) FHFA's statutory interpretation, however, has now been squarely rejected by the D.C. Circuit. *See Perry Capital*, 2017 WL 677589, at *22-*23.

Perry Capital illustrates the importance of a specific ruling as to the nature of the claims brought by Fannie Mae's minority shareholders against Deloitte. Plaintiffs ask this Court to grant relief under Rule 59(e), amend its judgment, and vacate its Order granting substitution. Because Plaintiffs' negligent misrepresentation claims are direct claims, FHFA does not succeed to the shareholders' rights. Instead, Plaintiffs should be permitted to proceed against Deloitte.

Notwithstanding its omission of *Perry Capital*, FHFA's arguments in response to Plaintiffs' Rule 59(e) motion are not persuasive. Plaintiffs will refute each of FHFA's arguments.

I. The shareholders are entitled to Rule 59(e) relief.

Plaintiffs do not "re-hash the same failed arguments" they originally raised in opposition to FHFA's motion to substitute. (Doc. 58, at 1.) Nor do Plaintiffs assert new arguments to get a "second bite" at the apple. On the merits, Plaintiffs are entitled to pursue their direct negligent misrepresentation claims against Deloitte.

A. FHFA cannot argue that this Court has already "correctly rejected" the shareholders' "failed arguments."

[1] In relying on the recent decision in *Perry Capital*, the shareholders do not abandon their alternative arguments. (*E.g.*, Doc. 20, at 16-19.)

FHFA first argues that the Rule 59(e) motion is "replete with failed arguments this Court [has] already correctly rejected." (Doc. 58, at 3.) Yet in its Order, the Court did not consider the allegations of harm specific to the Plaintiffs' claims for negligent misrepresentation or determine whether those tort claims were derivative or direct. Instead, the Court focused only on the Plaintiffs' aiding and abetting breach of fiduciary duty claims. (*E.g.*, Doc. 50, at 9.)

Nonetheless, FHFA emphasizes that the minority shareholders have "already made these same arguments, citing the very same cases" cited in opposition to the motion for substitution. (Doc. 58, at 4 (citing Doc. 20, at 12).) The shareholders do cite some of the "very same cases" in the Rule 59(e) motion that they cited in opposition to FHFA's motion to substitute. Yet nowhere within its Order did the Court "thoroughly consider[] and reject[] these arguments" (Doc. 58, at 4) in the context of Plaintiffs' *negligent misrepresentation* claims. (*See* Doc. 50, at 8-10.)

FHFA also misconstrues Plaintiffs' arguments on individualized harm. (Doc. 58, at 4.) Plaintiffs do *not* argue, as FHFA suggests, that they "are not required to allege they suffered any individualized harm separate and apart from any harm to the company." (*Id*.) Plaintiffs have consistently recognized that under Delaware law, a shareholder must state a "claim of individual harm upon which he or she can rely that was not *also* suffered by the corporation" before the claim will be considered direct. (Doc. 57, at 6 (citing *Poptech, LP. v. Stewardship Inv. Advisors, LLC*, 849 F. Supp. 2d 249, 263-64 (D. Conn. 2012); *Grimes v. Donald*, 673 A.2d 1207, 1212 (Del. 1996), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)); Doc. 20, at 12 ("[T]he stockholder must be able to prove his own injury *without regard to* whether the corporation was also harmed.").)

In other words, Delaware law does not provide that a direct claim can arise only when the corporation has suffered no injury. *See Poptech*, 849 F. Supp. 2d at 262-63. As Delaware courts

have long recognized, a wrong may harm both the corporation and its shareholders directly. *E.g.*, *Gatz v. Ponsoldt*, 925 A.2d 1265, 1278 (Del. 2007). To bring a direct claim, however, the shareholder must prove harm unique to him, and independent of any injury suffered by the company. (Doc. 20, at 12, 14 (citing *Gatz*, 925 A.2d at 1278; *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006); *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1036 (Del. 2004)).)

This is no different from the ruling in *El Paso Pipeline GP Co. v. Brinckerhoff*, as cited by FHFA. (Doc. 58, at 4-5.) In *El Paso*, the Delaware Supreme Court reiterated, "[T]o prove that a claim is direct, a plaintiff must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation." 2016 WL 7380418, at *10 (Del. Dec. 20, 2016) (quoting *Tooley*, 845 A.2d 1031, 1039 (Del. 2004)).

FHFA emphasizes that, in opposing substitution, Plaintiffs cited the Delaware Chancery Court's decision in *El Paso*, which has since been reversed. (Doc. 58, at 5.) Plaintiffs relied on the lower court's opinion in *El Paso* to argue that the "expropriation" of shareholders' rights (which can result in a breach of fiduciary duty) is not limited to the facts of *Gentile*. (Doc. 20, at 14-15). The Delaware Supreme Court's refusal to broaden the *Gentile* exception is not relevant to the relief that the Plaintiffs now seek on their negligent misrepresentation claims. And *Gentile* remains good law, in any event.

Once again, in granting substitution, this Court focused on Plaintiffs' aiding and abetting breach of fiduciary duty claims, finding that the minority shareholders could not bring those derivative claims against Deloitte. The Court did not consider the allegations of harm specific to Plaintiff's claims for negligent misrepresentation. Absent a ruling on the negligent misrepresentation claims, FHFA cannot assert that Plaintiffs' "same failed arguments" have

already been considered and rejected. (Doc. 58, at 5.)

B. Plaintiffs have not waived any "new" arguments.

Nor do Plaintiffs raise new arguments for the first time in their Rule 59(e) motions. FHFA emphasizes, for example, that Plaintiffs did not address the *Citigroup* decision in its opposition to motion to substitute, but instead "pursued *other* arguments under *different* strains of Delaware law." (Doc. 58, at 6 (emphasis in original).) Yet Plaintiffs were not required to distinguish each and every case cited by FHFA[2] to preserve their argument that the negligent misrepresentation claims – like their claims for aiding and abetting breach of fiduciary duty – are direct. *Cf. Arthur v. King*, 500 F.3d 1335, 1343 (11th Cir. 2007) (Rule 59(e) motion cannot be used to "relitigate old matters, raise argument or present evidence that could have been raised prior to the entry of judgment"); *Mincey v. Head*, 206 F.3d 1106, 1137 n.69 (11th Cir. 2000) (Rule 59(e) motion should not "serve as a vehicle to relitigate old matters or present the case under a new legal theory"); *Z.K. Marine Inc.*, 808 F. Supp. at 1563 ("[a] motion for reconsideration should not be used as a vehicle to present authorities available at the time of the first decision or to reiterate arguments previously made").

Plaintiffs have consistently argued that because the alleged wrongdoing caused harm to the minority shareholders, individually, they can prevail without showing an injury to Fannie Mae. (Doc. 20, at 12-13, 15-16.) Plaintiffs show the direct nature of the claims by emphasizing the individualized harm that resulted from their reliance on Deloitte's negligent

[2] In its motion to substitute, FHFA argued that *Citigroup* did not control because the negligent misrepresentation claims in that case were brought by a former shareholder against the corporation itself. (Doc. 15, at 14-15.) Notwithstanding that Fannie Mae "can pursue negligent misrepresentation claims against Deloitte" (*id*. at 15), it has not brought those claims here. FHFA ignores the nature of the negligent misrepresentation claims, which belong to the individual shareholders who purchased and owned the stock. *See Citigroup*, 140 A.3d at 1138.

misrepresentations. This is not a new argument.[3]

Likewise, FHFA's suggestion that the Plaintiffs' own flawed opposition invited the Court to analyze all the claims together is unwarranted. By arguing that its claims for aiding and abetting breach of fiduciary duty *and* negligent misrepresentation are direct (Doc. 20, at 4, 12), Plaintiffs did not waive their right to a ruling that separately addresses the allegations of each claim, and explains whether that claim is derivative or direct.

C. Plaintiffs' arguments are not meritless.

In its third and final argument, FHFA claims that Plaintiffs' "new arguments" are "meritless in any event." (Doc. 58, at 7.) FHFA fails in its efforts to show that Plaintiffs' tort claims are, in fact, derivative claims under Delaware law.

For instance, FHFA continues to misconstrue Plaintiffs' explanation of the test for direct claims. According to FHFA, Plaintiffs "assert that to state a direct claim, they need *only* 'allege that [they] suffered some individualized harm not suffered by all of the shareholders at large.'" (*Id*. at 7.) Notably absent from Plaintiffs' explanation is the word "only." (Doc. 57, at 6.) Indeed, Plaintiffs themselves cite *Feldman v. Cutaia* – the same case on which FHFA relies to argue that the shareholders must allege harm "independent of any injury to the corporation that would entitle [them] to an individualized recovery." 951 A.2d 727, 732-33 (Del. 2008).

Plaintiffs have not argued – and do not now contend – that the test for determining direct claims depends *only* on whether the shareholders can show individualized harm not suffered by all shareholders, or that they are somehow relieved of the obligation under Delaware law to show

[3] *See* Doc. 57, at 4-7; Doc. 20, at 11-13 (distinguishing FHFA's reliance on *Stephenson v. Pricewaterhouse Coopers, LLP*, 482 F. App'x 618 (2d Cir. 2012), *Ernst & Young Ltd. v. Quinn*, 2009 WL 3571573 (D. Conn. Oct. 26, 2009), "and cases that similarly involve harms suffered by plaintiffs due to accounting improprieties *that depended upon* underlying harms suffered by the companies in which they had invested"); Doc. 20, at 15-16 (citing *KPMG LLP v. Cocchi*, 88 So. 3d 327, 330 (Fla. 4th DCA 2012)).

individual harm separate and apart from injury to the company. (*See* Doc. 57, at 6; Doc. 20, at 12-13.) Instead, Plaintiffs sought to point out: (1) wrongs can harm both the corporation and the shareholders directly, and can be challenged in direct or derivative actions; (2) Delaware law does not require a shareholder to prove the company has suffered *no* injury before allowing that shareholder to bring a direct claim; and (3) a shareholder should not be precluded from bringing a direct suit because the nature of the alleged harm may be related in some way to the diminution in the value of his shares. (Doc. 57, at 4, 6; Doc. 20, at 12.)

Plaintiffs do not attempt to create a "new" test for measuring whether a claim is direct under Delaware law. The shareholders must demonstrate that they have suffered an individualized harm that is not dependent on an injury to the corporation.

Under Delaware law, Plaintiffs can satisfy this requirement. While FHFA argues that the shareholders' alleged economic harm is "classically derivative" (Doc. 58, at 8, 11), Plaintiffs do not contend that the Net Worth Sweep diminished Fannie Mae's overall corporate profits to harm all shareholders indirectly. Instead, Plaintiffs allege that the Net Worth Sweep improperly allocated profits to a single, dominant shareholder, thereby destroying the minority shareholders' economic interests. Plaintiffs can prevail without showing an injury to Fannie Mae. *See Tooley*, 845 A.2d at 1036.

The loss of stock value is not the only harm alleged by the Plaintiffs. Deloitte's negligent audits and material misstatements induced Plaintiffs to purchase and hold Fannie Mae stock. Plaintiffs justifiably relied to their detriment on Deloitte's negligent audit reports, incurring substantial losses in amounts to be proven at trial. (Doc. 1, at 30-31, ¶¶ 103-111.)

The Delaware Supreme Court's decision in *Citigroup, Inc. v. AHW Inv. P'ship*, 140 A.3d 1125 (Del. 2016), shows why the negligent misrepresentation claims belong to the Plaintiffs.

Although Fannie Mae *could* assert a negligent misrepresentation claim against Deloitte, Fannie Mae cannot assert the *same* negligent misrepresentation claim that the minority shareholders allege here. Aside from allegations that Fannie Mae, FHFA, and Treasury were complicit in Deloitte's misrepresentations, Fannie Mae cannot claim that it justifiably relied on the auditor's misstatements to "purchase and hold" its own stock, to its detriment. (Doc. 1, at 30, ¶¶ 103, 105; *id*. at 31, ¶¶ 108-11.) *See Citigroup*, 140 A.3d at 1139-40 (noting that the individual shareholders, and not Citigroup, held that corporate stock; Citigroup was unable to identify any New York or Florida law that suggests "the issuer of stock should be the plaintiff in a holder claim lawsuit"); *In re Activision Blizzard, Inc. S'holder Litig.*, 124 A.3d 1025, 1056 (Del. Ch. 2015) ("Quintessential examples of personal claims would include . . . a tort claim for fraud in connection with the purchase or sale of shares").

Plaintiffs' emphasis on individual reliance is not a "red herring." (Doc. 58, at 10.) The shareholders' negligent misrepresentation claims may not be "typical" inducement or holder claims. (Doc. 58, at 10.) This does not render Plaintiffs unable to prove that they suffered harm in justifiably relying on Deloitte's negligent audit reports and misstatements.

And, by claiming that "this is not a case where the Shareholders are contesting their dividend payments or interference with their voting rights" (Doc. 58, at 11), FHFA misstates the harm suffered by Plaintiffs. For instance, Plaintiffs allege that before 2007, "Fannie Mae regularly declared and paid dividends on its stock." (Doc. 1, at 5, ¶ 18.) In 2013, however, Deloitte's material misstatements of Fannie Mae's financial statements led to the Net Worth Sweep, which now requires Fannie Mae to pay its entire net worth to Treasury every quarter. By contrast, Plaintiffs will never receive any return on their investments – like dividends. (Doc. 20, at 3; Doc. 1, at 12-13, ¶¶ 37, 38.)

Plaintiffs *do* contest dividend payments and interference with voting rights. (Doc. 20, at 3, 11.) Aside from FHFA's mischaracterization of the record, the agency does not – and, indeed, cannot – show that these are the only kinds of claims that may be brought directly brought by minority shareholders. (*Contra* Doc. 58, at 11.)

FHFA also mistakenly argues that Plaintiffs "cannot identify any duties owed to them by Deloitte or any right of action against Deloitte." (Doc. 58, at 11.) Deloitte does not owe a duty of reasonable care to Fannie Mae alone. *E.g., First Fla. Bank, N.A. v. Max Mitchell & Co.*, 558 So. 2d 9, 14-16 (Fla. 1990) (accountants' liability is not limited only to those in privity).

And, contrary to FHFA's suggestion, courts have not concluded that accountants can never be liable to shareholders. (*See* Doc. 58, at 11.) *E.g.*, *Machata v. Seidman & Seidman*, 644 So. 2d 114 (Fla. 4th DCA 1994) (rejecting accountant's liability to shareholders under the specific facts of that case). Under section 552 of the Restatement, Deloitte can be liable for negligently providing false and inaccurate information to Fannie Mae and its shareholders, so long as the shareholders were within "a limited group of persons for whose benefit and guidance" Deloitte intended to supply the information (or were known by Deloitte to be among those with whom Fannie Mae, as the "recipient," would share that information). *See First Fla. Bank*, 558 So. 2d at 12.

Plaintiffs are entitled to relief under Rule 59(e). Respectfully, this Court misapprehended the personal and direct nature of the negligent misrepresentation claims. Plaintiffs – not FHFA – are entitled to bring those direct negligent misrepresentation claims against Deloitte.

II. The Shareholders are entitled to amend their Complaint, if necessary.

Plaintiffs have not waived their right to seek leave to amend. As part of the same motion, Plaintiffs asked this Court to grant relief under Rule 59(e). "Post-judgment, the plaintiff may

seek leave to amend if he is granted relief under Rule 59(e) or Rule 60(b)(6)." *Jacobs v. Tempur-Pedic Int'l*, 826 F.3d 1327, 1344 (11th Cir. 2010) (citation omitted).

Assuming this Court finds on rehearing that the Plaintiffs' claims for negligent misrepresentation are direct claims not barred by HERA, and reverses its ruling on substitution, the individual shareholders will be entitled to pursue this action against Deloitte. Should the Court consider the allegations of the Complaint to be inadequate, Plaintiffs ask for leave to amend the original state court Complaint to clarify that the claims brought against Deloitte are direct claims. As the newly-substituted plaintiff, FHFA is not "the master of the complaint" that it did not file, and for claims that it plainly does not intend to pursue. *Cf. May v. Sasser*, 2016 WL 6694540, at *2 (11th Cir. Nov. 15, 2016). Should this Court alter or amend its Order substituting FHFA, and allow the minority shareholders to pursue their direct, negligent misrepresentation claims against Deloitte, Plaintiffs are entitled to seek leave to amend the Complaint.

CONCLUSION

Plaintiffs ask this Court to reverse its ruling to find that the claims for negligent misrepresentation against Deloitte are direct, and that FHFA is not entitled to substitute as plaintiff. Should the Court grant relief under Rule 59(e), but determine that the claims for negligent misrepresentation were not sufficiently pled, Plaintiffs ask that the Court grant leave to amend the Complaint.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on March 8, 2017, 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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