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Case No. 12105-VCMR

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

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| TIMOTHY J. PAGLIARA,<br><br>Plaintiff,<br><br>v.<br><br>FEDERAL NATIONAL MORTGAGE ASSOCIATION,<br><br>Defendant. | ) | C.A. No. 12105-VCMR |

**BRIEF IN SUPPORT OF FANNIE MAE AND FHFA'S MOTION TO DISMISS OR, IN THE ALTERNATIVE, TO SUBSTITUTE FHFA AS THE PROPER PLAINTIFF**

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## INTRODUCTION

The Court should dismiss this stockholder demand to inspect the books and records of Fannie Mae for several independent reasons.

*First*, the Court lacks personal jurisdiction over Fannie Mae, a federally chartered company with its principal place of business in the District of Columbia.

*Second*, even if the Court had personal jurisdiction, Pagliara's claims are barred by issue preclusion because he already has litigated the very same issue—his ability as a stockholder to review the books and records of an enterprise under FHFA's conservatorship—in another court and lost. That court found that during conservatorship Pagliara no longer has any inspection rights. *See Pagliara v. Fed. Home Loan Mortg. Corp.*, 203 F. Supp. 3d 678 (E.D. Va. 2016) ("*Pagliara I*").

*Third*, even if the Court were to reach the merits of Pagliara's claim, the Court should likewise hold that Pagliara has no right to inspect Fannie Mae's books and records. Under federal law (the Housing and Economic Recovery Act of 2008 ("HERA")), FHFA as Conservator has succeeded to "all rights, titles, powers, and privileges" of Fannie Mae's stockholders, including any right of Plaintiff to inspect Fannie Mae's books and records. 12 U.S.C. § 4617(b)(2)(A)(i).

*Fourth*, HERA's jurisdiction withdrawal provision, *id*. § 4617(f), also bars the injunctive relief Pagliara seeks as it would restrain and affect the Conservator's exercise of statutory powers.

*Finally*, Pagliara has failed to identify a proper purpose for the proposed inspection. Pagliara seeks production of books and records purportedly because he is considering litigation against Fannie Mae's directors, FHFA and/or Treasury, but any such suit would be barred by the applicable statutes of limitations.

## NATURE AND STAGE OF PROCEEDING

Plaintiff Pagliara filed suit in this Court on March 14, 2016, seeking an inspection of Fannie Mae's books and records. On March 25, 2016, Defendant Fannie Mae removed the suit to the United States District Court for the District of Delaware. On March 8, 2017, that court remanded the suit to this Court for further proceedings. On March 28, 2017, this Court entered an order setting a trial date of May 1. In light of the threshold legal issues raised in this motion, Fannie Mae will also file a motion to reconsider that scheduling order today.

## STATEMENT OF FACTS[1]

### A. Fannie Mae and Freddie Mac

Congress created Fannie Mae and Freddie Mac (together, the "Enterprises"), as federally-chartered companies whose mission is to facilitate liquidity and efficiency in the mortgage market. *See* Compl. ¶¶ 22, 25, 30. Fannie Mae is not a Delaware corporation. Rather, federal law dictates that Fannie Mae is a citizen of the District of Columbia "for purposes of jurisdiction and venue in civil actions." 12 U.S.C. § 1717(a)(2)(B). Pursuant to its federal charter and its Bylaws, Fannie Mae is authorized to do business as "Federal National Mortgage Association" or "Fannie Mae." 12 U.S.C. § 1717(a)(1), (a)(2)(B); Ex. 1, Fannie Mae Bylaws (as amended through July 26, 2016) ("Fannie Mae Bylaws") § 1.01.[2] Fannie Mae does not have a certificate of incorporation nor is it required to register to do business in any state. *See* 12 U.S.C. § 1723a(a).

### B. The Housing and Economic Recovery Act of 2008 ("HERA")

In July 2008, in the wake of a national crisis in the U.S. housing market, Congress created FHFA as the Enterprises' independent federal regulator. *See* HERA, Pub. L. No. 110-289, 122 Stat. 2654 (codified as 12 U.S.C. § 4511 *et seq.*); *see also* Compl. ¶¶ 54, 55. HERA also granted the Director of FHFA

[1] This Brief draws, *arguendo*, on the allegations of the Complaint, without conceding the completeness or accuracy of those allegations.

[2] All cites to "Ex. [numeric]" refer to exhibits to the Transmittal Affidavit of S. Mark Hurd, filed herewith, unless otherwise noted.

discretionary authority to place Fannie Mae and Freddie Mac in conservatorship and to appoint FHFA as their conservator "for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity." 12 U.S.C. § 4617(a)(2). HERA provides that, upon its appointment as the conservator or receiver, FHFA "immediately succeed[s] to . . . all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity and the assets of the regulated entity." *Id.* § 4617(b)(2)(A)(i).

The statute accords the Conservator broad authority to "operate" and "conduct all business" of the Enterprises, *id.* § 4617(b)(2)(B)(i), including the power to take such action as may be "appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity," *id.* § 4617(b)(2)(D)(ii), and to "transfer or sell" any of the Enterprises' assets or liabilities, *id.* § 4617(b)(2)(G). HERA also provides FHFA as conservator the authority to exercise its statutory powers and any "necessary" "incidental powers" in the manner that "the Agency [FHFA] determines is in the best interests of the regulated entity or the Agency." *Id.* § 4617(b)(2)(J).

Finally, HERA affords FHFA broad discretion to operate the Enterprises without judicial interference. Section 4617(f) provides that "no court

may take any action to restrain or affect the exercise of powers or functions of [FHFA] as conservator or receiver."

### C. Conservatorship and the Preferred Stock Agreement with the Department of Treasury

FHFA's Director placed both Enterprises into statutory conservatorships in September 2008; they remain in that status today. *See* Compl. ¶ 65. Shortly after becoming Conservator, FHFA (on behalf of the Enterprises) entered into Senior Preferred Stock Purchase Agreements ("PSPAs") with the United States Department of the Treasury ("Treasury"). *Id.* ¶¶ 83-100.

Through the PSPAs, Treasury agreed to provide billions of dollars for the Enterprises' continued operations in exchange for a comprehensive package of rights. *See Perry Capital v. Mnuchin*, 848 F.3d 1072, 1082 (D.C. Cir. 2017). In return, Treasury received (i) a $1 billion senior liquidation preference—a priority right above all other stockholders, whether preferred or otherwise—to receive distributions from assets if the Enterprises were liquidated; (ii) a dollar-for-dollar increase in that liquidation preference each time the Enterprises drew upon Treasury's funding commitment; (iii) quarterly dividends that the Enterprises could either pay at a rate of 10% per annum of Treasury's liquidation preference or, if the dividends were paid in kind, at a rate of 12% per annum; (iv) warrants allowing Treasury to purchase up to 79.9% of the Enterprises' common stock; and (v)

significant periodic commitment fees to compensate Treasury's ongoing commitment of billions of dollars. *Id.*[3]

### D. The Third Amendment and the "Net Worth Sweep"

Through the first quarter of 2012, Fannie Mae and Freddie Mac "repeatedly struggled to generate enough capital to pay the 10% dividend they owed to Treasury under the amended [PSPAs]." *Perry Capital*, 848 F.3d at 1083. In August 2012, Treasury and FHFA, acting as Conservator for the Enterprises, entered into the Third Amendment to the PSPAs. Compl. ¶ 104. The Third Amendment eliminated the fixed dividend and suspended the periodic commitment fee. *Id.* ¶¶ 112, 119. In exchange, the Third Amendment provided that the Enterprises would pay to Treasury a quarterly variable dividend equal to their net worth (subject to a declining reserve)—however much or little that might be. *Perry Capital*, 848 F.3d at 1083.[4] If the Enterprises' net worth is negative in a quarter, no dividend is due. *Id*.; *see also* Compl. ¶¶ 118-121.

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[3] The PSPAs were amended twice in 2009—first to raise the funding commitment for each of the Enterprises from $100 billion to $200 billion, and then, in the Second Amendment, to raise the commitment according to a formula that would become capped at the end of 2012. *See* Compl. ¶¶ 92-95.

[4] Those annual earnings historically averaged below $19 billion, the amount owed under the fixed dividend. *See* Ex. 2, Fannie Mae, Quarterly Report (Form 10-Q) (Aug. 8, 2012) at 4 ("The amount of this dividend payment exceeds our reported annual net income for every year since our inception."); Ex. 3, Freddie Mac, Quarterly Report (Form 10-Q) (Aug. 7, 2012) at 8 ("[O]ur annual cash dividend obligation to Treasury on the senior preferred stock of $7.2 billion exceed[s] our annual historical earnings in all but one period."). All of Fannie

### E. Plaintiff Pagliara's Books and Records Demand

On January 19, 2016, Pagliara's counsel sent demands to both Fannie Mae and Freddie Mac seeking to inspect a massive volume of books and records in order to evaluate claims against their Directors, FHFA, and/or Treasury relating to the Third Amendment. *See* Compl., Ex. A. Among the fourteen separate requests that Pagliara included in his demand to Fannie Mae, he sought, for example, the following:

- All Board Materials concerning FHFA's and Treasury's management of Fannie Mae, including all "directives and/or instructions" given by FHFA or Treasury to Fannie Mae and all "policies, handbooks, rules, directives instructions, procedures, or other documents" concerning FHFA or Treasury oversight of Fannie Mae public statements;
- All Board Materials concerning any report, analysis, or evaluation of the solvency or insolvency of Fannie Mae;

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Mae's SEC reports are available at https://goo.gl/tuu32D. The Court may take judicial notice of these documents. *See, e.g.*, *Solomon v. Armstrong*, 747 A.2d 1098, 1121 n.72 (Del. Ch. 1999) (Chandler, C.) ("[I]t is well settled that where certain facts are not specifically alleged (or in dispute) a Court may take judicial notice of facts publicly available in filings with the SEC."), *aff'd*, 746 A.2d 277 (Del. 2000). Indeed, the Delaware Supreme Court has recognized that, "in acting on a Rule 12(b)(6) motion to dismiss, trial courts may consider hearsay in SEC filings to ascertain facts appropriate for judicial notice under Delaware Rule of Evidence 201." *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006) (alteration and quotation omitted). Where, as here, the complaint is devoid of any allegations casting doubt on the integrity of the filings, it is proper for the Court to take judicial notice of their contents. *See id.* at 171.

- All Board Materials concerning the Third Amendment, including those concerning payment of dividends pursuant to the Third Amendment;

- Books and records sufficient to show Fannie Mae's net worth, and the value of all outstanding shares of capital stock, from August 2012 until the present; and

- All Board Materials pertaining to the Company's outstanding public securities, stockholders, and debtholders.

*Id*. at 2-4.

ARGUMENT

## I. THIS COURT LACKS PERSONAL JURISDICTION OVER FANNIE MAE

The Court must consider whether it has general personal jurisdiction in this matter before proceeding to the merits.[5] *See Branson v. Exide Elecs. Corp.*, 625 A.2d 267, 268 (Del. 1993) ("[T]he Court of Chancery should have decided the personal jurisdictional challenge regarding the individual defendants, raised by [defendants'] motion to dismiss, prior to addressing the substantive aspect of that motion."). It does not. Fannie Mae is a federally-chartered government sponsored enterprise neither incorporated in Delaware nor at home in this state. The voided 2002 certificate of incorporation that Pagliara relies on to establish jurisdiction is not related to Fannie Mae, and Fannie Mae's congressional charter, Bylaws, and

[5] Pagliara has not alleged that the Court has specific personal jurisdiction over Fannie Mae arising out of relevant transactions within the State. Pagliara is a citizen of Tennessee and has no meaningful connection with Delaware. This motion therefore addresses only general personal jurisdiction.

SEC filings make no mention of it. Therefore, jurisdiction is not proper under Delaware's long-arm statute. In addition, Section 220 of the DGCL by its terms only applies to Delaware corporations, and thus has no application to Fannie Mae.

### A. Fannie Mae Is Not A Delaware Corporation.

Pagliara claims to have filed this lawsuit in Delaware because he believed Fannie Mae was incorporated in and operating under the laws of Delaware. Pagliara's sole basis for alleging jurisdiction is certificate of incorporation filed with the Secretary of State on August 21, 2002 for an entity called "Federal National Mortgage Association, ***Inc.***" Compl., Ex. C. (emphasis added) ("2002 Certificate"). Fannie Mae is not "Federal National Mortgage Association, Inc." Both Fannie Mae's Charter and its Bylaws state that Fannie Mae is only authorized to conduct business under two names: "Federal National Mortgage Association" and "Fannie Mae." 12 U.S.C. § 1717(a)(1), (a)(2)(B); Ex. 1, Fannie Mae Bylaws § 1.01.[6] Indeed, Pagliara did not sue "Federal National Mortgage Association, ***Inc.***" He sued "Federal National Mortgage Association." Compl. at 1. Similarly, he does not allege that he owns stock in "Federal National Mortgage Association, ***Inc.***"; again, the Verified Complaint reflects ownership in "Federal National Mortgage Association." *See* Compl., Ex. A, at 47.

[6] Fannie Mae's bylaws are incorporated by reference into the Verified Complaint, Compl. ¶ 44 & n.11, and attached thereto as an exhibit, Compl., Ex. B. Exhibit 1 is the operative version.

The 2002 Certificate contains other facial inconsistencies with the public record and allegations in the Complaint. Notably, it only authorizes the issuance of up to 1,500 shares of common stock. *See* Compl., Ex. C. In contrast, as Fannie Mae's annual filings with the SEC reflect, Fannie Mae had issued more than one billion shares of common stock in 2002. *See* Ex. 4, Fannie Mae Annual Report (Form 10-K), at 105 (Mar. 1, 2003) ("Fannie Mae 2002 10-K").

The 2002 Certificate is also inconsistent with Fannie Mae's history as a federally-chartered entity at home in the District of Columbia. During the period in which the 2002 Certificate was purportedly valid, Fannie Mae never described itself as a Delaware corporation or mentioned the certificate in any public filing. *See, e.g.*, Ex. 4, Fannie Mae 2002 10-K at Cover Page, (responding "federally chartered corporation" in section requesting "state or other jurisdiction of incorporation or organization"); Ex. 5, Fannie Mae Annual Report (Form 10-K), at Cover Page (Mar. 15, 2004) (same). In any event, the Delaware Secretary of State voided the 2002 Certificate on March 1, 2004, long before Pagliara filed suit.[7] *See* Ex. 6, Certificate of Sec'y of State Jeffrey W. Bullock ("Sec'y of State

[7] Whatever the 2002 Certificate is, it does not raise any questions of fact that should provide Pagliara with an opportunity for discovery. Even if there were a question of fact as to whether the 2002 Certificate was somehow associated with Fannie Mae, "Federal National Mortgage Association, Inc." is long defunct. Pagliara cannot revive personal jurisdiction even if it had existed in 2002, a fact Fannie Mae's counsel informed Pagliara of by letter dated August 4, 2016.

Certificate").[8] In voiding the certificate, the Secretary of State proclaimed that Federal National Mortgage Association, ***Inc.*** "is no longer in existence . . . under the laws of the State of Delaware."[9] *Id.*

### B. Fannie Mae Is A District of Columbia Corporation for Purposes of Jurisdiction, But As A Federally-Chartered Government Sponsored Enterprise, It Is Not Incorporated In Any State.

Fannie Mae's federal charter provides that it "shall maintain its principal office in the District of Columbia or the metropolitan area thereof and shall be deemed, for purposes of jurisdiction and venue in civil actions, to be a District of Columbia corporation." 12 U.S.C. § 1717(a)(2)(B). This language makes clear that Fannie Mae is "at home" in the District for purposes of general personal jurisdiction. *See Daimler AG v. Bauman*, 134 S. Ct. 746, 754 (2014).

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[8] This Court may take judicial notice of the Secretary of State Certificate. Facts "not subject to reasonable dispute" because they are "(1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned" are subject to judicial notice. Del. R. Evid. 201(b). This includes documents "obtainable by resort to, the office of the Secretary of State of Delaware" which is "a source whose accuracy cannot reasonably be questioned." *In re Wheelabrator Techs. Inc. S'holders Litig.*, 1992 WL 212595, at *11 (Del. Ch. Sept. 1, 1992).

[9] Under Delaware law, a corporation that has been voided, such as for failure to pay franchise taxes, is considered to be a dissolved corporation. *See, e.g., Wuerfel v. F.H. Smith Co.*, 13 A.2d 601, 602 (Del. Ch. 1940); Donald J. Wolfe & Michael A. Pittenger, *Corp. & Commercial Practice in DE Court of Chancery* § 8.11[b]. Section 278 of the D.G.C.L. provides that once a corporation is dissolved, it has a three-year "wind-up" period during which it can wind up its affairs, bring suit, and be sued. 8 *Del. C.* § 278. Thus, corporate liability for new lawsuits effectively ends at the end of the three-year "wind-up" period.

But while Fannie Mae may be subject to general personal jurisdiction in the District, it is not incorporated there or anywhere else. Indeed, Fannie Mae has not been incorporated in any state at any point during its nearly 80-year existence. Rather, Fannie Mae is a uniquely federal enterprise empowered by Congress to "conduct its business without regard to any qualification or similar statute in any State of the United States." 12 U.S.C. § 1723a(a). In 1938, Congress first authorized the Reconstruction Finance Corporation, a New Deal-era federal corporation, to establish Fannie Mae. *See* National Housing Act of 1934, Pub. L. No. 73-479, 48 Stat. 1246, as amended by the National Housing Act Amendments of 1938, Pub. L. No. 75-424, § 4, 52 Stat. 8, 23. In 1948, Congress went further and expressly established Fannie Mae as a subsidiary of the Reconstruction Finance Corporation. Act of July 1, 1948, Pub. L. No. 80-864, 62 Stat. 1206.

Congress re-chartered and reorganized Fannie Mae in 1954. Housing Act of 1954 ("1954 Act"), Pub. L. No. 83-560, 68 Stat. 590. Pursuant to the 1954 Act, Fannie Mae became a "constituent agency of the Housing and Home Finance Agency"—later, the Department of Housing and Urban Development.

In 1968, Congress passed legislation re-chartering Fannie Mae as a privately owned, government sponsored corporation. Housing and Urban Development Act of 1968 ("1968 Act"), Pub. L. No. 90-448, Title VII, 82 Stat.

476, 536-46. Despite this change, Fannie Mae retained its uniquely federal character. It continued to be known as the "Federal" National Mortgage Association, and Congress took no action to alter its fundamentally public purposes. Under the 1968 Act, Fannie Mae received an exemption from State taxes, *id.* § 802(aa)(4), 82 Stat. 540, and from registration under the Securities Act of 1933 and Securities Exchange Act of 1934, *see id.* § 802(ff), 82 Stat. 542.[10]

Fannie Mae's lengthy history establishes that it is federally-chartered and a long-time citizen of the District of Columbia. It is not incorporated in any state, including Delaware.

### C. Fannie Mae's Election To Follow Delaware Corporate Governance Practices Does Not Confer Jurisdiction.

Fannie Mae has chosen to follow Delaware's corporate governance *practices* pursuant to a federal regulation, 12 C.F.R. § 1239.3, which provides that, to the extent "not inconsistent" with its federal charter statute and "other Federal law, rules, and regulations," Fannie Mae must "elect to follow" one of three sets of corporate governance and indemnification practices: (1) the law of the jurisdiction in which its principal office is located (i.e., the District of Columbia); (2) Delaware General Corporation Law; or (3) The Revised Model Business Corporation Act. 12 C.F.R. § 1239.3(a)-(b). When Fannie Mae chose Delaware for this purpose, it

[10] Notwithstanding this exemption, Fannie Mae has voluntarily registered under the 1934 Act in furtherance of its goals of increased transparency and public mission. *See* Fannie Mae 2002 10-K at 4.

chose only to follow [Delaware's] "corporate governance and indemnification *practices*," *id.* § 1239.3(b) (emphasis added), not to subject itself wholly to Delaware's extensive body of corporate law, nor to subject itself to general jurisdiction in Delaware.

Section 1239.3(d) itself makes clear that Fannie Mae's compliance with the governance selection provision "shall [not] cause or be deemed to cause [Fannie Mae] to become subject to the jurisdiction of any state court with respect to the [its] corporate governance." 12 C.F.R. § 1239.3(d). And as the regulation's history plainly establishes, this language was drafted to address concerns that "by choosing a particular body of state law to follow [Fannie Mae and Freddie Mac] could subject themselves to the jurisdiction of those states' courts." 80 Fed. Reg. 72,327, 72,329 (Nov. 19, 2015).

Tellingly, the agency specified that § 1239.3(d) was intended to conclusively rebut any argument that Fannie Mae's shareholders were authorized to bring suit to enforce the panoply of stockholder rights available under the chosen state's laws. Specifically, FHFA addressed concerns "that by choosing a particular body of state law to follow they could subject themselves to the jurisdiction of those states' courts *and would allow their members to assert all of the rights available to stockholders of corporations organized under those state laws*." *Id.* (emphasis added). They specified that while the agency did "not

believe that its regulations would cause either of those possibilities to occur," § 1239.3(d) should be added "for the sake of clarity." *Id.*

### D. Fannie Mae is Not "At Home" in Delaware and Therefore Is Not Subject to Personal Jurisdiction in this Court

Because Fannie Mae is not a Delaware corporation, this Court's jurisdiction is only proper if it would be consistent with the Delaware long-arm statute, which allows the Court to exercise jurisdiction only over cases bearing a specific relationship to the state and over defendants that are essentially at home here. *See* 10 *Del. C.* § 3104. Fannie Mae is not at home in Delaware. The Company's Congressional charter expressly provides that Fannie Mae "shall maintain its principal office in the District of Columbia." 12 U.S.C. § 1717(a)(2)(B); *see also* Ex. 1, Fannie Mae Bylaws, § 1.02.

Pursuant to the Delaware Supreme Court's decision in *Genuine Parts Co. v. Cepec*, 137 A.3d 123 (Del. 2016), which relied on the United States Supreme Court's decision in *Daimler AG v. Bauman*, 134 S. Ct. 746, a corporation is subject to general personal jurisdiction in Delaware only if its contacts with the state are so continuous and extensive as to render it "essentially at home" in the state. *Cepec*, 137 A.3d at 127 & n.9.

The Delaware Supreme Court ruled that it would be "inconsistent with principles of due process for a corporation to be subject to general jurisdiction in every place it does business" on the sole basis of minimal business contacts. *Id.* at

137. Importantly, the Delaware Supreme Court expressly held that a company is not subject to general personal jurisdiction simply because it has qualified to do business in the state and appointed a registered agent therein for service of process. *Id.* at 133. Similarly, the fact that a corporation has employees and offices in the state is insufficient to confer general personal jurisdiction. *See id.* at 128 (noting that defendant had employees and stores in Delaware).

Indeed, under the principles set out in *Daimler*, an exercise of general personal jurisdiction is appropriate only under very narrow circumstances, such as when a corporation establishes its principal place of business in a forum state for a period of time, *Daimler*, 134 S. Ct. at 756, or its subsidiary acts on its behalf and is at home in the forum state, *id.* at 759. As the Delaware Supreme Court similarly made clear, in nearly every situation where a "corporation does not have its principal place of business in Delaware, that will mean that Delaware cannot exercise general jurisdiction." *Cepec*, 137 A.3d at 127.

Pagliara cannot and has not alleged that Fannie Mae has ever been at home in Delaware. Fannie Mae is headquartered in the District of Columbia and has maintained its principal place of business there by Congressional mandate for decades. Fannie Mae conducts only ordinary business activities in the state of Delaware, and its contacts with the state are indistinguishable from those found insufficient to establish general jurisdiction in *Cepec*. Pagliara cannot allege that

Fannie Mae is required to qualify to do business in Delaware (or any other state), or that Fannie Mae maintains a registered agent in Delaware (it does not). *See* 12 U.S.C. § 1723a(a); *Cepec*, 137 A.3d at 133. Nor has Pagliara alleged that Fannie Mae has any offices or employees in Delaware. *Cepec*, 137 A.3d at 128. Therefore, the Court lacks jurisdiction to order the requested relief. *See id.* at 125.

Even if this Court had personal jurisdiction over Fannie Mae—and as explained above it does not—Pagliara's inspection demand would still fail because Section 220 by its terms only applies only to Delaware corporations. *See, e.g.*, *Norfolk Cty. Ret. Sys. v. Jos. A. Bank Clothiers, Inc.*, 2009 WL 353746, at *5 (Del. Ch. Feb. 12, 2009) ("A stockholder *of a Delaware corporation* has a statutory right to inspect the books and records of the corporation under [§ 220]." (emphasis added)). As explained in the preceding section, Fannie Mae is not, nor has it ever been, a Delaware corporation.

## II. THE COURT SHOULD DISMISS THE COMPLAINT ON THE BASIS OF ISSUE PRECLUSION.

Even if this Court were to conclude it has personal jurisdiction over Fannie Mae, the Court should still dismiss Pagliara's suit, without any need for reaching the merits, on the basis of issue preclusion.

Pagliara has already litigated and lost the precise issue presented here: whether, during conservatorship, HERA has transferred exclusively to FHFA the stockholder right to demand an inspection of Enterprise records. Specifically, the

U.S. District Court for the Eastern District of Virginia ("EDVA") dismissed Pagliara's materially identical complaint to inspect the books and records of Freddie Mac on the ground, *inter alia*, that HERA transferred Pagliara's inspection rights to FHFA during the conservatorship. *See Pagliara I*, 203 F. Supp. 3d 678. Accordingly, Pagliara's complaint should be dismissed under the doctrine of issue preclusion.

Issue preclusion, or collateral estoppel, bars "successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment." *Taylor v.* Sturgell, 553 U.S. 880, 892 (2008) (quoting *New Hampshire v. Maine*, 532 U.S. 742, 748-49 (2001)). In so doing, issue preclusion protects "against the expense and vexation attending multiple lawsuits, conserving judicial resources, and fostering reliance on judicial action by minimizing the possibility of inconsistent verdicts." *B&B Hardware, Inc. v. Hargis Ind., Inc.*, 135 S. Ct. 1293, 1302-03 (2015) (internal quotation marks and citations omitted) (alteration adopted); *see also Peloro v. United States*, 488 F.3d 163, 176 (3d Cir. 2007) (observing that litigants are "not entitled to another bite of the apple" on issues resolved against them). Issue preclusion applies if "(1) the issue sought to be precluded [is] the same as that involved in the prior action; (2) that issue [was] actually litigated; (3) it [was] determined by a final and valid judgment; and (4) the determination [was] essential to the prior judgment." *Id.* at

174-75 (internal citation omitted); *see also Jean Alexander Cosmetics, Inc. v. L'Oreal USA, Inc.*, 458 F.3d 244, 249 (3d Cir. 2006) (same).[11]

All of the requirements for issue preclusion are satisfied here. In August, 2016, after full briefing, the EDVA resolved the precise legal issues presented here, those issues were essential to the judgment, and Pagliara participated fully in the litigation. That court held that HERA bars Pagliara from pursuing a stockholder inspection suit during the conservatorship of Freddie Mac. As the court explained:

> The Court concludes that the statutory transfer of power to the conservator destroyed the stockholder's right to inspect corporate records . . . . HERA's plain language evidences Congress's intent to transfer as much power as possible to the FHFA when acting as Freddie Mac's conservator. Within that context, the Court may only reasonably read the transfer of "all rights, titles, powers and privileges" of "any stockholder . . ." to include a stockholder's right to inspect Freddie Mac's corporate records. Accordingly, the Court must dismiss this case because Pagliara does not possess the right he seeks to enforce.

*Pagliara I*, 203 F. Supp. 3d at 689.

The EDVA further held that it could not order Freddie Mac to produce corporate records to Pagliara because 12 U.S.C. § 4617(f) prohibits the court from

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[11] The "preclusive effect of a foreign judgment is measured by standards of the rendering forum." *Acierno v. New Castle Cty.*, 679 A.2d 455, 459 (Del. 1966); *see also Yucaipa Am. Alliance Fund I v. SBDRE LLC*, 2014 WL 5509797, at *11 (Del. Ch. Oct. 31, 2014) (same). Since *Pagliara I* was issued by a federal district court, federal law governs the extent to which Pagliara is bound by that decision in this Court.

"tak[ing] any action to restrain or affect the exercise of powers or functions of [FHFA] as conservator or receiver." 203 F. Supp. 3d at 691.

Pagliara's EDVA case resolved *exactly* the same issues that are presented here, with the court's holding that Pagliara's inspection demand was barred by HERA, 12 U.S.C. §§ 4617(f) and 4617(b)(2)(A)(i). These issues were actually litigated and decided by a final and valid judgment, and Pagliara voluntarily dismissed his appeal from that judgment. Moreover, because they formed the basis for the Court's dismissal of Pagliara's inspection case, those issues were essential to the EDVA judgment.[12] *See TR Inv'rs, LLC v. Genger*, 2013 WL 603164, at *13-14 (Del. Ch. Jan. 3, 2013). Accordingly, Pagliara is bound in this Court by the EDVA's ruling that only FHFA can pursue stockholder inspection demands during the conservatorship.

## III. THE COURT SHOULD DISMISS THE COMPLAINT OR SUBSTITUTE FHFA AS PLAINTIFF BECAUSE ONLY FHFA HAS THE RIGHT TO INSPECT FANNIE MAE'S BOOKS AND RECORDS.

Even putting aside the preclusive effect of the EDVA judgment, the ruling that HERA has transferred all inspection rights to the Conservator is correct,

[12] Pagliara might argue that the impact of 12 U.S.C. §§ 4617(f) and 4617(b)(2)(A)(i) were not "essential" to the decision in the EDVA because the court there held alternatively that Pagliara had failed to identify a proper purpose for his inspection requests. But it is black-letter law that "independently sufficient alternative findings should be given preclusive effect." *Jean Alexander Cosmetics*, 458 F.3d at 255.

and the Court should follow it here. Plaintiff seeks to exercise the right of a stockholder to inspect books and records, but under HERA, if that right ever existed, it has transferred to FHFA.

HERA's succession provision is far-reaching and clear: during conservatorship, the Conservator "succeed[s] to . . . *all* rights, titles, powers, and privileges . . . of any stockholder [of Fannie Mae] with respect to [Fannie Mae] and the assets of [Fannie Mae]." 12 U.S.C. § 4617(b)(2)(A) (emphasis added). By this provision, "Congress . . . transferred everything it could to the conservator." *Kellmer v. Raines*, 674 F.3d 848, 851 (D.C. Cir. 2012) (alteration omitted) (quoting *Pareto v. FDIC*, 139 F.3d 696, 700 (9th Cir. 1998)). "[T]he plain meaning of the statute is that *all* rights previously held by [Fannie Mae's] stockholders . . . now belong exclusively to the FHFA." *In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 795 (E.D. Va. 2009), *aff'd sub nom La. Mun. Police Emps. Ret. Sys. v. FHFA*, 434 F. App'x 188 (4th Cir. 2011) (emphasis in original).

HERA's succession provision serves to "assure the expeditious and orderly protection of all who are interested in [Fannie Mae] by placing the pursuit of its rights, protection of its assets, and payment of its liabilities firmly in the hands of a single, congressionally designated agency." *Pareto*, 139 F.3d at 700 (interpreting a materially identical provision in the Financial Institutions Reform,

Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183).[13]

In light of HERA's succession provision, courts have routinely permitted FHFA as Conservator to substitute itself in place of plaintiffs purporting to assert claims based on their status as stockholders of Fannie Mae and Freddie Mac. *See Kellmer*, 674 F.3d at 850-51 (affirming FHFA's substitution in place of Fannie Mae stockholder purporting to assert claims against former officers and directors and various third parties for, *inter alia*, aiding and abetting breach of fiduciary duty and negligence); *La. Mun. Police Emps. Ret. Sys.*, 434 F. App'x at 190-91 (affirming FHFA's substitution in place of Freddie Mac shareholders asserting claims against former officers and directors for breach of fiduciary duties, waste, and mismanagement).[14]

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[13] FIRREA provides that the Federal Deposit Insurance Corporation ("FDIC") "shall, as conservator or receiver, and by operation of law, succeed to . . . all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution." 12 U.S.C. § 1821(d)(2)(A)(i). "While case law adjudicating HERA-related disputes is generally sparse," courts interpreting it have sometimes relied on decisions addressing "nearly identical" provisions of FIRREA applicable to FDIC conservatorships. *Perry Capital*, 70 F. Supp. 3d at 220 (quoting *Nat'l Res. Def. Council, Inc. v. FHFA*, 815 F. Supp. 2d 630, 641 (S.D.N.Y. 2011)).

[14] *See also Gail C. Sweeney Estate Marital Tr. v. U.S. Treasury Dep't*, 68 F. Supp. 3d 116, 117 (D.D.C. 2014) (granting FHFA motion to substitute in place of a Fannie Mae stockholder asserting claims for breach of fiduciary duty, abuse of control, waste, and mismanagement); *Esther Sadowsky Testamentary Tr. v. Syron*,

The result here should be no different. Indeed, Plaintiff's sole claim in this case seeks to enforce a purported *stockholder* right to inspect Fannie Mae's books and records, allegedly pursuant to Section 220,[15] for the purpose of investigating some kind of potential claim against the Conservator's appointed board of directors, FHFA or Treasury. *See* Compl. ¶¶ 207-12 & Ex. A. To the extent it applies here (and Fannie Mae does not concede that it does), Section 220 codifies "a *shareholder's* common law right to inspect" a corporation's records, *Compaq Comput. Corp. v. Horton*, 631 A.2d 1, 3 (Del. 1993) (emphasis added), and under Section 220, "only 'stockholders' of a corporation have a right, provided they satisfy the requirements of that statute, to inspect the books and records." *Pan Ocean Navigation, Inc. v. Rainbow Navigation, Inc.*, 1987 WL 7533, at *2 (Del. Ch. Feb. 18, 1987); *see also Cent. Laborers Pension Fund v. News Corp.*, 45 A.3d

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Footnote continued from previous page
639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009) (same, for Freddie Mac shareholder asserting similar claims). In the same manner, courts have also dismissed shareholder claims for lack of standing in light of HERA's succession provision. *See Perry Capital*, 70 F. Supp. 3d at 229 (dismissing shareholder claims for lack of standing in light of HERA's succession provision); *In re Cmty. Bank of N. Va.*, 418 F.3d 277, 293 n.6 (3d Cir. 2005) (granting motion to substitute where FDIC as receiver, pursuant to FIRREA, was "the true party in interest" after it had "succeeded to all 'rights, titles, powers, and privileges of . . . the insured depository institution'").

[15] To be clear, for the reasons stated above Fannie Mae is not a Delaware corporation; rather, it is a government sponsored enterprise that operates pursuant to Congressional charter. *See* 12 U.S.C. 1716 *et seq.*; *see also* Section I *supra*. Nothing in that charter renders Fannie Mae subject to the statutory provisions of 8 *Del. C.* § 220.

139, 143 (Del. 2012) (Section 220 codifies a "[s]tockholder['s] . . . qualified right to inspect the corporation's books and records" that "originated at common law").

The application of HERA's succession provision could not be more straightforward: Pagliara seeks to enforce a purported stockholder "right," but HERA transferred "all rights" of Fannie Mae's stockholders to FHFA during conservatorship.

Pagliara cannot escape HERA's transfer of stockholder rights to FHFA during conservatorship by claiming that he is asserting a "direct" rather than a "derivative" claim. As the EDVA explained, the "derivative-versus-direct distinction discussed in the cases Pagliara cites. . . has little bearing on the issues in this case." *Pagliara I*, 203 F. Supp. 3d at 686-87.

> In the derivative-versus-direct cases:
>
> > The courts were discussing a stockholder's right to bring a derivative suit as compared to a stockholder's standing to bring a lawsuit to remedy his own direct injuries. In that context, the derivative-versus-direct distinction is informative, because standing to bring a lawsuit to remedy a personal injury is not easily categorized as a right with respect to the corporation. The present case, however, questions whether a stockholder possesses the underlying right that he seeks to enforce through a direct lawsuit. In other words, the issue here is not whether Pagliara may pursue his right through a direct lawsuit, but whether he possesses the right he believes was infringed.
>
> *Id.*

The bottom line is that during the conservatorship HERA transfers to FHFA alone the stockholders' pre-conservatorship right to demand a books and records inspection:

> HERA's plain language evidences Congress' intent to transfer as much power as possible to the FHFA when acting as [the Enterprises'] conservator. Within that context, the Court may only reasonably read the transfer of "all rights, titles, powers and privileges" of "any stockholder . . . with respect to the regulated entity and the assets of the regulated entity" to include a stockholder's right to inspect Freddie Mac's corporate records. Accordingly, the Court must dismiss this case because Pagliara does not possess the right he seeks to enforce.

*Id.* at 689. Accordingly, the Court should dismiss this suit, or substitute the Conservator in place of Plaintiff Pagliara.

## IV. HERA'S JURISDICTION WITHDRAWAL PROVISION ALSO BARS PAGLIARA FROM PURSUING THIS SUIT.

Pagliara's request for injunctive relief in aid of his books and records demand is barred by HERA's jurisdiction withdrawal provision, 12 U.S.C. § 4617(f), which prohibits all courts from "tak[ing] any action to restrain or affect the exercise of powers or functions of the [FHFA] as a conservator." *Id.* Section 4617 bars all forms of "litigative interference—through judicial injunctions, declaratory judgments, or other equitable relief—with FHFA's statutorily permitted actions as conservator or receiver." *Perry Capital*, 848 F.3d at 1087. Conduct shielded from injunctive interference includes FHFA's efforts as Conservator "to '[o]perate [Fannie Mae and Freddie Mac],' 12 U.S.C.

§ 4617(b)(2)(B); to 'reorganiz[e]' their affairs, *id.* § 4617(a)(2); and to 'take such action as may be . . . appropriate to carry on the[ir] business,' *id.* § 4617(b)(2)(D)(ii)." *Perry Capital*, 848 F.3d at 1087.

Indeed, in multiple decisions granting FHFA's motions to substitute the Conservator for Fannie Mae or Freddie Mac stockholders, courts have held that Section 4617(f) reserves the prosecution of this sort of action exclusively to FHFA. *See, e.g.*, *Gail C. Sweeney Estate Marital Tr.*, 68 F. Supp. 3d at 119 (granting substitution in part because Section 4617(f) "suggests that the Court may not be empowered to authorize plaintiff to pursue litigation that the Conservator has declined to pursue"); *Sadowsky*, 639 F. Supp. 2d at 350 (without substitution, suit would violate Section 4617(f) "since maintenance of this suit with the shareholders acting as Plaintiffs would be inconsistent with the Conservator's exercise of its statutory purposes"); *In re Fed. Nat'l Mortg. Ass'n Sec., Derivative & "ERISA" Litig.*, 629 F. Supp. 2d 1, 4 n.4 (D.D.C. 2009) ("[A]llowing plaintiffs to continue to pursue derivative claims independent of FHFA would require this Court to take action that would 'restrain or affect' FHFA's discretion" in violation of § 4617(f)); *In re Fed. Home Loan Mortg. Corp.*, 643 F. Supp. 2d at 797 (Section 4617(f) "clearly demonstrates Congressional intent to transfer as much control of Freddie Mac as possible to the FHFA, including any right to sue on behalf of the corporation").

The same is true here: allowing Plaintiff to pursue his investigation would "be inconsistent with the Conservator's exercise of its statutory power" and, therefore, permitting Plaintiff to proceed with this suit would violate Section 4617(f). *Sadowsky*, 639 F. Supp. 2d at 350. As the EDVA found in *Pagliara I*, such demands are improper "[g]iven HERA's extraordinarily broad grant of operational discretion to FHFA and the bar on courts taking 'any action to restrain or affect the exercise of powers or functions of the Agency as conservator.'" *Pagliara I*, 203 F. Supp. 3d at 691.

Consequently, if there is to be any inspection of the Company's books and records, the authority and power to conduct that investigation falls within the Conservator's exclusive authority and powers to "operate [Fannie Mae] with all the powers of the shareholders, the directors, and the officers," to "conduct all business of [Fannie Mae]," and to "perform all functions of [Fannie Mae] consistent with the appointment as conservator." 12 U.S.C. § 4617(b)(2)(B)(i),(iii). Additionally, HERA provides that only the Conservator can "determine[] [what] is in the best interests" of the Enterprises. *Id.* § 4617(b)(2)(J)(ii).

## V. THE COURT SHOULD DISMISS THE COMPLAINT BECAUSE PAGLIARA HAS FAILED TO IDENTIFY A PROPER PURPOSE FOR THE INSPECTION HE DEMANDS.

Even if Pagliara had the right, which he does not, to inspect Fannie Mae's books and records, his suit would have to be dismissed. Pagliara still bears

the burden of demonstrating "a proper purpose entitling [him] to an inspection of every item sought." *Thomas & Betts Corp. v. Leviden Mfg. Co.*, 681 A.2d 1026, 1028 (Del. 1988). This burden "is not insubstantial." *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 123 (Del. 2006).

In making this showing, Pagliara must "do more than state, in a conclusory manner, a generally accepted purpose" such as "investigating wrongdoing." *West Coast Mgmt. & Capital, LLC v. Carrier* Access *Corp.*, 914 A.2d 636, 646 (Del. Ch. 2006). He must allege "a reason for the purpose, *i.e.*, what he will do with the information, or an end to which that investigation may lead." *Id.* If the alleged proper purpose is the investigation of a new lawsuit, Pagliara must show that any such suit would not be time-barred. *Graulich v. Dell Inc.*, 2011 WL 1843813, at *6 (Del. Ch. May 16, 2011) ("a time bar defense or a claim or issue preclusion defense would eviscerate any showing that might otherwise be made in an effort to establish a proper shareholder purpose" (quoting *Amalgamated Bank v. UICI*, 2005 WL 1377432, at *2 n.14 (Del. Ch. Feb. 12, 2009)); *Beatrice Corbin Living Irrevocable Tr. v. Pfizer, Inc.*, 2016 WL 4548101, at *6 (Del. Ch. Aug. 31, 2016) ("stockholder does not have a credible basis to investigate . . . if the litigation the stockholder is investigating would be barred by issue preclusion, lack of standing, or the statute of limitations"); *Se. Penn. Transp.*

*Auth. v. Abbvie, Inc.*, 2015 WL 1753033, at *13 n.106 (Del. Ch. Apr. 15, 2015) (same).

Here, Pagliara claims his purpose is to investigate "apparent[] misconduct by the Board, FHFA and Treasury" in connection with the Third Amendment and its Net Worth Sweep, purportedly in order to "evaluate legal claims" against those entities. *See* Compl. ¶ 164. But FHFA and Treasury executed the Third Amendment in *August 2012*, almost five years ago. The statute of limitations for breach of fiduciary duty claims is three years. *See Stevanov v. O'Connor*, 2009 WL 1059640, at *9 (Del. Ch. Apr. 21, 2009) (three-year limitations period for claims based on breach of fiduciary duty, citing 10 *Del. C.* § 8106); *Levey v. Brownstone Asset Mgt., L.P.*, 76 A.3d 764, 768 (Del. 2012) (three-year limitations period for claims based on contract, also citing § 8106).[16] Accordingly, any claim that Pagliara might "evaluate" through an examination of

[16] Because Fannie Mae is not subject to personal jurisdiction in Delaware and because Pagliara is not a citizen of the state, any lawsuit alleging breach of contract or breach of fiduciary duty would likely be filed in the District of Columbia, where Fannie Mae has its principal place of business, or in Pagliara's home state of Tennessee. The result would be the same. Both jurisdictions have three year statutes of limitations for breach of fiduciary duty claims. *See* D.C. Code § 12-301(8); Tenn. Code § 48-18-601 (2015). The District of Columbia has a three year limitations period for breach of contract claims. *See* D.C. Code § 12-301(7). And Tennessee has a four year limitations period for breach of contract claims. Tenn. Code § 47-2-725(1) (2015).

Fannie Mae's books and records would be time-barred. *Graulich*, 2011 WL 1843813, at *6.

Pagliara cannot avoid the effect of the statute of limitations by arguing that a new breach of fiduciary duty arises each time Fannie Mae makes a dividend payment to Treasury pursuant to the Third Amendment. *See, e.g.*, Compl. ¶ 11. The law is clear that for claims for breach of duty based on entering an unfair contract, the claim accrues at contract formation, not with every payment made pursuant to the contract. *See, e.g.*, *In re Sirius XM S'holder Litig.*, 2013 WL 5411268, at *4-6 (Del. Ch. Sept. 13, 2013) (Strine, C.) ("[u]nder Delaware law, a plaintiff's cause of action accrues at the moment of the wrongful act—not when the harmful effects of the act are felt") (internal quotes and citation omitted); *Kahn v. Seaboard Corp.*, 625 A.2d 269, 271 (Del. Ch. 1993); *see also Teachers' Ret. Sys. of La. v. Aidinoff*, 900 A.2d 654, 666 & n.11 (Del. Ch. 2006) (Strine, V.C.) (stating that "when a contract is contended to have resulted from fiduciary misconduct, the statute of limitations begins running at the time of the decision to contract"); *In re Marvel Entm't Grp., Inc.*, 273 B.R. 58, 73 (Bankr. D. Del. 2002) ("Delaware law supports finding that where the claimed breach of fiduciary duty is an allegedly unfair contract, the limitations period begins to run when the contract is formed").

Because any lawsuit Pagliara might file as a result of his proposed books-and-records inspection would be time-barred at this late date, even if Pagliara had the right to inspect Fannie Mae's books and records, which he does not, his suit would have to be dismissed. Pagliara has not shown a proper purpose for the proposed inspection. *See Graulich*, 2011 WL 1843813, at *6 ("a time bar defense or a claim or issue preclusion defense would eviscerate any showing that might otherwise be made in an effort to establish a proper shareholder purpose" (quoting *Amalgamated Bank v. UICI*, 2005 WL 1377432, at *2 n.14 (Del. Ch. Feb. 12, 2009)).

## CONCLUSION

For the reasons stated above, the Court should dismiss Pagliara's books and records inspection demand or, in the alternative, substitute FHFA as the only proper plaintiff for this suit.

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