



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

TIMOTHY PAGLIARA, :

Plaintiff, :

v : C.A. No.

FEDERAL NATIONAL MORTGAGE ASSOCIATION, : 12105-VCMR

Defendant. :

- - -

Chancery Courtroom No. 12C
New Castle County Courthouse
500 North King Street
Wilmington, Delaware
Tuesday, May 2, 2017
10:01 a.m.

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BEFORE: HON. TAMIKA MONTGOMERY-REEVES, Vice Chancellor

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ORAL ARGUMENT ON FANNIE MAE AND FHFA'S MOTION TO
DISMISS OR, IN THE ALTERNATIVE, TO SUBSTITUTE FHFA AS
THE PROPER PLAINTIFF

CHANCERY COURT REPORTERS
New Castle County Courthouse
500 North King Street - Suite 11400
Wilmington, Delaware 19801
(302) 255-0522

1 APPEARANCES:

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4 GREGORY J. BRODZIK, ESQ.
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for Plaintiff

5 S. MARK HURD, ESQ.
6 ZI-XIANG SHEN, ESQ.
Morris, Nichols, Arsht & Tunnell LLP
-and-

7 MICHAEL J. WALSH, JR., ESQ.
8 of the District of Columbia Bar
O'Melveny & Myers LLP
9 for Defendant Federal National Mortgage
Association

10 BLAKE ROHRBACHER, ESQ.
11 Richards, Layton & Finger, P.A.
-and-

12 HOWARD N. CAYNE, ESQ.
13 ASIM VARMA, ESQ.
of the District of Columbia Bar
14 Arnold & Porter Kaye Scholer LLP
for Federal Housing Finance Agency

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1 MR. FLINN: Good morning, Your Honor.

2 THE COURT: Good morning.

3 MR. FLINN: Barr Flinn from Young
4 Conaway for the plaintiff, Mr. Pagliara. If I may
5 make an introduction or two before Mr. Walsh starts.

6 THE COURT: Yes.

7 MR. FLINN: My colleague, Greg Brodzik
8 from Young Conaway. I think you already know
9 Ms. Muthu from my firm.

10 THE COURT: I do.

11 MR. FLINN: In the back of the
12 courtroom we have our client, Mr. Pagliara, the
13 plaintiff on this books and records action.

14 THE COURT: Welcome, Mr. Pagliara.

15 MR. ROHRBACHER: Good morning, Your
16 Honor.

17 THE COURT: Good morning.

18 MR. ROHRBACHER: Blake Rohrbacher of
19 Richards, Layton & Finger for the Federal Housing
20 Finance Agency.

21 With me, Your Honor, Howard Cayne and
22 Asim Varma from Arnold & Porter Kaye Scholer. With
23 Your Honor's permission, Mr. Cayne will be making the
24 presentation.

1 THE COURT: Thank you.

2 MR. HURD: Rounding out the table,
3 Your Honor, Mark Hurd of Morris, Nichols, Arsht &
4 Tunnell, on behalf of defendant, Fannie Mae; my
5 colleague, Zi-Xiang Shen from Morris Nichols. And
6 also seated at counsel table, Mike Walsh of
7 O'Melveny & Myers, and he will present argument on
8 behalf of Fannie Mae.

9 THE COURT: Thank you.

10 Who wants to start? Mr. Walsh?

11 MR. WALSH: I will, Your Honor. I'm
12 Michael Walsh. I am arguing the personal jurisdiction
13 piece on behalf of Fannie Mae, a federally chartered
14 corporation deemed by federal law to be a D.C.
15 corporation for purposes of jurisdiction and venue.
16 For that reason, the Delaware Chancery Court lacks
17 general personal jurisdiction over Fannie Mae.

18 I will start with the charter, Fannie
19 Mae's federal charter, which reads that Fannie Mae
20 "... shall maintain its principal office in the
21 District of Columbia or the metropolitan area thereof
22 and shall be deemed, for purposes of jurisdiction and
23 venue in civil actions, to be a District of Columbia
24 corporation." And that charter is at 12 USC Section

1 717(a)(2)(B) (sic).

2 Because of that charter, Fannie Mae is
3 at home in the District of Columbia for purposes of
4 general personal jurisdiction. And that's under the
5 Daimler case from the Supreme Court and also the
6 Genuine Auto Parts v. Cepec case by the Delaware
7 Supreme Court.

8 Fannie Mae is not incorporated in the
9 District of Columbia or anywhere. Fannie Mae is a
10 uniquely federal enterprise empowered by Congress to
11 "... conduct its business without regard to any
12 qualification or similar statute in any State of the
13 United States" And that's at 12 USC Section
14 1723a(a).

15 So that's Fannie Mae's charter, a D.C.
16 corporation for purposes of jurisdiction and venue,
17 but it is federally chartered and not incorporated
18 anywhere.

19 Fannie Mae's bylaws reflect the nature
20 of Fannie Mae as well. They follow its federal
21 charter. The bylaws say that the principal office of
22 Fannie Mae shall be in the District of Columbia.

23 As best we can tell, other than the
24 certificate of incorporation which was attached to the

1 complaint, which I will get to, there are no public
2 statements or any record of Fannie Mae holding itself
3 out as a Delaware corporation. Fannie Mae files 10-Ks
4 with the SEC, and started doing that in 2003 for
5 year-end 2002. The cover page of that SEC filing,
6 where it says state of incorporation -- state or other
7 jurisdiction of incorporation, says "federally
8 chartered corporation." It does not hold itself out
9 to be a Delaware corporation, and it has not in its
10 SEC filings since that time.

11 Fannie Mae files annual reports with
12 investors. We have found no record of Fannie Mae
13 holding itself out as a Delaware corporation in any of
14 those filings.

15 FHFA, the Federal Housing Finance
16 Agency, reports to Congress every year on the state of
17 Fannie Mae and Freddie Mac. We were unable to locate
18 any reference to Fannie Mae being a Delaware
19 corporation in those filings.

20 When Fannie Mae was placed into
21 conservatorship in 2008 as part of the financial
22 crisis, we did not find any record of any mention of
23 Fannie Mae being a Delaware corporation at that time.
24 And during the financial crisis, there were other

1 entities that did shuffle their incorporation for
2 purposes of -- in order to make it through the crisis.
3 For example, Goldman Sachs, I believe, became a bank
4 holding company under New York law. So regulators
5 were thinking about federal versus state law and the
6 most advantageous way to move forward. No reference
7 to Fannie Mae being a Delaware corporation there.

8 Fannie Mae makes various reports to
9 Housing and Urban Development, HUD. No reference to
10 Fannie Mae being a Delaware corporation there.

11 So between the charter, the bylaws,
12 and Fannie Mae's public statements, all of which make
13 clear that Fannie Mae is at home in the District of
14 Columbia and to be treated as a citizen of the
15 District of Columbia for purposes of jurisdiction and
16 venue, there's no question that Fannie Mae is not a
17 Delaware corporation, nor is it at home in Delaware.

18 One other point on that. In 2004,
19 Fannie Mae had to restate some of its accounting. And
20 there were dozens of federal shareholder class actions
21 under the securities laws, dozens of -- I guess one
22 dozen shareholder derivative actions. Not one was
23 filed in Delaware Chancery Court, which I find would
24 be odd if Fannie Mae were, in fact, a Delaware

1 corporation. These were filed in late 2004, early
2 2005, ultimately consolidated and proceeded in the
3 District of Columbia federal court before Judge Leon.

4 So that leaves us with this 2002
5 certificate of incorporation for Federal National
6 Mortgage Association, Inc.

7 First of all, that's not Fannie Mae.
8 Fannie Mae is either the Federal National Mortgage
9 Association or Fannie Mae. The charter and the bylaws
10 state that Fannie Mae is authorized to do business as
11 the Federal National Mortgage Association or Fannie
12 Mae; not Federal National Mortgage Association, Inc.,
13 not Fannie Mae, Inc. So that's there.

14 Mr. Pagliara didn't sue the Federal
15 National Mortgage Association, Inc., he sued the
16 Federal National Mortgage Association. His proof that
17 he had stock in Fannie Mae, it was proof that he had
18 stock in the Federal National Mortgage Association.
19 And that certificate from 2002 was voided in 2004 for
20 nonpayment of franchise taxes. That was 13 years ago
21 that it was voided.

22 THE COURT: So your position with
23 respect to that certificate, then, is given that the
24 name is different, there's nothing to suggest that

1 Fannie Mae has ever operated with the "Inc." on the
2 end of the name, that that certificate of
3 incorporation isn't enough to allow this to survive a
4 motion to dismiss on the basis of personal
5 jurisdiction?

6 MR. WALSH: I think that's exactly
7 right.

8 THE COURT: Would it be enough to
9 allow for jurisdictional discovery?

10 MR. WALSH: I don't think it is.

11 THE COURT: Why not?

12 MR. WALSH: I think given the
13 overwhelming lack of any other reference to Delaware,
14 and the fact that, I can tell you, Your Honor, based
15 on our own inquiries, that jurisdictional discovery
16 will not change the record before Your Honor. Fannie
17 Mae has no record of seeking to file in Delaware, as a
18 corporation in Delaware in 2002. I don't believe that
19 jurisdictional discovery will advance the ball.

20 There's two other things I will say on
21 jurisdictional discovery. One is that it is not
22 necessary because the certificate was voided in 2004
23 and the three-year period to sue a voided corporation
24 lapsed in 2007, nearly a decade before Mr. Pagliara

1 made his demand. So even if that was Fannie Mae in
2 2002 through March of 2004, it's not Fannie Mae now,
3 and the time to sue was a long time ago.

4 The second thing I will say about
5 jurisdictional discovery -- and I think -- I will let
6 Mr. Flinn speak for himself, but I think Mr. Pagliara
7 agreed in his brief that it's unlikely to -- that it
8 will cause delay. And I believe that's particularly
9 unnecessary here because, as Mr. Cayne will argue, the
10 right that Mr. Pagliara is seeking to enforce was
11 transferred by HERA, The Housing and Economic Recovery
12 Act, or H-E-R-A, to the Federal Housing Finance Agency
13 upon the placement of Fannie Mae into conservatorship.
14 So even if we do jurisdictional discovery, the record
15 doesn't change. We will get to that point anyway. So
16 that's why I don't think jurisdictional discovery will
17 help us here.

18 So in order for there to be
19 jurisdiction -- general personal jurisdiction in
20 Delaware over Fannie Mae, Fannie Mae has to be at
21 home, or essentially at home, in Delaware. Assuming
22 we all agree that it is not, in fact, a Delaware
23 corporation, for there to be general jurisdiction, it
24 has to be essentially at home in Delaware.

1 And for the reasons that Fannie Mae is
2 not a Delaware corporation, it is also not essentially
3 at home in Delaware. There is the charter that says
4 it shall maintain its principal place of business in
5 Washington, D.C., be a citizen of Washington, D.C. for
6 purposes of jurisdiction and venue. And the law under
7 the Genuine Auto Parts case is that a corporation is
8 subject to general personal jurisdiction in Delaware
9 only if its contacts with the state are so continuous
10 and extensive as to render it essentially at home.
11 Offices is not enough. A couple of employees is not
12 enough. Or even the fact that Fannie Mae does
13 business in Delaware, which it does, is not enough in
14 a case of general jurisdiction like this one.

15 The Delaware -- I'm sorry. The U.S.
16 Supreme Court said that general personal jurisdiction
17 is appropriate really under very narrow circumstances,
18 and we don't believe that Fannie Mae falls into any of
19 those narrow circumstances here.

20 And then, finally, I will just point
21 to the holding in the Genuine Auto Parts case that
22 said, in nearly every situation where a corporation
23 does not have its principal place of business in
24 Delaware, that will mean that Delaware cannot exercise

1 general jurisdiction.

2 The cases that Mr. Pagliara relies
3 upon are under the old Sternberg standard, which I
4 believe was overruled pretty clearly by the Genuine
5 Auto Parts case. And so the minimum business contacts
6 is just not the test anymore under new United States
7 Supreme Court jurisprudence and new jurisprudence
8 under the laws of Delaware.

9 And just to be clear, there's no
10 allegation of specific jurisdiction here.
11 Mr. Pagliara I believe is a citizen of Tennessee.
12 There is no conduct in Delaware that is being
13 challenged here. So not a Delaware corporation. Not
14 essentially at home in Delaware.

15 I will talk a little bit, Your Honor,
16 unless you have any questions about that portion of
17 the argument, I will talk a little bit about Fannie
18 Mae's election to follow Delaware corporate governance
19 practices.

20 Really, it's irrelevant to the issue
21 of personal jurisdiction that, in order to comply with
22 a federal regulation, Fannie Mae has chosen to follow
23 Delaware's corporate governance practices to the
24 extent those practices are not inconsistent with

1 federal law.

2 I would argue that Section 220 is
3 currently inconsistent with federal law on its face
4 because it provides shareholders a right that Fannie
5 Mae shareholders transferred to FHFA upon
6 conservatorship in 2008. But Mr. Cayne will expand
7 upon that.

8 But let me just talk a little bit
9 about the regulation itself. The regulation says
10 that, to the extent not inconsistent with federal law,
11 Fannie Mae could choose to follow the law -- the
12 corporate governance practices and procedures of the
13 jurisdiction in which its principal office is
14 located -- so that would be the District of
15 Columbia -- the Delaware General Corporation Law, or
16 the revised Model Business Corporation Act. And so
17 the election to follow one of these is an election to
18 follow the practices and procedures, not to subject
19 itself to any -- subject itself to a body of law or
20 subject itself to jurisdiction.

21 The fact that the District of Columbia
22 is one choice for jurisdiction means it's probably not
23 a jurisdiction-conferring statute because there's
24 already a charter that says that Fannie Mae is subject

1 to jurisdiction in D.C. The inclusion of the revised
2 Model Business Corporation code as a choice, that's
3 not jurisdiction confirming because there's no
4 jurisdiction of model. And it is -- you can't
5 incorporate in model. So it's not an incorporation
6 regulation, either. It's simply a mechanism through
7 which Fannie Mae can communicate to its investors how
8 it will be governed. That's not uncommon.

9 For example, privately listed
10 companies often agree to follow NASDAQ rules and
11 regulations, but they are not -- that doesn't mean
12 they are listed on NASDAQ. They are privately listed.

13 And what Fannie Mae did was to say to
14 its investors, "This is how we're going to govern
15 ourselves. We're going to follow Delaware." And I
16 would say that imitation is the sincerest form of
17 flattery. It is because Delaware corporate law is
18 robust and helpful, and investors know what it means.
19 But there's still "to the extent not inconsistent with
20 federal law" and there's still the fact that it's not
21 jurisdiction or venue conferred.

22 The regulation that was in place when
23 Fannie Mae originally made its election was modified
24 in November 2015, which was a couple months before

1 Mr. Pagliara -- I think a couple months before
2 Mr. Pagliara made his demand and several months before
3 he filed his lawsuit. But the regulation makes clear
4 that by choosing a particular body of state law to
5 follow -- oh, I'm sorry. I apologize. The FHFA
6 addressed concerns, quote, that by choosing a
7 particular body of state law to follow, they could
8 subject themselves to the jurisdiction of those courts
9 and would allow their members to assert all of the
10 rights available to stockholders of corporations
11 organized under those state laws. FHFA made clear
12 that while the agency did not believe its regulations
13 would cause that to occur, that's not what they were
14 intended to do.

15 And, in fact, one of the sets of
16 bylaws that Mr. Pagliara's counsel brought to your
17 attention on Monday was the bylaws of the Federal Home
18 Loan Bank of Dallas incorporating that -- that concept
19 from this very regulation into its own bylaws. But
20 that's -- it is very clear that the governance-
21 election regulation is not intended in any way to be
22 jurisdiction conferring.

23 There was one argument that
24 Mr. Pagliara made in opposition that I thought that I

1 should address: that the bylaws referenced a
2 certificate of incorporation. Our reading of the
3 bylaws is that the bylaws identify the provisions
4 within the bylaws that constituted Fannie Mae's
5 certificate of incorporation. They weren't referring
6 to some external certificate. They were deemed
7 certificate provisions. So there were a handful of
8 provisions of the bylaws that were identified as
9 constituting Fannie Mae's certificate of
10 incorporation. And that leads us to believe that,
11 again, the Delaware certificate that was attached to
12 the complaint is not, in fact, Fannie Mae.

13 THE COURT: Can you address for me
14 their waiver arguments?

15 MR. WALSH: I can, Your Honor.
16 Absolutely.

17 This is Fannie Mae's first responsive
18 pleading. And the standard is that as long as you
19 raise a jurisdictional defense in the first responsive
20 pleading under Rule 12, it is not waived. Now,
21 there's a couple of different arguments that counsel
22 has raised, and I will address them in turn.

23 First is that somehow FHFA's motion to
24 substitute waived Fannie Mae's jurisdictional defense.

1 And I would submit that that motion to substitute that
2 was filed in federal court was not a motion under Rule
3 12. It's not a -- it's just simply not listed as a
4 motion under Rule 12. So that is not, in and of
5 itself, a Rule 12 motion. And the Federal Housing
6 Finance Agency is not Fannie Mae.

7 So then I believe the next argument
8 was that by, in its remand opposition, encouraging or
9 suggesting to the district court that it rule on
10 FHFA's substitution motion, that Fannie Mae engaged on
11 the merits and waived its jurisdictional defense. And
12 to that I would say that is a simple -- let me back up
13 just a little bit. Removal doesn't create personal
14 jurisdiction. I believe that's fairly well settled.
15 Opposing a remand does not constitute -- does not
16 constitute a waiver of personal jurisdiction. Those
17 are not responsive pleadings under Rule 12, and they
18 are not jurisdiction conferring. So Fannie Mae is
19 allowed to remove and oppose remand without waiving a
20 personal jurisdiction argument.

21 And as for that one sentence, first of
22 all, we did not -- we did not believe that the
23 substitution motion that FHFA filed was a merits
24 motion or a request to engage on the merits of the

1 case. It was more along the lines of an easy way to
2 resolve the case. And we believe that the case law
3 order of decision that we cited in the district court
4 supports that. That was subject matter jurisdiction,
5 but we believe it supports the personal jurisdiction
6 argument as well.

7 So that leaves one more, which is that
8 we did not timely file in 20 days. I believe we
9 pointed out in our brief that we removed before the 20
10 days ran. The case was stayed for a very long time.
11 We believed that we had an agreement that no answer
12 was required. We believe we had that agreement before
13 the stay in federal court was lifted. But even if
14 not, we would submit that it's inequitable to find
15 waiver on these grounds because the jurisdictional
16 issue is real. We flagged it for Mr. Pagliara's
17 counsel in August 2016 in a letter, making clear that
18 we were not a Delaware corporation. And nothing has
19 really changed. It's always been there. So we would
20 submit that, at the very least, the equities would
21 allow Your Honor to consider that argument.

22 But first and foremost, we believe
23 that this is our first Rule 12 pleading and,
24 therefore, it is not waived. And I believe it's the

1 Foss v. Klapka case that says it is the filing of the
2 motion, regardless of the timing. And that's a
3 federal court case, but it interprets Rule 12 and the
4 waiver argument.

5 Last, for me, even if you find that
6 personal jurisdiction was waived, we would submit that
7 the fact that Fannie Mae is not a Delaware corporation
8 means that it is not subject to Section 220. Given
9 the fact that Fannie Mae is not a Delaware corporation
10 and the fact that Section 220 now directly conflicts
11 with the federal law which says that all shareholder
12 rights have been transferred to FHFA, even if personal
13 jurisdiction is waived, it still gets you to the same
14 result because Fannie Mae is not a Delaware
15 corporation.

16 If there are no further questions,
17 Your Honor, I will turn it over to my colleague,
18 Mr. Cayne, to make the remaining arguments.

19 THE COURT: I do not have further
20 questions. Thank you.

21 MR. FLINN: Your Honor, would it make
22 sense for me to address personal jurisdiction at this
23 time?

24 THE COURT: No, let's allow them to

1 finish their argument, and then you can address them
2 all.

3 MR. CAYNE: Good morning, Your Honor.
4 May it please the Court, Howard Cayne for the Federal
5 Housing Finance Agency.

6 As my colleague from Fannie Mae
7 stated, the issues that I'm going to discuss only need
8 be addressed by the Court if the Court, respectfully,
9 in our view, erroneously concludes that it has
10 jurisdiction, personal jurisdiction. If the Court
11 agrees with the argument that my client agrees with,
12 the Federal Housing Finance Agency as conservator
13 that's been advanced this morning and in the papers,
14 what I have to say I hope the Court finds interesting,
15 and I would be pleased to have the Court agree and
16 rule on it, but the Court need not reach it.

17 But with that premise, the reason my
18 client, the Federal Housing Finance Agency as
19 conservator, asked to be involved in this litigation
20 is because the right and the power that plaintiff,
21 Mr. Pagliara, here seeks to assert belongs to my
22 client. Mr. Pagliara does not hold the power to
23 investigate, the power to look, to require production
24 of books and records. And I will go through that,

1 Your Honor, right now.

2 The key provision at issue is 12 USC
3 Section 4617(b)(2)(A)(i). And that states that upon
4 the imposition of the conservatorship of Fannie Mae,
5 which, as the Court knows, occurred on September 6th,
6 2008, "all rights, titles, powers, and privileges ..."
7 of the stockholders, with respect to Fannie Mae and
8 the assets of Fannie Mae, are transferred to the
9 conservator.

10 And those rights, as already found by
11 Judge Cacheris in the Eastern District of Virginia,
12 include any purported right to demand production of
13 books and records. And as we state in our papers, but
14 I will just sum up with this in a minute -- or more
15 than a minute, unfortunately. But first I will set
16 out the merits. As a legal matter, we submit that the
17 findings, the conclusions, the rulings of Judge
18 Cacheris preclude this and, frankly, any other court
19 from independently reaching the same issues.

20 But let me first, if the Court decides
21 to reach the issues, demonstrate why Judge Cacheris
22 got it right. In Pagliara -- we will call that
23 Pagliara I. Both cases were filed at about the same
24 time. And in Pagliara I, Judge Cacheris ruled that

1 inspection demands are much like voting rights. And
2 it is beyond question that Judge Cacheris found, and
3 as even the plaintiffs in this case concede, voting
4 rights for a board of directors, or for anything else,
5 have been transferred. For the duration of the
6 conservatorship, shareholders no longer have voting
7 rights. All of that has been transferred by operation
8 of law by the provisions of what my colleague
9 described as HERA, H-E-R-A, they have been transferred
10 to the conservator. And in doing that, Congress made
11 very clear that for the duration of the
12 conservatorship, only one entity has the power to
13 control every aspect of, in this case, Fannie Mae.
14 And that is the conservator of Fannie Mae, which is
15 the Federal Housing Finance Agency acting as
16 conservator.

17 And as the Court knows from the papers
18 -- it's a very lengthy complaint -- 60, 70 pages --
19 that reads almost identically to the complaints filed
20 in all of the third amendment cases, Your Honor, which
21 I believe the Court is familiar with from the various
22 pleadings. All sorts of wrongdoing is hinted at or
23 alleged -- it's really alleged, even though the books
24 and records haven't been produced yet -- and the basis

1 for the books and records demand is to facilitate
2 plaintiff's effort to investigate: to investigate
3 Fannie Mae, to investigate the board of directors, to
4 investigate officers of Fannie Mae, and to investigate
5 anything else plaintiff deems appropriate.

6 Your Honor, Mr. Pagliara, the
7 plaintiff in this case, does not have that right. He
8 does not have that power. Congress authorized one
9 party, and one party only, to control every aspect of
10 the business of Fannie Mae. And it's not even the
11 board of directors of Fannie Mae, Your Honor. It is
12 the conservator appointed by -- under federal statute.

13 And plaintiff is just flat wrong, Your
14 Honor, that the judgment, the ruling by Judge Cacheris
15 in Pagliara I is somehow at odds with the decision of
16 the D.C. Circuit in Perry Capital. And, Your Honor, I
17 am very familiar with that decision. I argued that
18 case on behalf of the Federal Housing Finance Agency.
19 And Perry Capital had -- no aspect of Perry Capital
20 addressed books and records demands. Perry Capital,
21 in very large part, dismissed massive claims against
22 the Federal Housing Finance Agency, Freddie, Fannie,
23 and the United States Department of the Treasury. It
24 left one aspect of state-based damages claims in

1 existence. And that is what's left in that case,
2 state common law claims for monetary damages, Your
3 Honor.

4 This case is not about monetary claims
5 for damages. This case is about who did Congress give
6 the right to to control the business, the operations
7 of Fannie Mae and Freddie Mac. Again, Congress gave
8 that, Your Honor, exclusively to the Federal Housing
9 Finance Agency in its capacity as conservator.

10 Plaintiff makes much of, "Well, are
11 these claims direct? Are these claims derivative?"
12 And plaintiff goes on that it's only derivative claims
13 that are nullified by the first statute I read that
14 transferred everything to the conservator.

15 Your Honor, again, that's not correct.
16 Plaintiff is confusing an entirely separate issue. Do
17 shareholders retain any type of claim for monetary
18 damages following the imposition of a federal
19 conservatorship? That is the issue that the D.C.
20 Circuit dealt with. And plaintiff goes so far as to
21 say, Your Honor, that Judge Cacheris, in Pagliara I,
22 got his decision wrong, and essentially that the D.C.
23 Circuit decision overrides that. And, Your Honor,
24 that's just not right.

1 Judge Cacheris properly recognized
2 that the distinction, the meaning, the difference
3 between derivative claims and direct claims is of no
4 moment in this context. It is of no moment when we're
5 dealing, in front of Your Honor, with not claims based
6 on state law for monetary damages, but were based on,
7 under federal law, who gets to control Fannie.

8 And, for example, as I indicated, on
9 the stock -- rights to vote shares, if plaintiffs
10 filed a suit, "Our right to vote shares has been taken
11 away from us," well, that would be a direct claim,
12 Your Honor. It was plaintiff's right to vote shares.
13 Plaintiff doesn't dispute that that right was taken by
14 statute and vested in the conservator. And the key
15 point, though, is that would be direct, and it still
16 was transferred.

17 What we have here is essentially the
18 same thing, the right to look at books and records,
19 demand production, essentially to be involved in the
20 administration of Fannie Mae, to make sure that Fannie
21 Mae is being operated as Mr. Pagliara would like
22 rather than the federal conservator. Well, that
23 sounds much like the voting rights. Plaintiff could
24 bring a direct suit to say, "Hey, my right for books

1 and records, if I had one, has been taken."

2 But as Judge Cacheris correctly noted,
3 the distinction between direct and derivative for
4 those purposes gives the Court no pertinent
5 information. It is not relevant. And, Your Honor,
6 this then all ties in with the broad bar against court
7 injunctive relief, court orders that would affect the
8 operations of the conservator, 12 USC 4617(f).

9 Because first of all, again, that's
10 not something we need to reach because the powers
11 Mr. Pagliara seeks to enforce are not his powers, Your
12 Honor. Those are federal powers. Those are powers,
13 under federal law, that have been transferred under
14 federal law to my client, the Federal Housing Finance
15 Agency. Again, Your Honor, we weren't named as a
16 defendant, but that's why we're here, because we
17 believe it is important to protect the rights and the
18 powers that Congress assigned to the agency. And it's
19 not appropriate for third parties to attempt to seize
20 those powers, to seize those levers of control and, I
21 don't know, essentially act as a co-conservator.

22 The Federal Housing Finance Agency can
23 decide on its own what needs to be investigated and
24 what does not need to be investigated. The Federal

1 Housing Finance Agency Congress deemed to be
2 essentially the expert in operating and controlling
3 the operations of these massive institutions. And
4 from time to time the agency may and does retain
5 experts, retains officials, it has assistance in
6 carrying out its duties. But it's the decision of the
7 agency. The agency has not gone out to retain
8 Mr. Pagliara, Your Honor, to conduct his own
9 independent investigation of Fannie Mae.

10 But past that point that this is not a
11 power held by Mr. Pagliara, Your Honor, even if it
12 was, go to the next step. Even if it was, this --
13 neither this Court nor any other court in the United
14 States could issue an order enforcing that power
15 because that power, under Delaware state law, which is
16 what Mr. Pagliara says he has, the exercise of that
17 power would affect the ability of the conservator to
18 operate, to control the business of Fannie Mae, and it
19 would be the same thing, Your Honor, if we dealt with
20 Freddie Mac.

21 The statute itself, and I'm sure the
22 Court is familiar with it, it prohibits any court,
23 state or federal, from taking "... any action to
24 restrain or affect the exercise of powers or functions

1 of the [Federal Housing Finance] Agency as a
2 conservator"

3 Your Honor, that language, as the
4 Court will have seen from the cases we have cited, has
5 been used by the agency across the country to shut
6 down all sorts of actions taken by individuals, taken
7 by states, taken by municipalities, where essentially
8 third parties have come in and said, "We want to force
9 Fannie Mae or Freddie Mac to do this or that." And in
10 these instances, we go into court to shut that down
11 because we're protecting the exclusive powers of this
12 federal conservator.

13 We've argued case -- I have argued
14 cases in the Ninth Circuit, Eleventh Circuit, Second
15 Circuit, all over the country. And the cases have
16 been uniform. This sentence, this anti-injunction
17 provision, bars a wide spectrum of requested relief.
18 It bars issuance of any type of injunctive-related
19 relief that will affect -- and that's a very broad
20 term, Your Honor -- affect the conservator's ability
21 to exercise its powers and functions.

22 So, Your Honor, another point that I
23 would make beyond the larger picture is, again, let's
24 assume that Mr. Pagliara did have some type of

1 investigatory power. Well, there's nothing here to
2 investigate. In this lengthy complaint, Your Honor,
3 the first part of it is about, starting from really
4 the first page, page after page after page after page
5 of all these awful, unlawful, not-safe-and-sound
6 actions taken by the board of directors. And
7 Mr. Pagliara seeks to investigate these actions under
8 Delaware law.

9 But, Your Honor, what Mr. Pagliara
10 fails to acknowledge is the board of directors of
11 Fannie Mae that existed prior to the federal
12 conservatorship is gone. The federal conservatorship,
13 as I said, in addition to transferring the powers of
14 the stockholders, such as the power to vote, any power
15 to inspect books and records, it transferred all the
16 powers and functions of the board of directors from
17 the board to the conservator. That was -- we can
18 agree with that decision or not, but that was a
19 decision of the United States Congress that has been
20 applied by courts all over the country and has not
21 been undermined.

22 And, Your Honor, that -- so, as I
23 said, when the conservator was appointed in
24 September 2008, the board of directors was gone. For

1 the next approximately two months Fannie operated with
2 nothing even called a board. And it was the same
3 situation at Freddie Mac.

4 Eventually the conservator decided a
5 body of well-qualified individuals could help the
6 conservator in controlling and monitoring and carrying
7 out the functions of Fannie Mae. So the conservator
8 appointed a number of individuals to serve, and he
9 called it, just to use the common term, a board. And
10 that's what's there now.

11 But this is not a board of the type
12 this Court is very familiar with under Delaware state
13 law or the corporate law of any state. This is a
14 group of individuals that get together and meet and do
15 and carry out the functions that the conservator
16 assigns to them. On any given day, the conservator is
17 free to expand the duties of the board or contract the
18 duties of the board. Unlike a statutory board, as in
19 Delaware, this board does not report to the
20 shareholders. It reports only to one entity, the
21 conservator of Fannie Mae.

22 So when you go through page after page
23 of this complaint, all the different things the
24 board -- paragraph 12, I will just pick it out

1 randomly, Your Honor. "Third, since the Third
2 Amendment, the Board" -- again, the board of directors
3 -- "has breached both fiduciary and statutory duties
4 in ... approving the payment of the dividends under
5 the Net Worth Sweep."

6 Well, again, the board has no
7 fiduciary duties to the shareholders. It reports to
8 the conservator. The board doesn't have the final
9 decision in paying dividends; the conservator has
10 that, Your Honor.

11 And so I mentioned earlier how the
12 relief sought by plaintiff would interfere with, would
13 affect the conservator's operation of the institution
14 and would affect it in a way impermissible under 12
15 USC 4617(f).

16 Well, this paragraph, this particular
17 charge that I just randomly selected, it makes the
18 point. Because there's no question that this
19 investigation and the massive production of
20 information and documents sought by Mr. Pagliara would
21 very much affect the ability of this group of
22 individuals selected by the conservator to assist in
23 controlling the functions, the business of Fannie Mae,
24 would very much affect their ability to do what the

1 conservator hoped. And that is a direct effect, a
2 direct constraint on the ability of the -- on the
3 conservator's ability to do what Congress has vested
4 in the conservator exclusive authority.

5 Your Honor, I am not, unless the Court
6 has questions, because it's all laid out in our brief,
7 and I am sure I have taken way too much of the Court's
8 time already, I'm not going to go through all the four
9 factors that we show in our briefs are satisfied as to
10 why we submit the Court is required to follow --

11 THE COURT: The issue preclusion
12 factors?

13 MR. CAYNE: Yes. Unless the Court has
14 a question on that, I'm not going to recite what's in
15 our brief. I think we do an excellent job there in
16 laying it all out and why that applies.

17 And the last point I would make is,
18 towards the end of the brief, the plaintiff set out
19 other alternative purposes for their books and records
20 request. And as we say in our papers, Your Honor,
21 each one of those are pretextual.

22 They argue they want to discuss the
23 third amendment with other shareholders. Well,
24 Mr. Pagliara has for years maintained a web page under

1 the name "Investors Unite" that has been one of the
2 central points where investors in Fannie Mae and
3 Freddie Mac comment. Mr. Pagliara comments on all the
4 third amendment litigations. There is already this
5 exchange of information, exchange of ideas between
6 shareholders. And none of these points at the end
7 that are given, like, a line each -- again, this is
8 going on to another point, Your Honor -- if the Court
9 were not to agree with the positions I have already
10 advanced that there is not a proper purpose that has
11 been listed.

12 But, Your Honor, unless the Court has
13 any questions, I will sit and reserve any other
14 comments for reply.

15 THE COURT: I do not. Thank you.

16 MR. CAYNE: Thank you.

17 MR. FLINN: Good morning again, Your
18 Honor.

19 THE COURT: Good morning, Mr. Flinn.

20 MR. FLINN: I would like to make a
21 brief, two-minute introduction to the case, since it's
22 the first time that we have been before Your Honor,
23 and then I will turn directly to the arguments.

24 The Housing and Economic Recovery Act,

1 or HERA, authorized Treasury to invest in Fannie Mae.
2 But only on terms agreeable to Fannie Mae, a private
3 corporation. At the time of Treasury's investment,
4 Fannie Mae was under the conservatorship of the
5 Federal Housing Finance Agency, referred to as FHFA.

6 During the conservatorship, FHFA
7 succeeds to Fannie Mae's powers and therefore is
8 constrained by the same laws that constrain Fannie
9 Mae's powers as a private corporation. Nonetheless,
10 during the conservatorship, HERA bars certain claims
11 against FHFA and Fannie Mae. To give FHFA the ability
12 to operate quickly during the financial crisis, such
13 claims may not be brought until the conservatorship
14 ends.

15 After Treasury invested in senior
16 preferred stock of Fannie Mae for a fixed 10 percent
17 dividend, our client, Mr. Pagliara, and his clients
18 invested in junior preferred stock of Fannie Mae.
19 These investors include doctors, lawyers, judges,
20 teachers. They anticipated that Fannie Mae would
21 return to profitability, that there would be value in
22 the junior preferred stock. And they were right.
23 What they did not anticipate, and could not have
24 anticipated, Your Honor, was the third amendment in

1 which Fannie Mae agreed, for no consideration
2 whatsoever, to give its controlling stockholder,
3 Treasury, Fannie Mae's entire net worth in perpetuity.

4 Mr. Pagliara and his clients also
5 could not have anticipated that Fannie Mae would
6 thereafter pay the net worth sweep dividends every
7 quarter since. They could not have anticipated that
8 Fannie Mae would not refinance Treasury's senior
9 preferred and free Fannie Mae from the damaging
10 effects of the net worth sweep dividends.

11 Mr. Pagliara and his clients were
12 seriously harmed by the third amendment, the dividends,
13 and Fannie Mae's failure to refinance.

14 The D.C. Circuit, in *Perry Capital*,
15 recently held that, even during the conservatorship,
16 stockholders may pursue direct claims for damages
17 arising from the third amendment against Fannie Mae,
18 FHFA, and Treasury. Those claims may include claims
19 under Delaware law for breach of the certificates of
20 designation.

21 The idea that Mr. Cayne is putting
22 forward that FHFA is just completely blocked and no
23 one can ever touch anything that it does during the
24 conservatorship is wrong. And, of course, after the

1 conservatorship ends, all that is lifted. FHFA simply
2 stands in the shoes of Fannie Mae.

3 Fannie Mae says the third amendment
4 was needed to prevent a death spiral for Fannie Mae as
5 Fannie Mae drew funds from Treasury to pay the
6 preexisting fixed dividend on the senior preferred.
7 But in view of Fannie Mae's immediately ensuing
8 profitability, the death spiral theory looks very
9 unlikely. The third amendment looks more like it was
10 designed for the exclusive benefit of Fannie Mae's
11 controlling stockholder.

12 Fannie Mae does not want the
13 stockholders to see its books and records.
14 Mr. Pagliara brought this action to get to the truth.
15 He wants to inspect the books and records to enhance
16 discussions concerning the regulatory and legislative
17 resolution of the third amendment and Fannie Mae's
18 future. He also wants to investigate potential
19 claims.

20 Now, Your Honor, Mr. Cayne pointed out
21 that FHFA has succeeded to the powers of the board
22 and, therefore, claims against -- and, therefore, the
23 board is somehow not responsible for what's going on.
24 That may be true. But if that's true, the complaint

1 seeks to investigate claims against FHFA, it seeks to
2 investigate claims against Treasury, it seeks to
3 determine, frankly, what is the relationship between
4 FHFA and the board, none of which has been made very
5 public.

6 As the Court is aware, Mr. Pagliara
7 has been delayed in his request for books and records
8 for over a year based upon meritless arguments. We
9 submit that the motion to dismiss presents more
10 meritless arguments.

11 Your Honor, let me turn first to the
12 issue -- the preclusion issue, which will address also
13 the succession provision question.

14 Fannie Mae concedes that issue
15 preclusion does not apply if there's been an
16 intervening change in the law. There has been an
17 intervening change in the law here. The Eastern
18 District of Virginia decision from which they say
19 issue preclusion arises held that a succession
20 provision barred a stockholder's claim for books and
21 records. But the D.C. Circuit in Perry Capital and
22 the district court in this case, which Mr. Cayne
23 doesn't even mention, held that a succession provision
24 does not bar a claim for the books and records.

1 THE COURT: Well, let's take the Perry
2 Capital case first. That case is not about books and
3 records. Correct?

4 MR. FLINN: No; it's about direct
5 claims, among other things, Your Honor.

6 THE COURT: Well, I understand that.
7 But is it your position, then, that based on that
8 case, every single claim that could be brought as a
9 direct claim is a claim that is now allowed -- stated
10 a little bit differently, hopefully more clearly, is
11 it your position that, based on the Perry Capital
12 case, the succession clause doesn't bar any direct
13 claims at all, no matter what the direct claim is
14 based on? So, for example --

15 MR. FLINN: Your Honor -- I'm sorry
16 for interrupting. I think I can answer that question.

17 THE COURT: Okay. Go ahead.

18 MR. FLINN: I think the answer to that
19 question is yes. But it doesn't mean that the direct
20 claim would be barred by the anti-injunction
21 provision. So, for example, Mr. Cayne posits this
22 parade of horrors. "Your Honor, if you hold that
23 Mr. Pagliara can assert a direct claims for books and
24 records, that means that the stockholders can assert

1 voting rights and can vote for the board and start to
2 control Fannie Mae." And that's just not true.

3 In contrast to a claim for books and
4 records, which has zero impact on FHFA's ability to
5 control Fannie Mae, a claim that the stockholders can
6 elect the board and vote for Fannie Mae and elect all
7 of those changes at Fannie Mae would interfere with
8 the right -- excuse me -- with the exercise of FHFA's
9 powers as conservator and, therefore, it would be
10 blocked.

11 To be clear, the decision of Perry
12 Capital, when it was addressing the succession
13 provision, held that -- and, Your Honor, because they
14 make such an issue out of this, I do need to read it.
15 "We conclude" --

16 THE COURT: Wait a minute. I have it
17 here, too. I want to read it with you.

18 MR. FLINN: Very good.

19 THE COURT: All right. Where are you?

20 MR. FLINN: I'm at page 1104. I think
21 this carries on to page 1105.

22 THE COURT: I'm there.

23 MR. FLINN: Okay. Do you see the
24 sentence beginning with the words, "We conclude the

1 Succession [Provision] transfers ..."?

2 THE COURT: I do.

3 MR. FLINN: Okay. I'm going to read
4 this. There's an ellipses. We are going to have to
5 jump to the next sentence. But here's where it
6 starts. "We conclude the Succession Clause transfers
7 to the FHFA without exception the right to bring
8 derivative suits but not direct suits. The class
9 plaintiffs' claims for breach of fiduciary duty are
10 derivative and therefore barred, but their
11 contract-based claims are direct and therefore may
12 proceed."

13 HERA, they refer to as "The Recovery
14 Act thereby transfers to the FHFA all claims a
15 shareholder may bring derivatively on behalf of a
16 Company whilst claims a shareholder may lodge directly
17 against the Company are retained by the shareholder in
18 conservatorship"

19 Later on the Court says, "...
20 shareholders' direct claims against and rights in the
21 Companies survive during conservatorship."

22 So, Your Honor, Perry Capital didn't
23 address a claim for books and records, but it did
24 address direct claims generally. And nowhere did it

1 suggest that direct claims could not be brought under
2 the succession provision. Its rationale is consistent
3 with the notion that a claim for books and records may
4 be brought. The rationale was that HERA provides that
5 direct rights are extinguished in receivership.
6 Because a conservatorship is not yet a receivership,
7 that means they must exist in conservatorship.

8 So to be clear, all rights, all direct
9 rights of the stockholders are retained during
10 conservatorship under Perry Capital. And as I said,
11 that doesn't mean that you could necessarily enforce
12 those rights, because it's possible that some of those
13 rights may interfere with the anti-injunction
14 provision. But I will get to the anti-injunction
15 provision in just a moment. Right now we are dealing
16 with the succession provision.

17 So I said that the decision of the
18 Eastern District of Virginia was inconsistent with
19 Perry Capital. It was because it was dealing with a
20 succession provision.

21 And then if you look at the District
22 of Delaware's remand order in this case, Judge Sleet
23 wrote, "The normal procedure" -- I will give you a
24 moment, Your Honor.

1 THE COURT: I'm there.

2 MR. FLINN: "The normal procedure for
3 enforcing a shareholder's right to inspect ... books
4 and records is not altered or preempted by Section
5 4617(b)(2)(A)." That's the succession provision.
6 "The court is persuaded by the recent District of
7 Columbia decision on Section 4617(b)(2)(A)." There he
8 cites Perry Capital. "That court found that Section
9 4617(b)(2)(A) did not bar 'direct claims and rights in
10 ... [c]ompanies ... during conservatorship.'"

11 So Judge Sleet concluded that Perry
12 Capital held that the succession provision does not
13 bar a claim for books and records. He then followed
14 that, and he held -- and on this one, Your Honor, he
15 was specifically addressing a claim for books and
16 records. It came up in the remand order. It wasn't
17 on the substitution motion. But that doesn't matter.
18 Their argument had been that because the succession
19 provision bars Mr. Pagliara's claim, federal law
20 completely preempted any Section 220 action, which
21 made it a -- which made the case about a federal
22 question such that remand should not be granted.

23 THE COURT: And why is this holding
24 broader than "this is not a federal question"?

1 MR. FLINN: Because he expressly says,
2 based upon Perry Capital, that the normal procedure
3 for enforcing the shareholder's rights is not
4 affected. And he needed to do that. In order to
5 determine -- they were arguing that there was a
6 complete bar from the succession provision. He had to
7 decide whether there was a complete bar from the
8 succession provision in order to decide the preemption
9 question, and he decided there's no bar. And that's
10 consistent with Perry Capital.

11 And so Perry Capital and the district
12 court's remand order are directly inconsistent with
13 the Eastern District of Virginia. To be clear, Your
14 Honor, Judge Sleet, when he wrote his remand order,
15 was fully aware of what Judge Cacheris had done in the
16 Eastern District. He cited that decision on a
17 different point. He just disagreed with it, which is
18 why he went with Perry Capital and held that the right
19 to books and records are not preempted by the
20 succession provision and they are not even altered by
21 the succession provision.

22 We submit, Your Honor, that it would
23 not only be incorrect, but it would be unjust to hold
24 Mr. Pagliara to a decision that has been determined to

1 be incorrect by the highest federal authority to
2 consider the issue, the United States Court of Appeals
3 for the District of Columbia, and by the district
4 court in this very same case for remand.

5 Now, Your Honor, issue preclusion
6 doesn't apply on the -- do you have more questions on
7 that, Your Honor, before I move on to the
8 anti-injunction provision?

9 THE COURT: I do not.

10 MR. FLINN: Okay. Your Honor, issue
11 preclusion does not apply on the anti-injunction
12 provision for the very simple reason that the Eastern
13 District of Virginia did not hold that the anti-
14 injunction provision barred Mr. Pagliara's claim for
15 books and records.

16 The Eastern District of Virginia
17 addressed the anti-injunction provision only in citing
18 it as a support for -- generally for FHFA's broad
19 powers. And that was used to support generally the
20 idea that the succession provision barred direct
21 claims, barred direct rights. And, of course, that
22 was -- as I said, that part was overturned by Perry
23 Capital, which Judge Sleet then followed in the
24 district court.

1 Issue preclusion cannot be applied on
2 either the succession provision or the anti-injunction
3 provision because they involve pure questions of law.
4 And we have cited authority for that proposition in
5 our briefs.

6 THE COURT: How do you respond to your
7 friend's reply at page 16, where they say you need
8 purely law plus? That is, purely law plus the claims
9 must be unrelated, or purely law plus demonstrated
10 need; that there is a demonstrated need to have a new
11 decision in order to avoid inequitable administration
12 of the law.

13 MR. FLINN: Sure, Your Honor. I think
14 we actually satisfy that test, but that's not the
15 right test here.

16 First of all, we look to the law of
17 the Fourth Circuit, because that's where the decision
18 is coming out of. That's what determines issue
19 preclusion. Under that law, they apply Restatement
20 Section 29. And Restatement Section 29 deals with
21 nonmutual issue preclusion. It's nonmutual here
22 because Fannie Mae and Freddie Mac are different
23 parties. So we have different parties in this
24 litigation. In that setting, which is our setting,

1 issue preclusion does not arise from a pure question
2 of law, period. All right?

3 Now, if we were to even apply that
4 test nonetheless, what we would see is that it is --
5 so this is the test for issue preclusion in a
6 perfectly mutual setting. Then you would need to have
7 both a pure question of law, and one of the things is
8 a change, an intervening change in the law. We have
9 that. We have that based upon Perry Capital and Judge
10 Sleet's decision in the district court.

11 Issue preclusion does not apply also
12 because it was -- the succession provision issue was
13 an alternative holding. Judge Cacheris made very
14 clear that he was holding in the alternative. The
15 other alternative holding dealt with a proper purpose.

16 In some circuits it's not the case
17 that an alternative -- that issue preclusion would not
18 arise from an alternative holding, but that is
19 definitely the case in the Fourth Circuit.

20 THE COURT: Is it your position that
21 because there are two holdings, they are both
22 alternative holdings? Is that what you are saying?

23 MR. FLINN: No, I don't think that's
24 it, Your Honor. It's the language where he says,

1 "Even if I wouldn't hold that, I am holding this."
2 That's where he establishes that it's in the
3 alternative.

4 THE COURT: You're talking about where
5 he goes from the --

6 MR. FLINN: Right at the beginning.

7 THE COURT: So first he does the
8 succession clause --

9 MR. FLINN: That's right.

10 THE COURT: -- analysis. And then he
11 says, "But even if I'm wrong on that, then this."

12 MR. FLINN: That's right.

13 THE COURT: Why doesn't that suggest
14 the second holding is the alternative holding?

15 MR. FLINN: I think it suggests that
16 they are both alternative holdings.

17 THE COURT: So that was the first
18 question I asked. Your position is that both of these
19 holdings are alternative holdings?

20 MR. FLINN: Yes. I'm sorry. I
21 misunderstood your question. I apologize.

22 THE COURT: That's okay.

23 MR. FLINN: No; they are both
24 alternative holdings.

1 THE COURT: Okay.

2 MR. FLINN: So they cite some case law
3 talking about this idea that you can have a primary
4 alternative holding, and if it's the primary
5 alternative holding, that will be given
6 issue-preclusive effect. That's not the law of the
7 Fourth Circuit. It's certainly not the law of the
8 restatement as the Fourth Circuit has followed it.

9 I want to talk for a minute, Your
10 Honor, about the anti-injunction provision. The
11 anti-injunction provision does not bar a claim for
12 books and records. It bars only relief that would
13 restrain or affect FHFA's exercise of its
14 conservatorship powers.

15 An inspection of books and records
16 would not interfere in any way with FHFA's exercise of
17 its conservatorship powers. It wouldn't even
18 interfere with FHFA's exercise of its own power to
19 inspect the books and records because the books and
20 records would stay there. They keep saying over and
21 over again, "It will affect our exercise of our
22 conservatorship powers," but they never say what it is
23 that they could do before the books and records
24 demand -- before Your Honor ordering an inspection

1 that they could not do afterwards. It's just a --
2 there's just nothing. Because all we are doing is
3 looking at documents. You necessarily can't, in any
4 way, shape, or form, affect their control of Fannie
5 Mae with that.

6 And we looked around for some
7 authority on this point. We have cited authority that
8 the anti-injunction provision and its analog in
9 FIRREA -- substantially the same language in FIRREA --
10 do not bar similar relief. We found claims in which
11 the anti-injunction provision is not barring damages,
12 which, of course, we already knew from Perry Capital.
13 We found cases citing that -- requiring FHFA, despite
14 the assertion of the anti-injunction provision, to
15 produce documents in litigation. And we found cases
16 dealing with an accounting in which an accounting was
17 required.

18 FHFA says, "Well, an accounting,
19 that's just damages." That's not true. An accounting
20 is a request for information from the regulated
21 entity. And when FHFA tried to say, "Hey, you are not
22 allowed to do that," Your Honor, the Court said, "You
23 haven't cited me any authority for how an accounting
24 could interfere with the exercise of your powers."

1 Well, a books and records claim is the same on that
2 issue.

3 And on the discovery point, Fannie Mae
4 says, "Well, HERA contemplates that there is going to
5 be discovery against regulated entities in
6 conservatorship and, therefore, there would have to be
7 documents produced, and so forth."

8 We say that's our point. That's our
9 point. A books and records claim doesn't do anything
10 different than the requirement for production of
11 documents in a case, which HERA apparently allows, as
12 they say.

13 Your Honor, I would like to turn to
14 personal jurisdiction now.

15 First, I'm going to make one very
16 general point, and then I want to hit the waiver
17 points. Most of what you heard Mr. Walsh arguing
18 about was the whole question of whether or not Fannie
19 Mae is at home in Delaware. Aside from making the
20 argument that Fannie Mae's certificate is Fannie Mae's
21 certificate and, therefore, it's a Delaware
22 corporation, we don't make an argument that Fannie Mae
23 is at home. We don't make a general jurisdiction
24 argument. Our argument is that Fannie Mae has

1 consented by means of its bylaws and certificate. I
2 will get to that in just a minute.

3 Let's first talk about the waiver. So
4 Fannie Mae waived the personal jurisdiction defense
5 when it moved under Rule 12 without asserting a
6 personal jurisdiction defense. In response to the
7 complaint, FHFA filed a substitution motion on Fannie
8 Mae's behalf. The substitution motion was a Rule 12
9 motion.

10 At page 13 of Fannie Mae's remand
11 brief, it describes the substitution motion as going
12 to Pagliara's standing under Article III. And that
13 is, as I think it was Mr. Walsh said earlier, a
14 question of subject matter jurisdiction, the federal
15 court's subject matter jurisdiction. That is a Rule
16 12(b)(1) motion, as they describe it. A Rule 12(b)(1)
17 motion will waive -- without asserting personal
18 jurisdiction will waive a personal jurisdiction
19 defense like anything else.

20 But the D.C. Circuit in Perry Capital,
21 and the District of Delaware in this case, and the
22 Eastern District of Virginia all held that the
23 succession-provision defense raises not actually a
24 12(b)(1) issue, but a 12(b)(6) issue. And the

1 citations for that, because I'm not sure you've got
2 them there, for Perry Capital it's 848 F.3d at 1104,
3 and in the Eastern District of Virginia it's at 203
4 F.Supp.3d at 685. So all of those three courts held
5 this motion was a Rule 12 motion. They said it was a
6 Rule 12(b)(6) motion. It doesn't really matter,
7 because whether it's a Rule 12(b)(6) motion, as those
8 three courts held, or a Rule 12(b)(1) motion, as they
9 just said, it's still a Rule 12 motion, and the
10 failure to assert personal jurisdiction waived the
11 defense.

12 In its reply, Fannie Mae appeared to
13 be no longer claiming that it and FHFA are somehow
14 separate actors. And they definitely aren't. HERA
15 authorizes FHFA to act for Fannie Mae in litigation.
16 That's precisely what FHFA is doing here. It's not a
17 separate party. It hasn't moved to intervene. If
18 it's successful in its arguments, the substitution
19 argument that it made in federal court, Fannie Mae
20 would have been dismissed. As conservator -- lots of
21 authority out there. We have it in our brief -- FHFA
22 simply stands in the shoes of Fannie Mae. So it's
23 acting for Fannie Mae. And as the real party in
24 interest on the motion for substitution in federal

1 court, Fannie Mae is responsible for it under the
2 Bigelow case that we have cited in our papers. Fannie
3 Mae cannot avoid responsibility for the substitution
4 motion.

5 Now, they cite a case called Villery
6 in their papers, saying that it stands for the
7 proposition that a substitution motion is not a
8 dismissal motion, it's not a Rule 12 motion. Well,
9 the substitution motion in that case was not a Rule 12
10 motion. It didn't address standing. It didn't seem
11 to dismiss the claims. What it was was an unopposed
12 motion by two defendants to -- by one defendant to
13 come in for the other defendant under the Federal Tort
14 Claims Act. So there wasn't a Rule 12 issue there,
15 and that's a different situation. As I mentioned, the
16 D.C. Circuit, the District of Delaware, the Eastern
17 District of Virginia all held that a substitution
18 motion raised a Rule 12 issue, so there was a waiver
19 there.

20 There's also a waiver by litigation.
21 It's undisputed that the party waives the personal
22 jurisdiction defense if it urges the Court to find --
23 if it urges the Court to bind the plaintiff on the
24 merits. We cite authority that makes that perfectly

1 clear in our papers, and it's logical. Fannie Mae did
2 just that. Fannie Mae asked the district court to
3 decide first the merits of the substitution motion,
4 without mentioning the personal jurisdiction defense.

5 Fannie Mae seeks to diminish its
6 conduct, saying in its reply papers that it's just one
7 sentence. It wasn't just one sentence, Your Honor; it
8 was multiple sentences. It included a very important
9 sentence. It was the relief that Fannie Mae sought in
10 the conclusion of its remand brief. At the conclusion
11 of its remand brief, Fannie Mae wrote, "For all of
12 these reasons, the Court should decide FHFA's
13 substitution motion before turning to Pagliara's
14 remand motion." So it's perfectly happy to have one
15 Delaware court decide the merits of this case in a way
16 that potentially could have dismissed Mr. Pagliara's
17 claims.

18 Later it -- elsewhere in its papers it
19 wrote, "Simultaneously with this Opposition, FHFA is
20 filing a brief that urges the Court to resolve the
21 substitution question before turning, if necessary, to
22 this remand motion. Fannie Mae agrees that the Court
23 should resolve the potentially fully-dispositive
24 motion to substitute first, and incorporates FHFA's

1 arguments by reference into this Opposition." So it
2 incorporated FHFA's arguments for dismissal into its
3 opposition.

4 By seeking to bind Mr. Pagliara on the
5 merits in Delaware, Fannie Mae agreed also to be bound
6 on the merits in Delaware, and has waived for this
7 reason also.

8 I will take one second, Your Honor,
9 and then talk about the waiver based upon the timing
10 of the filing of this motion.

11 Fannie Mae waived the personal
12 jurisdiction defense also by asserting it eight months
13 late. Delaware requires timeliness. The cases that
14 Fannie Mae has cited are not Delaware law.

15 My June 2nd e-mail, June 2nd, 2016,
16 e-mail did not extend the time to answer by anything
17 like eight months. To cover the time of my vacation,
18 it was a place holder for a week and some days, as I
19 think the e-mail makes very clear. The burden was on
20 Fannie Mae to follow-up to get a longer extension. It
21 did not do so. Instead, it filed the substitution
22 motion.

23 The Court should not give Fannie Mae
24 the retroactive extension that it seeks. They haven't

1 shown any good cause for excusable neglect. Fannie
2 Mae chose not to assert the personal jurisdiction
3 defense because it wanted the district court to decide
4 the case on the merits, probably to assist it in
5 litigation around the country. But anyway, now that
6 that strategy has not worked out, Fannie Mae must live
7 with the consequences.

8 They mention that they somehow flagged
9 for us that there was an absence of personal
10 jurisdiction in this case somewhere earlier on. First
11 of all, that wouldn't change anything they actually
12 need to do in the litigation. But what they are
13 talking about is a letter in which they argued that
14 they were not a Delaware corporation. They didn't say
15 there was a lack of personal jurisdiction in this
16 case. And in a few days, they went on to answer or to
17 respond to the complaint in the related Jacobs matter
18 in the district court. They didn't assert a personal
19 jurisdiction defense. They haven't asserted a
20 personal jurisdiction defense where they needed to.

21 Your Honor, if I can just take a quick
22 second to grab -- I'm talking pretty quickly. I hope
23 Ms. Donnelly is keeping up with me. I apologize.

24 I now want to talk about consent to

1 jurisdiction.

2 THE COURT: Can you step a little
3 closer to the mic.

4 MR. FLINN: Yes, right now.

5 Fannie Mae agreed to personal
6 jurisdiction in Delaware, Your Honor. There is no
7 dispute that if they agreed to venue in Delaware, they
8 agreed to personal jurisdiction in Delaware. That's
9 clear from all the cases and authority.

10 Fannie Mae agreed to venue in
11 Delaware. The bylaws and the certificate are a
12 contract with the stockholders under Delaware law. In
13 its bylaws it wrote -- and this is in Section 1.05.
14 There's some introductory material, and then we get to
15 the meat. "Pursuant to Section 1710.10(b) of the
16 Office of Federal Housing Enterprise Oversight ...
17 corporate governance regulation, 12 CFR 1710.1 et
18 seq., to the extent not inconsistent with the Charter
19 Act and other Federal law, rules, and regulations, the
20 corporation has elected to follow the applicable
21 corporate governance practices and procedures of the
22 Delaware General Corporation Law, as the same may be
23 amended from time to time."

24 Then it goes on to say, "The inclusion

1 of ... Provisions) in these Bylaws shall constitute
2 inclusion in the corporation's 'certificate of
3 incorporation' for all purposes of the Delaware
4 General Corporation Law."

5 Fannie Mae agreed to be governed by
6 the DGCL in its contract with its stockholders.
7 Fannie Mae has not previously disputed this. In the
8 Perry Capital case, before the court of appeals,
9 Fannie Mae wrote in its brief, "Pursuant to their
10 bylaws and 12 C.F.R. ... 1710.10(a)-(b), Fannie Mae
11 follows Delaware law ..., and Freddie Mac follows
12 Virginia law ..., but only to the extent those laws
13 are not inconsistent with federal law."

14 Also, in Perry Capital, the court of
15 appeals wrote, "All parties agree we should apply
16 Delaware law to claims regarding Fannie Mae." By
17 incorporating its bylaws into its certificate for all
18 purposes of the DGCL, Fannie Mae agreed to be treated
19 as a Delaware corporation for all purposes of the
20 DGCL. That would include the purpose of personal
21 jurisdiction.

22 Now, Your Honor, the bylaws refer to a
23 certificate of incorporation. That is evidence that
24 the certificate of incorporation that we have found is

1 Fannie Mae's certificate of incorporation. There is a
2 discovery issue to be had on that certificate, Your
3 Honor, to really pin it down. But even if it turns
4 out that's not Fannie Mae's certificate, Fannie Mae's
5 bylaws state that they have elected Delaware law, and
6 they have incorporated that into a certificate of
7 incorporation for purposes of Delaware law. So Fannie
8 Mae should be deemed to have treated themselves as a
9 Delaware corporation in its contract with its
10 stockholders.

11 Fannie Mae has attempted to back away
12 from this. Referring to the bylaws in reference to
13 practices and procedures, they are saying they are not
14 quite bound by the DGCL. This is definitely wrong.
15 It said it followed Delaware law in Perry Capital, and
16 it needs to be held to that. Also, it's in the
17 certificate -- in the bylaws and included in the
18 certificate.

19 Your Honor, by the way, when they
20 ultimately amended this bylaw provision to divide it
21 up so that some of the provisions of the bylaws were
22 to be treated as certificate provisions and others
23 were to be treated as bylaw provisions, the provision
24 that elected Delaware law was treated as a certificate

1 provision.

2 But even if we take a really overly
3 narrow reading of the bylaw and we say that Fannie Mae
4 has elected -- Fannie Mae has at least elected the
5 procedures, right, because it says the procedures.
6 This is a books and records action. Where do we find
7 the procedures in the DGCL for a books and records
8 action? Only Section 220. What's the procedure?
9 Upon refusal of the demand, the stockholder may sue in
10 Chancery.

11 Fannie Mae has consented to that
12 venue. By consenting to that venue, they have
13 consented to personal jurisdiction in this Court. We
14 respectfully submit that it's not possible to give the
15 bylaw election any meaning that does not include
16 consent to venue in Chancery for this action.

17 Fannie Mae says that the regulations
18 pursuant to which it elected the DGCL do not have
19 jurisdictional effect. It says, for example, that
20 pursuant to the regulations, it might have elected the
21 Model Business Corporation Act, which would not have
22 had any jurisdictional effect. They are right on
23 that. It wasn't the regulations that had the
24 jurisdictional effect. It was Fannie Mae's election

1 in the bylaws to be governed by Delaware law that had
2 the jurisdictional effect.

3 By the same token, the 2015
4 regulations didn't remove -- the 2015 regulations --
5 this is the ones that come after we filed suit -- do
6 not remove the jurisdictional effect. They stated
7 only the truism that they did not have, or would not
8 cause somebody to have, a jurisdictional effect.
9 Fannie Mae's bylaws, its contract with its
10 stockholders, remained unchanged after the 2015
11 regulations were adopted.

12 The 2015 regulations might have
13 directed Fannie Mae to amend its bylaws to remove the
14 jurisdictional effect, but they didn't do that.
15 Fannie Mae's contract with the stockholders did not
16 change. If Fannie Mae desired to hold back the
17 jurisdictional effect of its DGCL election, it might
18 have done so. Others have. We provided yesterday the
19 bylaws of the Federal Home Loan Bank of Dallas, which
20 elect the DGCL but contain a provision holding back
21 the jurisdictional effect.

22 Fannie Mae asks the Court to read into
23 Fannie Mae's bylaws a provision like that in these
24 other banks' bylaws that's not in Fannie Mae's bylaws,

1 asking you to read into Fannie Mae's bylaws something
2 that is not there, although it may be in others.

3 On this issue of the charter provision
4 deeming Fannie Mae to be a D.C. corporation, that --
5 and for jurisdictional purposes, that's fine. So I'm
6 sure Mr. Pagliara could sue Fannie Mae in D.C. But it
7 doesn't change the fact that Fannie Mae has consented
8 to jurisdiction in Delaware. Just because you are
9 incorporated in one state doesn't mean you can't
10 consent to jurisdiction in another state. So, for
11 example, a Delaware corporation can consent to
12 jurisdiction in D.C.

13 Due to the consent to personal
14 jurisdiction, Your Honor, there's no need to get into
15 issues of specific jurisdiction or general
16 jurisdiction. It's just based upon consent.

17 I heard -- there was an argument that
18 the -- never mind, Your Honor. I don't need to
19 address that.

20 So that brings us now to the proper
21 purposes point. This action should not be dismissed
22 for lack of a proper purpose. At this time, there's
23 ongoing discussions among Fannie Mae, FHFA,
24 regulators, legislators, stockholders about resolving

1 the third amendment and Fannie Mae's future by
2 regulation, legislation, or otherwise.

3 As one primary purpose, Mr. Pagliara
4 seeks books and records to assist in those
5 discussions. And Fannie Mae doesn't dispute that
6 that's a proper purpose. It just says it's not true.
7 But Fannie Mae has not shown, has done nothing to show
8 that it's not true. Fannie Mae says only that
9 Mr. Pagliara has all the information he needs. He's
10 already got a website up. He's talking to people.

11 But there must be some reason why
12 Fannie Mae does not want him to see more. We think
13 that the books and records will show how badly Fannie
14 Mae has trampled on stockholder rights. Such
15 information would be exceedingly helpful, Your Honor,
16 in persuading relevant actors to respect stockholder
17 rights in working out Fannie Mae's future.

18 As another primary purpose,
19 Mr. Pagliara seeks to investigate claims. This
20 purpose is not invalidated by the limitation period
21 arguments. We didn't hear much more about that today,
22 but I want to say a couple words about that.

23 It's inappropriate to decide complex
24 limitations period defenses now in a summary

1 proceeding. We have cited the Amalgamated case in our
2 papers for that point. But in all events, there is
3 little probability that the limitations period will
4 defeat most of the claims to be investigated. Here is
5 a point that's not in our brief. For the derivative
6 claims, the limitations period has not even commenced.
7 As Perry Capital held, during the conservatorship, the
8 succession provision bars Mr. Pagliara and other
9 stockholders from asserting derivative claims. The
10 limitations period can't run on claims they can't even
11 assert.

12 The Section 170 claims that he seeks
13 to investigate arise every quarter. It's not barred
14 by the limitations period. They say he has all the
15 information he needs in order to sue. That's not
16 true. On the 170 claims particularly, it looks like
17 it's a good likelihood of a violation of Section 170.
18 It looks like they have paid out of surplus capital.
19 But we really can't tell from the public information;
20 we need the actual information to see if that's the
21 case.

22 The claim for refinancing the senior
23 preferred, that's an ongoing breach. The failure to
24 refinance that is an ongoing breach.

1 Even for the direct claims for breach
2 of fiduciary duty, which Perry Capital says the
3 stockholders can bring during the conservatorship, we
4 may discover information showing that Fannie Mae's
5 excuse for the third amendment was false; that it was
6 not to prevent a death spiral, but rather to benefit
7 Fannie Mae's controlling stockholder, Treasury. Such
8 deception would toll the limitations period.

9 Under Amalgamated, we may inspect
10 books and records, even for time-barred transactions,
11 if that would shed light on subsequent transactions,
12 as documents concerning the third amendment certainly
13 would.

14 Mr. Pagliara is using the tools at
15 hand as urged by our courts. Fannie Mae's contention
16 that Mr. Pagliara is investigating only derivative
17 claims that they say are barred under Perry Capital
18 should be stricken. Your Honor, this argument appears
19 first in their reply. It wasn't in the opening brief.
20 It should be stricken. But it's also wrong because
21 the Section 170 242 claims, certificate claims, are
22 all direct claims. And even under Gentile, the
23 fiduciary duty claims based upon the massive transfer
24 of value to a controlling stockholder would constitute

1 a direct claim.

2 There is also no reason Mr. Pagliara
3 should not be permitted to inspect derivative claims
4 for the reasons I have already mentioned.

5 I don't have more for you, Your Honor,
6 unless you have questions.

7 THE COURT: I do not. Thank you.

8 MR. FLINN: Thank you.

9 THE COURT: Mr. Walsh.

10 MR. WALSH: Thank you, Your Honor.
11 Just a few points on jurisdiction.

12 I think I heard Mr. Flinn concede that
13 there is no general jurisdiction in this case, and so
14 the question of jurisdiction rises and falls on that
15 2002 certificate of incorporation.

16 THE COURT: Well, there are a few
17 things. He also argues waiver. For example, he
18 argues that the succession motion is either a 12(b)(1)
19 motion or a 12(b)(6) motion.

20 MR. WALSH: I will get to that. But
21 with the corporation --

22 THE COURT: Understood.

23 MR. WALSH: -- I will just finish that
24 thought -- that certificate expired in 2004. There's

1 no question there.

2 So even if jurisdiction was -- even if
3 our personal jurisdiction defense was waived, which we
4 don't think it is -- and I will get to that -- but
5 even if it was waived, with the expiration of that
6 certificate, even assuming it was for Fannie Mae,
7 Fannie Mae has not been a Delaware corporation since
8 2004. So Delaware Section 220 would not apply.

9 Now, there were -- there were some
10 bylaws, Section 1.05, that Mr. Flinn was reading from.
11 And I'm fairly certain he is reading from an older
12 version of the bylaws that is not currently in effect.
13 I have the bylaws from July 21st, 2016, and I will
14 read a couple of sections and perhaps annotate them
15 just to point out some of the differences.

16 First, "Section 1.05, Corporate
17 Governance Practices and Procedures." It says,
18 "Pursuant to Sections 12 C.F.R. 1236 and 1239 of the
19 Federal Housing Finance Agency Regulations" I
20 believe the version Mr. Flinn was reading from had the
21 older regulations, the pre-2015 regulations. I
22 believe those are 1709. This is important because
23 1236 and 1239 have that language about not conferring
24 jurisdiction in them. So the bylaws that are in

1 effect now, and that were in effect at the time of
2 Mr. Pagliara's demand, did not constitute a
3 jurisdictional consent because the regulations they
4 are citing to expressly disavow jurisdictional
5 consent.

6 THE COURT: This is the point with
7 respect to, for example, the Dallas entity; you didn't
8 need to incorporate that language specifically because
9 the statute is incorporated that has the same
10 language?

11 MR. WALSH: That's exactly right, Your
12 Honor.

13 THE COURT: Okay.

14 MR. WALSH: And then it says, "... to
15 the extent not inconsistent with the Charter Act and
16 other Federal law" So I will stop there. The
17 Charter Act says jurisdiction and venue in Washington,
18 D.C., the District of Columbia. And other federal law
19 says that shareholder rights and powers have been
20 transferred to FHFA, which I will get back to. "...
21 to the extent not inconsistent with the Charter Act
22 and other Federal law, rules, and regulations, the
23 corporation has elected to follow the applicable
24 corporate governance practices and procedures of the

1 Delaware ... Corporation Law."

2 Now, I heard Mr. Flinn, I believe,
3 several times say that Section 1.05 said we agree to
4 follow Delaware law, we agree to follow Delaware law.
5 And that's really not what it says. It says follow
6 the applicable corporate governance practices and
7 procedures of the Delaware corporation law.

8 And as I said earlier, imitation is
9 the sincerest form of flattery, and people do follow
10 Delaware law. But it was actually one of Mr. Flinn's
11 law partners at Young Conaway in an Amicus brief in
12 Genuine Auto Parts that put it better than I can. He
13 said, "This Court is highly influential in the
14 development and explication of corporate law.
15 Delaware corporate law 'provides a lingua franca for
16 lawyers,' and the state's 'common law of corporations
17 ... is widely accepted as American [corporate] law.'"
18 So the concept that people copy Delaware and do what
19 Delaware does is one that I'm sure Your Honor is very
20 familiar with, as is the Delaware bar.

21 So there's no agreement to
22 jurisdiction or venue, and there's no agreement to
23 follow Delaware law wholesale. And so what I will get
24 to is even if we waived on jurisdiction, which I don't

1 believe that we did, because FHFA filed a Rule 12
2 motion, Fannie Mae did not -- and FHFA can act on
3 behalf of Fannie Mae -- but here, FHFA is acting to
4 preserve its rights as plaintiff. FHFA is acting on
5 behalf of Mr. Pagliara because Mr. Pagliara is seeking
6 to assert FHFA's rights.

7 THE COURT: What about your friend on
8 the other side's argument that Fannie Mae's brief
9 incorporated by reference all of the arguments in
10 FHFA's succession motion?

11 MR. WALSH: Your Honor, that still is
12 not Fannie Mae's own motion to dismiss. It's simply a
13 procedural necessity to say you can rule on that
14 first. And, again, we didn't believe it was a merits
15 motion. So I think that doesn't waive jurisdiction.
16 But, again, even if it does --

17 THE COURT: Well, wait a minute. Let
18 me just flesh that out for a moment.

19 So you're saying we didn't believe it
20 was a merits motion. But the Pagliara case does say
21 that that's a 12(b)(6) issue, the succession issue. I
22 think my memory there is it was raised as a 12(b)(1)
23 issue. That Court said, "No, this is a 12(b)(6)
24 issue," and it specifically first went through and

1 discussed why it was a 12(b)(6) issue. So what's the
2 basis for "We didn't believe this was a Rule 12
3 motion"?

4 MR. WALSH: Sure, Your Honor. Let me
5 make that a little bit more clear. We did not believe
6 that that's Fannie Mae's Rule 12 motion. We can -- we
7 can say that we adopt and agree with arguments that
8 the agency made. But Fannie Mae's name was not on the
9 papers. So the rest -- we believed that the arguments
10 were articulated correctly. We believed that the
11 arguments were in favor of FHFA. But we -- and we had
12 to say as much. But we did not believe that we were
13 making those arguments as our own. And we weren't,
14 because those are FHFA's specific arguments.
15 Substitution is something that only FHFA can do. The
16 Court could not have granted a motion by Fannie Mae to
17 substitute.

18 THE COURT: Okay.

19 MR. WALSH: So what does that leave us
20 with? It leaves us with a certificate of
21 incorporation that was voided in 2004. Even if the
22 personal jurisdiction argument is waived, Fannie Mae
23 is not a Delaware corporation. And I think the most
24 important thing to consider here is that Pagliara does

1 not have the underlying right to books and records
2 that he is seeking to enforce.

3 And there was a lot made of Perry
4 Capital. I know Mr. Cayne is going to cover it, so I
5 will be very brief. But Perry Capital said that
6 direct claims can't proceed. And Mr. Pagliara's
7 direct claim is proceeding now. But it is a direct
8 claim to enforce a right that he does not have. And
9 Judge Cacheris picked up on that.

10 It would be as if I -- let's say I
11 sued Fannie Mae for breach of contract for failing to
12 deliver a certain bundle of mortgages that I wanted to
13 purchase, but it turns out there was no contract or
14 any sort of agreement between me and Fannie Mae.

15 What Perry Capital says is I can bring
16 that lawsuit, I can bring a direct claim against
17 Fannie Mae for breach of contract. But if there's no
18 contract, I lose. Same here. There's no right. And
19 so he can bring this action, but he loses.

20 Are there any additional questions?

21 THE COURT: No. Thank you.

22 MR. WALSH: Thank you, Your Honor.

23 MR. CAYNE: Your Honor, if I might
24 start with the point made by Mr. Walsh. And I start

1 with it because it's so stunning in its effect and
2 simplicity.

3 Counsel yesterday, as the Court knows,
4 filed a letter with additional items that for some
5 reason they chose to wait until the last minute.
6 Nothing here is new. But -- and we couldn't file a
7 written response. So I do want to emphasize this.
8 The item counsel highlighted, the bylaws of the
9 Federal Home Loan Bank of Dallas, as counsel correctly
10 stated, those bylaws were amended. And the pertinent
11 passage was, Your Honor, nor shall this section, this
12 section of the bylaws, "... cause or be deemed to
13 cause the Bank to become subject to the jurisdiction
14 of any state court with respect to the Bank's
15 corporate governance or indemnification practices or
16 procedures."

17 And counsel suggested, "Well, if
18 Fannie Mae wanted that kind of protection, it should
19 have changed its bylaws." Your Honor, as a matter of
20 law, a matter of standard corporate law, that is
21 incorrect. The passage I just read you was adopted on
22 March 11th, 2016, by the Federal Home Loan Bank in
23 Dallas. And it basically parrots the same provision
24 in the new regulation to which counsel referred, both

1 counsel referred Your Honor, and it just restates the
2 regulation. It is hornbook -- and I hate using that
3 term, Your Honor, but it is hornbook corporate law
4 that a regulation does not have to be adopted in an
5 institution's bylaws for that regulation to be
6 applicable to the institution. So the concession here
7 is counsel has conceded that a statement in the
8 bylaws, which is, for all intents, the same as the
9 statement in the regulation, is effective to bar this
10 Court's jurisdiction as a result of the adoption of
11 Delaware corporate procedures. Because, again, the
12 regulation applies both to the Federal Home Loan Bank
13 of Dallas and equally to Fannie Mae.

14 So, Your Honor, I just start with that
15 point, even though my colleague had already mentioned
16 it, because it is so stunningly dispositive of the
17 entirety of what we are here about today, and it's
18 based on a concession.

19 THE COURT: Well, does that mean that
20 Fannie Mae couldn't waive? Even if you are right
21 about that, does that mean that Fannie Mae could not
22 have waived the personal jurisdiction argument?

23 MR. CAYNE: Your Honor, what we are
24 referring to here -- and there's a fine line between

1 personal jurisdiction and jurisdiction. I read this
2 as subject matter jurisdiction. I'm not reading this
3 as an issue of personal jurisdiction, Your Honor.
4 It's just like 4617(f) and lots of issues about
5 jurisdiction. This is not waivable. This is
6 jurisdiction. Jurisdiction is not waivable. And
7 because of that, that concession is dispositive. All
8 these arguments about "You did it wrong, you did it
9 too late, you didn't do it soon enough" have no
10 applicability, Your Honor, to this language. It is
11 subject matter jurisdiction, plain and simple.

12 Your Honor, as I said in my comments,
13 to move on to another point --

14 THE COURT: Sure.

15 MR. CAYNE: -- plaintiff's complaint
16 reads as a third amendment complaint -- and that's the
17 term we use to refer to these different litigations --
18 challenging the agreement between Treasury and the
19 Federal Home Loan -- excuse me -- the FHFA. And so
20 the first part of the presentation was all about -- I
21 thought I was defending the third amendment itself
22 here. But that reminds me of one point I want to
23 emphasize. It is not only in D.C. that we have
24 prevailed. We have prevailed on third amendment

1 claims and had the entirety of the complaint thrown
2 out in Des Moines, Iowa; in Cedar Rapids, Iowa; in
3 Chicago, Illinois; and in Pikeville, Kentucky. And
4 each of those cases rejected the entirety of the
5 claims advanced. So now we are on appeals to the
6 Eighth Circuit, the Seventh Circuit, and the Sixth
7 Circuit.

8 And there is nothing new here. All
9 the arguments that they want to investigate X, Y, and
10 Z, plaintiffs in all these cases already have enough
11 to think that they have viable cases. The courts
12 haven't agreed about the viability, but those cases
13 are all out there. And for some reason, plaintiffs
14 want to drag the Delaware Chancery Court into
15 adjudicating, at the end of the day, the validity of
16 this agreement between Treasury and FHFA.

17 And I highlight that because the Court
18 asked plaintiff's counsel, my colleague on the other
19 side, "Well, you are dealing with the board of
20 directors. And does this board really have any
21 powers?"

22 He says, "Well, if we can't do that,
23 we can turn this into an investigation of the
24 Department of Treasury or we can turn this into

1 investigation of the FHFA." I'm not sure if he
2 limited it to the FHFA as conservator or the FHFA in
3 all of its authorized capacities, Your Honor.

4 But I would just submit -- and I'm
5 going to go on -- but this proceeding, this books and
6 records proceeding in the Chancery Court of the State
7 of Delaware, is not an appropriate procedure to
8 investigate two federal entities, the Department of
9 Treasury and the independent agency, the FHFA.
10 Because at the end of the day, the conclusion, the
11 final result of the point I was making is that's
12 precisely where you go. Because there is not a board
13 in this case that reports to -- has duties to
14 shareholders. There's a board that reports directly
15 to the conservator. So although they purport to want
16 to investigate the board, in the real world, Your
17 Honor, they want to investigate the federal
18 conservator appointed by Congress to control and
19 administer the operations of Fannie Mae.

20 And the Court asked a question which I
21 believe gets to the heart of the matter, Your Honor.
22 The Court asked my colleague, "Are you saying that
23 direct claims in all instances are not transferred?"

24 And, again, in what I view as another

1 stunning admission/answer/misstatement, he said,
2 "Yes." And then he purported to rely on -- counsel,
3 colleague purported to rely on the Perry decision. In
4 doing that, though, counsel was expanding, by just
5 exponential magnitudes, the meaning of the term
6 "claim."

7 "Claim" is used by the Court in a
8 technical sense. In a legal sense, "claim" is
9 meant -- and Judge Cacheris in Virginia did the same
10 thing -- it's meant to capture a claim for damages.

11 Counsel refers to this case
12 generically as asserting a claim to inspect records.
13 That's not how the D.C. Circuit was using the term
14 "claim." What we have here, as we discussed, is an
15 effort to enforce a right, a power Mr. Pagliara does
16 not possess. And I think -- and I know the Court has
17 read it based on the Court's excellent questions, but
18 I would just highlight -- and I promise I'm almost
19 done, Your Honor -- I would just highlight, Judge
20 Cacheris dealt very well, very succinctly, he answered
21 the Court's question about, "Are you really saying
22 that all -- no direct claims are transferred?"

23 And in Judge Cacheris's opinion, he
24 points out that -- first he said that Mr. Pagliara

1 believes that the interpretation or the determination
2 of whether the claim for books and records is direct
3 or derivative is determinative. But the judge
4 rejected that, and he rejected that for good reasons.
5 And that rejection is fully consistent with Perry
6 Capital.

7 In his decision, Your Honor -- and I
8 believe this is on pages 686 and 687 of the decision.
9 And the decision begins at 203 F.Supp.3d 678. Judge
10 Cacheris says, "The derivative-versus-direct
11 distinction discussed in the cases Pagliara cites,
12 however, has little bearing on the issue in this case.
13 The 'right' at issue in the cases Pagliara cites was
14 the right to bring a claim on behalf of a
15 corporation."

16 And then he continues and concludes
17 with the statement, in this paragraph, "In that
18 context, the derivative-versus-direct distinction is
19 informative, because standing to bring a lawsuit to
20 remedy a personal injury is not easily categorized as
21 a right with respect to the corporation. The present
22 case, however" -- and this is the books and records
23 case in front of him -- "The present case, however,
24 questions whether a stockholder possesses the

1 underlying right" -- and this is something my good
2 friend for Fannie Mae emphasized. Let me start again.
3 "The present case, however, questions whether a
4 stockholder possesses the underlying right that he
5 seeks to enforce through a direct lawsuit. In other
6 words, the issue here is not whether Pagliara may
7 pursue his right through a direct lawsuit, but whether
8 he possesses the right he believes was infringed. The
9 cases Pagliara cites do not bear on that issue."

10 And just as Perry Capital, Your Honor,
11 does not bear on that issue, that question was not
12 before the D.C. Circuit. And this -- if I just may,
13 with the Court's tolerance, just highlight a couple of
14 other passages, because they are directly responsive
15 to the Court's question to my colleague on the other
16 side.

17 THE COURT: And the next paragraph,
18 right, the "Transferring"?

19 MR. CAYNE: Yes. "Transferring the
20 derivative-versus-direct distinction from the context
21 in which it arose" -- and the context in which it
22 arose were damages claims for money held by
23 stockholders. Transferring it "... to a completely
24 different question of whether an underlying right even

1 exists would have obvious adverse implications."
2 Implications which -- implications which my good
3 friend on the other side wishes to avoid.

4 And then he continues, skipping down
5 towards the bottom, "If the Court were to adopt
6 Pagliara's derivative-versus-direct distinction
7 wholesale, the Court must also likely accept that
8 common stockholders continue to possess those other
9 rights enforceable through a ... lawsuit. To read the
10 above list of rights is to understand that a
11 stockholder's exercise of at least some of those
12 rights would directly conflict with HERA's clear
13 intention to transfer as governance -- to transfer as
14 governance authority to FHFA as possible."

15 And I may have left out a word, but
16 I'm not going to go back and correct it, Your Honor.
17 You have, obviously, the passage in front of you.

18 And then the final statement, "That
19 undesirable consequence" -- and Judge Cacheris
20 correctly describes the consequence of counsel's
21 answer as undesirable. "That undesirable consequence
22 supports the Court's conclusion that ...
23 derivative-versus-direct distinction should remain
24 confined to the limited context that fostered its

1 creation, namely inquiries into a stockholder's
2 standing to pursue a claim."

3 And, Your Honor, the statements made
4 by counsel with respect to Judge Sleet's remand order
5 are equally off base and no more helpful to counsel's
6 position and did not accurately answer the Court's
7 question. Because Judge Sleet was doing precisely
8 what the Court suggested. Judge Sleet was finding
9 that he had -- did not have federal-question
10 jurisdiction. Frankly, it's a determination with
11 which we disagree, but that was his determination.

12 The notion that Judge Sleet reached
13 out and decided the issue before Your Honor is wrong,
14 as is reflected by at the end of his lengthy footnote.
15 He -- Judge Sleet says, "As mentioned previously, a
16 federal defense to a state-law cause of action is not
17 enough to establish federal question jurisdiction, and
18 it would be improper to provide the Chancery Court --
19 a court very capable of interpreting federal law -- of
20 its exclusive jurisdiction over Section 220 actions."

21 So Judge Sleet right there, in
22 explicit words, is acknowledging that Your Honor has
23 the question before you; that the question has not
24 been answered by him. And if we took more time to go

1 through the footnote, we would look at the statements
2 made by Judge Sleet were in the context of standing.
3 And he was finding whether there is standing to assert
4 things, and he said, "I take -- for determining
5 standing, I take what's stated in the complaint as
6 true. I take it as accurate." But -- he makes
7 similar statements throughout. But I will just
8 highlight the end. He says in express terms the issue
9 we are all here today debating is left to this
10 Honorable Court. It was not resolved by him, Your
11 Honor.

12 And just a couple of last points.
13 With respect to all these challenges to the board, and
14 they had fiduciary duties, the Court -- counsel
15 ignores also the wording of HERA. Because HERA
16 doesn't say, even if there was a board of directors, a
17 statutory board here, and we have the conservator, it
18 doesn't that the conservator or the agency had duties
19 directly to shareholders and they must be guided
20 exclusively by those duties.

21 What it says in express terms in the
22 context of the conservator is that when the
23 conservator makes a decision what to do, the
24 conservator should look at the best interests of the

1 institution or he can look at the best interests of
2 the agency. It expressly says the conservator can --
3 do I have that right? The conservator can consider
4 the best interests of the agency. And the best
5 interests of the agency, the FHFA, may be precisely
6 the same as the -- those of the shareholders or they
7 might diverge.

8 Because we have to remember that when
9 Congress created this agency, and even the
10 institutions, the goal was not, you know, maximization
11 of shareholder benefits. It was to facilitate a
12 national market for mortgages to allow Americans to
13 become homeowners. And that passage makes it clear
14 that the conservator can consider factors broader than
15 the economic interest of shareholders. It can
16 consider its broad statutory mission.

17 And I'm just making that as another
18 point that all these allegations against a board
19 that -- we don't have a statutory board here, but it
20 just answers the question that whereas under standard
21 Delaware law it may well be that a normal board of a
22 plain vanilla corporation, everything is guided by the
23 interests of the shareholders. What we have here is a
24 much broader inquiry with differing considerations.

1 And I would suggest that to take counsel up on his
2 invitation to apply Delaware law the way he suggests
3 it be applied would cause a direct violation of the
4 fundamental principles of federal law of HERA.

5 Just one last thing, Your Honor, if I
6 might beg the Court's indulgence for a moment. And
7 I'm not going to take up, other than to highlight
8 this, more of the Court's time to debate with counsel
9 the standards for preclusion. But I will just say,
10 and our brief has the answers to it, but there's just
11 no basis for counsel's bizarre suggestion that
12 alternative holdings or alternative conclusions
13 eliminate the possibility of preclusion. Judges often
14 will make a finding, make a conclusion, but reach
15 another one, because, "Well, if I'm wrong, I also come
16 to the same result this way." And there's no basis to
17 argue that that somehow eliminates the legal bar of
18 preclusion.

19 And, Your Honor, I'm done unless the
20 Court has any questions. Thank you for your
21 attention.

22 THE COURT: I do not. Thank you.

23 MR. FLINN: Your Honor, may I have a
24 little bit of follow-up?

1 THE COURT: We need to give the court
2 reporter a break. We have been going for two hours
3 now. So let's take a five-minute break. And when we
4 come back, you will have a very few minutes. And
5 because it's your motion, I will give you the last
6 word, but you will have even fewer minutes than he
7 does.

8 (A brief recess was taken from 11:59
9 a.m. to 12:06 p.m.)

10 MR. FLINN: Thank you, Your Honor. I
11 was able to speed things up on the break, so I will be
12 brief.

13 It sounds like we have got this
14 microphone working now, which means I won't have to
15 yell at people.

16 Your Honor, the bylaws that they
17 reference that first mentioned the 2015 regulations
18 were adopted in July of 2016. That's after the time
19 period that's relevant for personal jurisdiction,
20 which is before the complaint was filed in, I think,
21 January of 2016. It's also after the time period in
22 which the substantive claims that we would be seeking
23 to investigate would have occurred.

24 We disagree with the idea that the

1 mere mention of a statute or -- excuse me -- a
2 regulation could constitute incorporation of that by
3 reference and, therefore, somehow allow them to have
4 the type of provision in their bylaws that, for
5 example, the Federal Home Loan Bank of Dallas had.

6 THE COURT: But ultimately you are
7 saying it doesn't matter because it happened after the
8 complaint was filed.

9 MR. FLINN: Comes too late. Thank you
10 for speeding me along, Your Honor.

11 Mr. Cayne said it's hornbook law that
12 federal regulations that are out there are
13 incorporated by reference into the bylaws of private
14 corporations. That's just not true. It's not true.
15 Federal regulations are not incorporated by reference.
16 They are just not self-executing things. And this one
17 didn't even purport to be. It said, as they have said
18 in their briefs, it doesn't have a jurisdictional
19 effect.

20 If they wanted to actually have the
21 corporation withhold the jurisdictional effect and
22 they wanted to direct that to be the case, the
23 regulation would have needed to have said, "We direct
24 you, as your regulator." By the way, this was done by

1 FHFA in its capacity as regulator, where its powers
2 are like any other regulator, not in its capacity as
3 conservator. They could say, "We direct you to do
4 something."

5 Until it's done by the corporation,
6 it's not part of the private contract with the
7 stockholders. In this case, they didn't even do that,
8 and it certainly didn't get into Fannie Mae's bylaws.
9 So it is a contract.

10 You asked Mr. Cayne whether or not the
11 personal jurisdiction defense is waivable. Of course
12 it's waivable. It's personal jurisdiction. He said,
13 "It's subject matter jurisdiction, so it's not
14 waivable." I don't know what he's talking about, Your
15 Honor. They have made no argument that this Court
16 lacks subject matter jurisdiction.

17 They say Perry Capital did not mean
18 that direct claims may be brought, that it was dealing
19 with this very, very sort of unusual area between
20 derivative claims and direct claims; that's all it
21 means. That is what it means. You have derivative
22 claims. You have direct claims. This is a direct
23 claim. A direct claim may be brought under the
24 succession provision.

1 Perry Capital went on to say that some
2 of the direct claims could not be brought, even though
3 they cleared the succession provision, because they
4 didn't clear the anti-injunction provision. We're in
5 the same situation. So they had direct claims there
6 that sought injunctive relief, and the Court said,
7 "You can -- you may be able to assert that claim under
8 the succession provision, but you cannot assert it
9 under the -- under the anti-injunction provision
10 because it seeks injunctive relief and it would
11 interfere with FHFA's powers."

12 So I submit to you that for purposes
13 of this case, we clear the succession provision, and
14 Perry Capital and the district court's decision are,
15 indeed, inconsistent with the Eastern District of
16 Virginia's decision. And then you get to the question
17 of whether or not there's -- our direct claim that we
18 can bring seeks a relief that's barred by the
19 anti-injunction provision. And on that one, I said
20 our situation is entirely different.

21 This is a piece that was just
22 completely missed by Judge Cacheris, but it wasn't
23 missed on the U.S. Court of Appeals and it wasn't
24 missed by Judge Sleet. And that is that we have a

1 claim that does not seek to restrain or affect the
2 exercise of FHFA's powers. And it's completely
3 different from a voting rights claim, which would do
4 that.

5 Now I'm getting repetitious, so let me
6 move on.

7 So for that reason, reading from the
8 Eastern District of Virginia decision doesn't help,
9 because that was rejected by the D.C. Circuit and by
10 the District of Delaware. The District of Delaware
11 did not claim -- oh, right. They bring the argument,
12 the issue that at the end of Judge Sleet's decision
13 there he wrote that this Court is competent to handle
14 federal issues. That's surely true. But that was
15 dealing with a different issue.

16 So we had -- one argument that we were
17 making was we argued, "We are asserting only a
18 state-law claim. As a state-law claim, whatever they
19 may have to say in the way of federal defenses is for
20 Judge Montgomery-Reeves to decide."

21 And His Honor agreed with us on that.
22 He said, "Yeah, federal defenses the Chancery Court
23 can decide." So long as it's a state-court claim,
24 that's all that mattered.

1 They also made a separate argument,
2 which is a different argument, in which they said that
3 the succession provision bars the stockholder's claim.
4 Therefore, there is complete preemption by means of
5 that federal statute. That was a separate argument.
6 So even though he had said that Your Honor can handle
7 federal defenses, to address that argument he had to
8 address whether or not the succession provision barred
9 the claim. He did address it. He did it after the
10 Eastern District went the other way. He went a
11 different way, following Perry Capital.

12 That's all I have, Your Honor.

13 THE COURT: Thank you.

14 MR. WALSH: Your Honor, very briefly.

15 The bylaws of Fannie Mae can contain
16 language consenting to jurisdiction in Delaware, but
17 they don't. There is no language in the bylaws
18 consenting to jurisdiction in Delaware. There is no
19 language in the bylaws consenting to venue in
20 Delaware. The Charter Act does talk about
21 jurisdiction and venue, and it says that it should be
22 in the District of Columbia. If Fannie Mae wanted to
23 consent to jurisdiction and venue someplace else, it
24 would have said so. The bylaws don't say so.

1 So what are we left with? We are left
2 with Fannie Mae, which is not a Delaware corporation.
3 Because Fannie Mae is not a Delaware corporation,
4 Section 220 does not apply to Fannie Mae. And any
5 inspection right that Pagliara has was transferred to
6 FHFA, and the action he is bringing to enforce them is
7 not -- he should not prevail.

8 Thank you, Your Honor.

9 MR. CAYNE: A single point, Your
10 Honor. And that is, with respect to Judge Sleet's
11 remand decision, I disagree with the characterization
12 of the ruling. But even if it was correct, it's
13 meaningless, Your Honor, because Judge Sleet found he
14 had no jurisdiction. So even if he made rulings that
15 he didn't make, it's beyond overt dicta, it's
16 meaningless. He did not have jurisdiction. That's
17 why he remanded the case.

18 Thank you, Your Honor.

19 THE COURT: Thank you.

20 Thank you all for your arguments. I
21 am going to take the matter under advisement. I do
22 recognize that this is a summary proceeding, which is
23 supposed to be expedited, although it's been around
24 for a year, so I will get back to you as soon as I can

1 on this one.

2 Thank you.

3 (Court adjourned at 12:13 p.m.)

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CERTIFICATE

I, DEBRA A. DONNELLY, Official Court Reporter for the Court of Chancery of the State of Delaware, Registered Merit Reporter, Certified Realtime Reporter, and Delaware Notary Public, do hereby certify the foregoing pages numbered 3 through 93, contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing before the Vice Chancellor of the State of Delaware, on the date therein indicated.

IN WITNESS WHEREOF, I have hereunto set my hand at Wilmington this 17th day of May, 2016.

/s/ Debra A. Donnelly

Debra A. Donnelly
Official Court Reporter
Registered Merit Reporter
Certified Realtime Reporter
Delaware Notary Public