IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

MICHAEL ROP, STEWART KNOEPP, and ALVIN WILSON, Plaintiffs, v. THE FEDERAL HOUSING FINANCE AGENCY, MELVIN L. WATT, in his official capacity as Director of the Federal Housing Finance Agency, and THE DEPARTMENT OF THE TREASURY, Defendants.	Civil Action No. 1:17-cv-00497 Hon. Paul L. Maloney

MEMORANDUM IN SUPPORT OF THE MOTION TO DISMISS BY THE DEPARTMENT OF THE TREASURY

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INTRODUCTION

During and after the financial crisis, the Department of the Treasury ("Treasury") committed hundreds of billions of dollars to ensure the solvency of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, "the GSEs" or "the enterprises"). That commitment eventually became capital infusions of $187.5 billion, with an additional pledged commitment of $258 billion. "That $200 billion-plus lifeline is what saved the [GSEs] – none of the institutional stockholders were willing to infuse that kind of capital during desperate economic times." *Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 613 (D.C. Cir. 2017).

Nevertheless, plaintiffs, shareholders in the enterprises, have filed suit in an effort to overturn the Third Amendment to the Preferred Stock Purchase Agreements (the "Third Amendment") between Treasury and the Federal Housing Finance Agency ("FHFA"), the conservator of the GSEs. *See* Pls.' First Amended Complaint for Declaratory and Injunctive Relief, ECF No. 17 ("Amended Complaint"). That agreement changed the dividend formula on the preferred stock held by Treasury, replacing a fixed dividend with a variable dividend tied to the enterprises' net worth. *See Perry Capital*, 864 F.3d at 612. Plaintiffs object to the agreement based on their belief that without it they would receive dividends, and seek injunctive relief reversing the agreement. They do so, however, not by alleging that the Third Amendment is illegal on its own terms (as many of the suits that precede this one have argued and lost), but instead by alleging that FHFA is unconstitutionally structured, was led by an improperly serving acting director at the time the Third Amendment was executed, and that the Housing and Economic Recovery Act ("HERA") is an unconstitutional delegation of legislative or executive power.

Despite presenting page upon page of allegations questioning the motives underlying the Third Amendment – allegations that numerous other courts have found insufficient to sustain suits against either FHFA or Treasury[1] – plaintiffs identify no legal basis for any claim against Treasury. Fundamentally, plaintiffs fail to connect the legal claims they assert, which attack FHFA's structure and general legal authority, with any actionable conduct by Treasury. These allegations provide no basis upon which to invalidate the Third Amendment because the Acting Director of FHFA entered into the Third Amendment in his capacity as conservator of the enterprises. And plaintiffs do not even allege any illegal conduct on the part of Treasury; in presenting Counts I-V, the Amended Complaint does not even mention Treasury, let alone explain how its conduct is implicated by those counts. In any event, plaintiffs' claims are precluded because they could have been asserted in earlier shareholder suits challenging the Third Amendment; principles of res judicata foreclose this type of endless stream of piecemeal litigation, arising out of the same transaction between the same parties in interest. Plaintiffs' claims are further barred because they are derivative in nature and thus barred by HERA's transfer of shareholder rights provision. The Court should dismiss this suit in its entirety.

BACKGROUND

I. FANNIE MAE AND FREDDIE MAC

Fannie Mae and Freddie Mac are government-sponsored enterprises, chartered by Congress, that provide liquidity to the mortgage market by purchasing residential loans from banks

[1] *See Perry Capital*, 864 F.3d at 598–99 (*affirming in pertinent part Perry Capital v. Lew*, 70 F. Supp. 3d 208, 246 (D.D.C. 2014)); *Collins v. FHFA*, --- F. Supp. 3d ---, 2017 WL 2255564, at 3–4 (S.D. Tex. May 22, 2017), *appeal docketed*, No. 17-20364 (5th Cir. May 30, 2017); *Saxton v. FHFA*, --- F. Supp. 3d ---, 2017 WL 1148279, at *10 (N.D. Iowa Mar. 27, 2017), *appeal docketed*, No. 17-1727 (8th Cir. April 4, 2017); *Roberts v. FHFA*, --- F. Supp. 3d ---, 2017 WL 1049841, at *2 (N.D. Ill. Mar. 20, 2017), *appeal docketed*, No. 17-1880 (7th Cir. April 27, 2017); *Robinson v. FHFA*, 223 F. Supp. 3d 659, at *665-671 (E.D. Ky. 2016), *appeal argued*, No. 16-6680 (6th Cir. July 27, 2017); *Cont'l W. Ins. Co. v. FHFA*, 83 F. Supp. 3d 828, 840 n.6 (S.D. Iowa 2015).

and other lenders, thereby facilitating the ability of lenders to make additional loans. *See* Amended Complaint ¶ 15 ("Am. Compl."). These entities, which own or guarantee trillions of dollars of residential mortgages and mortgage-backed securities, have played a key role in housing finance and the United States economy. *Perry Capital*, 864 F.3d at 599.

"[I]n 2008, the United States economy fell into a severe recession, in large part due to a sharp decline in the national housing market. Fannie Mae and Freddie Mac suffered a precipitous drop in the value of their mortgage portfolios, pushing the Companies to the brink of default." *Id.* In response to the developing financial crisis, in July 2008, Congress passed HERA, Pub. L. No. 110-289, 122 Stat. 2654. Am. Compl. ¶ 20. HERA created FHFA, an independent federal agency, to supervise and regulate Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. 12 U.S.C. § 4501 *et seq.*; Am. Compl. ¶ 20. HERA also granted the Director of FHFA the authority to place Fannie Mae and Freddie Mac in conservatorship or receivership. *See* 12 U.S.C. § 4617(a). FHFA could use this discretionary authority to "be appointed conservator or receiver for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity." 12 U.S.C. § 4617(a)(2). The statute provides that, upon its appointment as the conservator or receiver, FHFA would "immediately succeed to … rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity and the assets of the regulated entity." *Id.* § 4617(b)(2)(A). The statute accords the conservator the power to "operate" and "conduct all business" of the enterprises, *id.* § 4617(b)(2)(B), including the power to take such action as may be "appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity," *id.* § 4617(b)(2)(D), and to "transfer or sell" any of the enterprises' assets or liabilities, *id.* § 4617(b)(2)(G).

HERA also amended the statutory charters of the enterprises to grant the Secretary of the Treasury the authority to purchase "any obligations and other securities" issued by the enterprises "on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine," provided that Treasury and the enterprises reached a "mutual agreement" for such a purchase. *See* 12 U.S.C. § 1719(g)(1)(A) (Fannie Mae); *id.* § 1455(*l*)(1)(A) (Freddie Mac). Treasury was required to determine, prior to exercising this purchase authority, that the purchase was necessary to "provide stability to the financial markets," "prevent disruptions" in mortgage financing, and "protect the taxpayer." *Id.* § 1719(g)(1)(B) (Fannie Mae); *id.* § 1455(*l*)(1)(B) (Freddie Mac). This purchase authority would expire on December 31, 2009, *id.* § 1719(g)(4); *id.*, § 1455(*l*)(4), but the statute expressly recited that Treasury would retain the power to exercise its rights with respect to previously-purchased securities after that sunset date, *id.* § 1719(g)(2)(D); *id.* § 1455(*l*)(2)(D).

II. THE CONSERVATORSHIP OF THE GSES AND TREASURY'S SENIOR PREFERRED STOCK PURCHASE AGREEMENTS WITH THE ENTERPRISES

On September 6, 2008, the Director of FHFA placed Fannie Mae and Freddie Mac into conservatorship. Am. Compl. ¶ 37. In connection with the placement of the enterprises in conservatorship, Treasury used its authority "to promptly invest billions of dollars in Fannie and Freddie to keep them from defaulting. Fannie and Freddie had been 'unable to access [private] capital markets' to shore up their financial condition, 'and the only way they could [raise capital] was with Treasury support.'" *Perry Capital*, 864 F.3d at 601. Treasury entered into Senior Preferred Stock Purchase Agreements (the "PSPAs") with each enterprise, through FHFA. Under the PSPAs, Treasury committed to advance funds to each enterprise for each calendar quarter in which the enterprise's liabilities exceeded its assets, in accordance with generally accepted accounting principles, so as to maintain the solvency (*i.e.*, positive net worth) of the enterprise. If

a draw was needed, FHFA submitted a request to Treasury to allow the enterprise to draw on the funds committed under its PSPA. Treasury would then provide funds sufficient to eliminate any net worth deficit. *See* Ex. A, Fannie Mae PSPA §§ 2.1, 2.2; Freddie Mac PSPA §§ 2.1, 2.2 (cited in, *e.g.*, Am. Compl. ¶¶ 42-47).[2] As of August 2012, Fannie Mae had drawn $116.15 billion and Freddie Mac had drawn $71.34 billion from Treasury. *See* Am. Compl. ¶ 123. Under HERA, both enterprises enter mandatory receivership, and their assets must be liquidated, if they maintain a negative net worth for 60 days. *See* 12 U.S.C. § 4617(a)(4)(A) (FHFA must place the enterprise in receivership if the obligations of the enterprise exceed its assets for 60 calendar days).

In exchange for the capital commitment and infusions that it provided to the enterprises, Treasury received senior preferred stock with a liquidation preference,[3] warrants to purchase 79.9 percent of each enterprise's common stock, and commitment fees. Am. Compl. ¶¶ 45-46, 52; Fannie Mae PSPA §§ 3.1–3.4; Freddie Mac PSPA §§ 3.1–3.4. The face value of the liquidation preference on Treasury's senior preferred stock was $1 billion from each enterprise, and it increased dollar-for-dollar as either Fannie Mae or Freddie Mac drew on its PSPA funding capacity. Fannie Mae PSPA § 3.3; Freddie Mac PSPA § 3.3. Treasury received no additional shares of stock when the enterprises made draws under the PSPAs. *See* Fannie Mae PSPA § 3.1, Freddie Mac PSPA §§ 3.1. Currently, Treasury has a combined liquidation preference of $189.5

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[2] On a motion to dismiss, the Court may consider documents relied upon in the complaint without converting the motion to dismiss into a motion for summary judgment. *See Commercial Money Ctr., Inc. v. Ill. Union Ins. Co.*, 508 F.3d 327, 335–36 (6th Cir. 2007) ("[W]hen a document is referred to in the pleadings and is integral to the claims, it may be considered without converting a motion to dismiss into one for summary judgment.").

[3] A liquidation preference is "[a] preferred shareholder's right, once the corporation is liquidated, to receive a specified distribution before common shareholders receive anything." BLACK'S LAW DICTIONARY 1298 (9th ed. 2009).

billion for the two enterprises. (This reflects approximately $187.5 billion in draws, plus the initial $2 billion in liquidation preference.) *See* Am. Compl. ¶¶ 46, 123.

Treasury also received quarterly dividends on the liquidation preference of its senior preferred stock. Am. Compl. ¶ 47. Prior to the Third Amendment, the GSEs paid dividends at an annual rate of ten percent of their respective liquidation preferences. Ex. B, Fannie Mae Senior Preferred Stock Certificate § 5; Freddie Mac Senior Preferred Stock Certificate § 5 (cited in Am. Compl. ¶¶ 46-47). (The quarterly dividend payment thus amounted to 2.5% of the liquidation preference.) Treasury would provide funds to the enterprises to cure both enterprises' negative net worth, which was caused in part by the payment of dividends to Treasury. *See* Am. Compl. ¶ 70.

The original PSPAs also restricted dividend payments to all shareholders who were subordinate to Treasury in the capital structure. Fannie Mae PSPA § 5.1; Freddie Mac PSPA § 5.1. Under these agreements, the enterprises cannot pay or declare a dividend to subordinate shareholders without the prior written consent of Treasury so long as Treasury's preferred stock is unredeemed. *Id.* Nor can the enterprises "set aside any amount for any such purpose" without the prior written consent of Treasury. *Id.*

The original PSPAs further required the enterprises to pay a periodic commitment fee to Treasury beginning on March 31, 2010. Fannie Mae PSPA §§ 3.1, 3.2; Freddie Mac PSPA §§ 3.1, 3.2. The periodic commitment fee "is intended to fully compensate [Treasury] for the support provided by the ongoing Commitment following December 31, 2009." *Id.* The amount of the fee for this continuing indefinite commitment of taxpayer funds was to be "determined with reference to the market value of the Commitment as then in effect," as mutually agreed between Treasury and the enterprises, in consultation with the Chair of the Federal Reserve. *Id.* Treasury's rights under the PSPAs – senior preferred stock with accompanying dividend rights, warrants to purchase

common stock, and periodic commitment fees – reflected the significant commitment taxpayers had made to the enterprises.

In August 2012, Treasury and FHFA, acting as conservator for the GSEs, entered into the Third Amendment to the PSPAs. Am. Compl. ¶ 84. The amendment eliminated the 10 percent fixed annual dividend in favor of a quarterly variable dividend in the amount (if any) of the GSEs' positive net worth, minus a capital reserve. Ex. C, Third Amendment to Amended and Restated Fannie Mae PSPA, § 3 (Aug. 17, 2012); Third Amendment to Amended and Restated Freddie Mac PSPA, § 3 (Aug. 17, 2012)) (cited in Am. Compl. ¶ 84). If the GSEs have a negative net worth, they pay no dividend. *Id*. Since the execution of the Third Amendment, the enterprises have not drawn funds from Treasury to pay dividends to Treasury. The Third Amendment also suspended the periodic commitment fee that each enterprise would otherwise owe to the taxpayers for the remaining $258 billion in funding available to the GSEs for so long as the variable dividend remains in effect. *Id.*

LEGAL STANDARD

To withstand a motion to dismiss, the amended complaint must contain "enough facts to state a claim to relief that is plausible on its face." *Long v. Insight Commc'ns of Cent. Ohio, LLC*, 804 F.3d 791, 794 (6th Cir. 2015) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). In ruling on the motion to dismiss, the court must take the well-pleaded facts as true but is "not bound to accept as true a legal conclusion couched as a factual allegation." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citation omitted).

ARGUMENT

Plaintiffs' Amended Complaint should be dismissed because it fails to state any claim to relief against Treasury. Even ignoring the disconnect between plaintiffs' claims and any

actionable conduct by Treasury, plaintiffs' separation of powers and Appointments Clause claims provide no basis upon which to invalidate the Third Amendment because in executing that agreement, FHFA acted in its capacity as conservator for the GSEs and did not exercise the executive power.

Additionally, because plaintiffs allege harm to the GSEs as the result of the Third Amendment and seek relief that would benefit the GSEs, their claims are derivative and thus barred for two reasons. First, they assert claims on behalf of the GSEs that could have been asserted in previous suits by GSE shareholders, and as such are precluded from bringing these further claims arising out of the Third Amendment. Second, plaintiffs' derivative claims are barred by HERA's succession of shareholder rights provision, 12 U.S.C. § 4617(b)(2)(A)(i), which provides that FHFA, as conservator or receiver, would "immediately succeed" to "all rights, title, powers, and privileges of the [GSEs], and of any stockholder[]" with respect to the enterprises and their assets. This provision "[plainly transfers [to FHFA the] shareholders' ability to bring derivative suits on behalf of the [GSEs]." *Perry Capital*, 864 F.3d at 623.

I. PLAINTIFFS DO NOT STATE A CLAIM TO RELIEF AGAINST TREASURY

A. The Amended Complaint Does Not Allege That Treasury Has Engaged In Any Actionable Conduct

"A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678. But to survive a motion to dismiss, "a complaint must contain either direct or inferential allegations respecting all the material elements to sustain a recovery under some viable legal theory." *Varljen v. Cleveland Gear Co.*, 250 F.3d 426, 429 (6th Cir. 2001) (internal quotation marks and citation omitted).

In this case, plaintiffs have not pled facts supporting an inference that Treasury is liable

under any of plaintiffs' asserted claims. To be sure, the Amended Complaint is replete with allegations that the Third Amendment harmed the financial interests of the GSEs' shareholders. *See, e.g.*, Am. Compl. ¶ 96 ("The Net Worth Sweep furthered FHFA's goal of enriching the federal government at private shareholders' expense."); ¶ 105 ("The effect of the Net Worth Sweep is thus to force the Companies to operate in perpetuity on the brink of insolvency and to immediately nullify the rights of private shareholders to any return *of* their principal or any return *on* their principal (i.e., in the form of dividends)."). The complaint, however, focuses entirely on the structure and legal authority of FHFA. Plaintiffs do not challenge any aspect of *Treasury*'s structure or authority, or otherwise allege that Treasury's conduct caused them any legal harm.

Tellingly, none of the five counts in the amended complaint even mention Treasury in the operative paragraphs. (This despite the fact that each claim is captioned as supposedly being "against . . . Treasury," *see, e.g.*, Am. Compl. at 62, Claims for Relief, Count I.)

- The first count alleges that, "[b]y making FHFA's head a single Director rather than a multi-member board and eliminating the President's power to remove the Director at will, HERA violates the President's constitutional removal authority." *Id.* ¶ 136. This count does not challenge any action or legal authority applicable to Treasury, which is, in any event, an Executive Branch department headed by a Secretary who serves at the pleasure of the President. 31 U.S.C. § 301(b); *see also* Am. Compl. ¶ 14 (characterizing Treasury as an "executive agency.").
- Count II alleges that HERA violates the separation of powers because FHFA allegedly operates "without any supervision by the President," Am. Compl. ¶ 148, "has no meaningful direction or supervision from Congress," *id.*, and, because of HERA's limitations on judicial review, "courts are powerless to ensure that FHFA

complies with federal law." *Id.* ¶ 149. Again, however, this count relates to oversight of FHFA, not Treasury. Treasury is subject to presidential oversight as an Executive Branch agency, *see* 31 U.S.C. § 301; *see also* Am. Compl. ¶ 14, and its budget is established by annual Congressional appropriations. *See, e.g.*, Consolidated Appropriations Act of 2017, Pub. L. 115-31, 131 Stat. 135, Div. E., Title I.

- Count III alleges that Edward DeMarco's service as acting director of FHFA was unreasonable in duration and thus a violation of the Appointments Clause. Am Compl. ¶¶ 152-61. This count also does not mention Treasury or explain how Treasury is implicated in the challenged conduct. At the time of the Third Amendment, the Secretary of the Treasury was Timothy F. Geithner, who had been confirmed to the position on January 26, 2009. *See, e.g.*, Am. Compl. ¶ 60.[4] Further, the Amended Complaint specifically pleads that Treasury could not direct or control Mr. DeMarco's actions. *See id.* ¶¶ 60-63.

- Count IV alleges that HERA violates the non-delegation doctrine because "nothing in HERA specifies the *ends* to which FHFA should exercise" its authority as conservator, or its authority as the successor to the GSEs' directors, officers, and shareholders. Am Compl. ¶¶ 165-66.[5] This count concerns FHFA's authority as conservator under Section 4617 of HERA; it does not cite, or otherwise discuss, Treasury's authority under HERA, codified at 12 U.S.C. §§ 1455(l) and 1719(g),

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[4] *See also* Timothy F. Geithner https://www.treasury.gov/about/history/Pages/tgeithner.aspx

[5] Plaintiffs appear to be at great pains to avoid arguing that HERA actually created a non-delegation problem. Instead, it is HERA "under the interpretation of the statute that FHFA has successfully advanced in other litigation," Am. Compl. ¶ 165, that gives rise to the problem. We are aware of no precedent holding that federal courts, in construing limitations on their own authority to impose particular remedies, and federal agencies can collectively create an unconstitutional non-delegation.

to invest in securities and other obligations of the GSEs, let alone plausibly allege that Treasury's authority violates the non-delegation doctrine.

- Count V, which alleges HERA has unconstitutionally delegated executive power to a private entity because FHFA, as conservator of the GSEs, is not a governmental actor for constitutional purposes, Am. Compl. ¶¶ 170-177, similarly does not implicate Treasury's authority under HERA. Nor could it; Treasury is indisputably a government actor for constitutional purposes.

Only one allegation in the amended complaint conceivably bears on the central question of whether, in agreeing to the Third Amendment, Treasury engaged in any conduct that satisfies the elements of any legal claim and inflicted concrete legal harm on the plaintiffs. Paragraph 127 alleges that "FHFA's approval of the Net Worth Sweep also authorized" Treasury "to engage in conduct that would have otherwise violated HERA and the Administrative Procedure Act," because Treasury "acted arbitrarily and capriciously" in agreeing to the Third Amendment, and "it violated HERA, which does not permit Treasury to purchase the Companies' securities after 2009." Am. Compl. ¶ 127. But the Amended Complaint does not present any claim under the Administrative Procedure Act, or any claim related to this alleged violation of HERA. In any event, every court to have considered the merits of this kind of claim has concluded that the Third Amendment was not a purchase of securities and was consistent with Treasury's authority under HERA. *See Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 223 (D.D.C. 2014); *see also Roberts v. FHFA*, --- F. Supp. 3d ---, 2017 WL 1049841, at *8 (N.D. Ill. Mar. 20, 2017); *Robinson v. FHFA*, 223 F. Supp. 3d 659, 666–67 (E.D. Ky. 2016).

Plaintiffs have thus not established any legal claim against Treasury. On the contrary, the five counts of their Amended Complaint are focused on conduct by FHFA, and the factual

allegations of the Amended Complaint plead that Treasury and FHFA operate independently of one another, and that Treasury cannot compel action by FHFA. *See* Am. Compl. ¶¶ 60-62. Nothing in the Amended Complaint purports to establish that Treasury is liable for the alleged misconduct of FHFA. Further, nothing in the Amended Complaint purports to establish that Treasury is itself liable for any of the five counts set forth. Thus, any claim that plaintiffs would try to develop would be patently insubstantial. Plaintiffs' amended complaint is clear only with respect to the relief they want the Court to order: Vacating the Third Amendment. *See, e.g.*, *id.* ¶¶ 145, 151, 161, 169, 177. For the reasons explained below, plaintiffs are not entitled to that relief.

B. Plaintiffs' Separation of Powers and Appointments Clause Claims Provide No Basis for Invaliding the Third Amendment

The Third Amendment does not implicate either the separation of powers or the Appointments Clause because the FHFA, as conservator for the GSEs, did not exercise the executive power in agreeing to it.[6]

In agreeing to the Third Amendment, FHFA undertook the "quintessential conservatorship tasks" of "[r]enegotiating dividend agreements, managing heavy debt and other financial obligations, and ensuring ongoing access to vital yet hard-to-come-by capital." *Perry Capital*, 864 F.3d at 607. Such tasks are the hallmarks of a private financial manager. They bear no resemblance to the regulatory activities and enforcement actions that characterize the exercise of Executive power. *See Free Enterprise Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 508 (2010); *Collins v. FHFA*, --- F. Supp. 3d ----, 2017 WL 2255564, at *5 (S.D. Tex. May 22, 2017) (finding that the Third Amendment "was adopted by the FHFA in its capacity as conservator

[6] "The nondelegation doctrine is rooted in the principle of separation of powers that underlies our tripartite system of Government." *Mistretta v. United States*, 488 U.S. 361, 371 (1989); *see also Nat'l Fed'n of Fed. Employees v. United States*, 905 F.2d 400, 404 (D.C. Cir. 1990) (same). Plaintiffs' non-delegation claims are thus appropriately categorized as separation of powers claims.

of Fannie Mae and Freddie Mac, not as an executive enforcing the laws of the United States"). When FHFA acts as conservator, it "merely steps into the shoes of [the GSEs, which are] private corporation[s]." *FHLMC v. Shamoon*, 922 F. Supp. 2d 641, 645 (E.D. Mich. 2013) (citation omitted); *see also Herron v. Fannie Mae*, 861 F.3d 160, 169 (D.C. Cir. 2017) (When "FHFA step[ped] into Fannie Mae's privates shoes[, as conservator] . . . FHFA 'shed its government character and became a private party.'" (quoting *Meridian Invs., Inc. v. FHLMC*, 855 F.3d 573, 579 (4th Cir. 2017))); *United States v. Beszborn*, 21 F.3d 62, 68 (5th Cir. 1994) (noting in a similar context that when the Resolution Trust Corporation acts as a receiver, it "stands in the shoes" of an insolvent financial institution and any actions it takes are "private, non-governmental" in character).

Moreover, viewing FHFA's actions as conservator as non-governmental in nature is in keeping with historical practice. Federal regulators appointed private entities to be conservators and receivers of troubled financial institutions until the advent of the FDIC, and may continue to appoint private entities as receivers for banks that are not insured by FDIC. *See* 12 U.S.C. § 191; 12 C.F.R. § 51.2; *see also* FDIC, *Managing the Crisis: The FDIC and RTC Experience* 212-13 (1998). Similarly, state law generally authorizes the appointment of private entities to serve as receivers for failed banks chartered under state authority. *Id.* at 213-15.

The actions FHFA takes as conservator are not governmental actions. Thus, the President's inability to remove the conservator's top manager except for cause, the fact that the conservator's director served in an acting role[7] at the time of the Third Amendment, and any asserted improper

[7] Indeed, plaintiffs' arguments that HERA unconstitutionally constrains the President's removal power is fundamentally undermined by the fact that at the time of the Third Amendment, FHFA was headed by an Acting Director whose designation as an acting officer was revocable at will by the President. *See* Am. Compl. ¶ 58 (noting that Edward DeMarco served as Acting Director from August 2009 until January 2014); 12 U.S.C. § 4512(f). The for-cause removal restriction that plaintiffs challenge here, 12 U.S.C. § 4512(b)(2), applies by its plain terms only to FHFA's permanent Director, who is "appointed by the

delegation of government authority to FHFA as conservator do not sufficiently impinge on "the functioning of the Executive Branch," *Morrison v. Olson*, 487 U.S. 654, 691 (1988), to run afoul of the Constitution in the ways plaintiffs assert.

Plaintiffs' constitutional claim suffers from an additional infirmity. As a remedy for the alleged separation of powers violation, plaintiffs seek an order vacating the Third Amendment and requiring Treasury to return the dividends it received under the Third Amendment. Am. Compl. at 76. But under plaintiffs' theory, all actions taken by FHFA as conservator would be unlawful, including its agreement to the original Purchase Agreements and the First and Second Amendments. As the D.C. Circuit recognized in *Perry Capital*, the original Purchase Agreements and subsequent amendments rescued the GSEs and continue to provide capital that is essential to their ongoing operation. 864 F.3d at 613. In asking that only the Third Amendment be set aside and unwound, leaving the Purchase Agreements and first two amendments in place, plaintiffs seek to benefit from agency action they now insist is unlawful. Principles of equity do not support such a remedy. *See Lemon v. Kurtzman*, 411 U.S. 192, 200 (1973) ("[I]n constitutional adjudication as elsewhere, equitable remedies are a special blend of what is necessary, what is fair, and what is workable.").

II. CLAIM PRECLUSION BARS ALL COUNTS ASSERTED IN THE AMENDED COMPLAINT

As noted above, plaintiffs are not the first shareholders in the GSEs to bring a lawsuit seeking to set aside the Third Amendment based on the harm it allegedly inflicts on the GSEs. Because the claims they assert are derivative in nature (i.e., they allege harm to the GSEs and seek relief that would flow to the GSEs in the first instance), and could have been asserted in prior derivative suits challenging the Third Amendment, plaintiffs are barred by claim preclusion from

President, by and with the advice and consent of the Senate." No such for-cause removal limitation exists with respect to an Acting Director of the agency.

presenting them here.

The res judicata effect of a federal court judgment is determined by federal law. *J.Z.G. Resources, Inc. v. Shelby Ins. Co.*, 84 F.3d 211, 213 (6th Cir. 1996) (citing Restatement (Second) of Judgments § 87 (1982)). Thus, under federal res judicata principles, "[a] final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were *or could have been* raised in that action." *Rawe v. Liberty Mut. Fire Ins. Co.*, 462 F.3d 521, 528 (6th Cir. 2006) (citation omitted). Specifically, claim preclusion requires: "(1) a final decision on the merits by a court of competent jurisdiction; (2) a subsequent action between the same parties or their privies; (3) an issue in the subsequent action which was litigated or which should have been litigated in the prior action; and (4) an identity of the causes of action." *Id.* (quoting *Kane v. Magna Mixer Co.*, 71 F.3d 555, 560 (6th Cir. 1995)).

Each element is satisfied here. GSE shareholders—often represented by the same coordinating counsel—already have brought prior, unsuccessful derivative actions in federal court seeking to vacate the Third Amendment. Although this suit purports to be brought by different shareholders asserting different causes of action from the prior suits, it likewise asserts derivative claims challenging the same underlying transaction—the Third Amendment. Indeed, much of the Amended Complaint reads precisely like those in the prior actions, and the primary remedy sought—vacating the Third Amendment—is the same. As set forth below, claim preclusion bars plaintiffs' attempts to assert new claims arising from the Third Amendment.

A. Prior Third Amendment Actions Resulted in Final Decisions on the Merits

In two prior Third Amendment cases, federal courts rejected shareholder derivative claims seeking to undo the Third Amendment through injunctive relief. *See Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 228-29 (D.D.C. 2014), *aff'd*, 864 F.3d 591 (D.C. Cir. 2017); *Saxton v. FHFA*,

--- F. Supp. 3d ----, 2017 WL 1148279 at *6-7, *11 (N.D. Iowa 2017), *appeal docketed*, No. 17-1727 (8th Cir. April 4, 2017).[8] *Perry Capital* and *Saxton* represent final decisions on the merits by courts of competent jurisdiction rejecting derivative claims by enterprise shareholders. The first element of claim preclusion accordingly is satisfied.

B. This Action Involves Privies of the Parties to the Prior Actions

Res judicata "do[es] not always require one to have been a party to a judgment in order to be bound by it." *Heike v. Central Mich. Univ. Bd. of Trustees*, 573 F. App'x 476, 481 (6th Cir. 2014). Instead, "there is an exception when 'there is 'privity' between a party to the second case and a party who is bound by the earlier judgment.'" *Id* (citation omitted). Although plaintiffs here were not named parties to the prior Third Amendment cases, they are in privity with their fellow enterprise shareholders because their claims—like those in *Perry Capital* and *Saxton*—are entirely derivative in nature.

"[I]n shareholder derivative actions arising under Fed. R. Civ. P. 23.1, parties and their privies include the corporation and all nonparty shareholders." *Nathan v. Rowan*, 651 F.2d 1223, 1226 (6th Cir. 1981). Indeed, where a second shareholder derivative action follows the resolution of a prior shareholder derivative action, the corporation—and its shareholders—are bound by the judgment in the first case. *See id.*; *see also In re Sonus Networks, Inc. S'holder Deriv. Litig.*, 499 F.3d 47, 64 (1st Cir. 2007) ("[I]f the shareholder can sue on the corporation's behalf, it follows that the corporation is bound by the results of the suit in subsequent litigation, even if different shareholders prosecute the suits."); *Akin v. PAFEC Ltd.*, 991 F.2d 1550, 1560–61 (11th Cir. 1993)

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[8] In *Perry Capital*, the shareholder plaintiffs expressly framed their claims as derivative. 70 F. Supp. 3d at 229. In *Saxton*, while the shareholder plaintiffs took the position their claims were not derivative, the court analyzed them and found them to be derivative. 2017 WL 1148279 at *6-7. The pending appeal in *Saxton* does not lessen its preclusive effect. *See, e.g.*, *Commodities Export Co. v. U.S. Customs Serv.*, 957 F.2d 223, 228 (6th Cir. 1992) ("It is well established that a final trial court judgment operates as *res judicata* while an appeal is pending.").

(because "there is . . . an identity of parties between [initial and subsequent shareholder plaintiffs]" where "the[] claims are derivative in nature," the subsequent shareholder plaintiff is "barred from raising any claim on [the corporation's] behalf logically related to . . . the subject matter of the prior [shareholder] suit").

Here, the claims at issue are derivative. "A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities." *Dole Food Co. v. Patrickson*, 538 U.S. 468, 474 (2003). Thus, legal harms committed against a corporation give rise to claims belonging to the corporation itself, and shareholder suits seeking to enforce those claims are derivative. This principle is reflected in the shareholder standing rule, also known as the derivative injury rule, which prevents shareholders from suing over injuries to the corporation. *Franchise Tax Bd. of California v. Alcan Aluminum Ltd.*, 493 U.S. 331, 336 (1990) ("Related to this principle we think is the so-called shareholder standing rule . . . [T]he rule is a longstanding equitable restriction that generally prohibits shareholders from initiating actions to enforce the rights of the corporation unless the corporation's management has refused to pursue the same action for reasons other than good-faith business judgment."); *see also In re Kaplan*, 143 F.3d 807, 811-12 (3d Cir. 1998) (Alito, J.) ("The derivative injury rule holds that a shareholder (even a shareholder in a closely-held corporation) may not sue for personal injuries that result directly from injuries to the corporation.").

The Sixth Circuit has consistently held that "an action to redress injuries to a corporation . . . cannot be maintained by a stockholder in his own name." *Canderm Pharmacal, Ltd. v. Elder Pharm., Inc.*, 862 F.2d 597, 602-03 (6th Cir. 1988) (citing cases). This result holds "even though in an economic sense real harm may well be sustained as the impact of such wrongful acts bring about reduced earnings, lower salaries, bonuses, injury to general business reputation, *or*

diminution in the value of ownership." *Schaffer v. Universal Rundle Corp.*, 397 F.2d 893, 896 (5th Cir. 1968) (quoting *Martens v. Barrett*, 245 F.2d 844, 846 (5th Cir. 1956)) (emphasis added). Indeed, courts do not regard a decline in the value of stock as a personal injury suffered by the holder of stock: "[A] diminution in the value of corporate stock resulting from some depletion of or injury to corporate assets is a direct injury only to the corporation; it is merely an indirect or incidental injury to an individual shareholder." *Gaff v. Fed. Deposit Ins. Corp.*, 814 F.2d 311, 315 (6th Cir. 1987) (citing *Eagle v. American Tel. & Tel. Co.*, 769 F.2d 541, 545-46 (9th Cir. 1985)).

The determination whether a federal-law claim is direct or derivative is governed by federal law. *See* 7C Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1821 (2017); *cf. Rifkin v. Bear Stearns & Co.*, 248 F.3d 628, 631 (7th Cir. 2001) ("[S]tanding to bring a federal claim in federal court is exclusively a question of federal law."). Where standing turns on the "allocation of governing power within [a] corporation," however, federal law often looks to state-law principles. *Kamen v. Kemper Fin. Servs.*, 500 U.S. 90, 99 (1991). *Starr Int'l Co. v. United States*, 856 F.3d 953, 965-66 (Fed. Cir. 2017) ("federal law dictates" whether a plaintiff has standing to assert federal law claims, but state law "also plays a role").[9]

The principles for distinguishing direct from derivative claims are well-established and consistent across federal and state law. The analysis is governed by two questions: "(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who

[9] "Fannie Mae is governed by its federal charter and federal law. *See* 12 U.S.C. § 1716 *et seq.*; *id.* at § 1451 *et. seq.*; 12 C.F.R. § 1710.10(a). For issues not addressed by the charter or federal law, Fannie Mae may follow applicable corporate law of Delaware so long as that law is not inconsistent with federal law. 12 C.F.R. § 1710.10(b)." *Edwards v. Deloitte & Touche, LLP*, No. 16-21221-CIV, 2017 WL 1291994, at *6 (S.D. Fla. Jan. 18, 2017), *appeal docketed*, No. 17-12852 (11th Cir. June 22, 2017). Freddie Mac, similarly, is governed by its federal charter and federal law, *see* 12 U.S.C. § 1451 *et seq.*, but may follow Virginia corporate law so long as it is not inconsistent with federal law. Virginia has not adopted the *Tooley* test for direct and derivative claims, but also distinguishes between direct injuries to the shareholder and injuries to the corporation. *See Remora Investments, L.L.C. v. Orr*, 277 Va. 316, 324, 673 S.E.2d 845, 848 (2009).

would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004) (en banc). A claim is "direct" when "the duty breached was owed to the stockholder" and the stockholder "can prevail without showing an injury to the corporation." *Id*. 845 at 1039. A claim is "derivative" if the harm to the shareholder is the byproduct of some injury to the corporate body as a whole. *Id*.

With respect to Treasury, plaintiffs ask that the Third Amendment be declared invalid and enjoined, so that future increases in net worth would be retained by the GSEs, and also requests that the dividends Treasury has already received be returned to the GSEs. Am. Compl. Prayer for Relief (c). Such an order would not benefit plaintiffs directly. The relief sought would flow to the GSEs and supposedly make plaintiffs' stock in the GSEs more valuable. Similarly, the harm that plaintiffs allege – the assertedly improper transfer of the GSEs' net worth to Treasury – was suffered by the GSEs. *See, e.g.*, Am. Compl. ¶¶ 96, 105, 129. That the Third Amendment will allegedly cause plaintiffs indirect harm as shareholders, such as a decline in the value of their shares or a reduced likelihood of future dividends or liquidation payouts, does not transform those claims into direct claims. *See, e.g.*, *Potthoff v. Morin*, 245 F.3d 710, 716 (8th Cir. 2001) ("[D]epreciation or destruction of the value of the [shareholder's] stock" is a derivative injury.); *Gaff*, 814 F.2d at 318 ("Gaff primarily claims that his shares in the failed bank became totally worthless as a result of the defendants' conduct. . . . [A] diminution in the value of stock is merely indirect harm to a shareholder and does not bestow upon a shareholder the standing to bring a direct cause of action."); *Tooley*, 845 A.2d 1031, 1037 (Del. 2004) (a claim is derivative where "the *indirect* injury to the stockholders arising out of the harm to the corporation comes about solely by virtue of their stockholdings.").

With respect to FHFA, plaintiffs also seek various forms of injunctive or declaratory relief to rectify the agency's allegedly unconstitutional conduct. *See* Am. Compl. ¶¶ 145, 151 161, 169, 177. Again, however, such relief would not benefit plaintiffs directly. This relief would affect plaintiffs, if at all, only insofar as it affects the GSEs in which they own stock. Nothing in plaintiffs' amended complaint suggests that FHFA, either as regulator or as conservator of the GSEs, has taken any action specific to them; their argument, rather, is that FHFA has mismanaged the conservatorship of the GSEs, and that this has affected them as investors. *Id.* ¶ 144 ("Plaintiffs are suffering ongoing injuries as a result of FHFA's misuse of the Companies' resources and private shareholders' rights"); ¶ 149 ("FHFA has repeatedly abused these restrictions on judicial review by making numerous arbitrary decisions that have gratuitously dissipated the Companies' assets and severely harmed the property interests of the Companies' private shareholders."). Plaintiffs' claims are derivative and thus brought on behalf of the GSEs. *See Edwards*, 2017 WL 1291994, at *7 (holding claims challenging the Third Amendment to be derivative); *Saxton*, 2017 WL 1148279, at *6 (same).

Thus, plaintiffs are in privity with the GSE shareholders that pursued derivative suits in *Perry Capital* and *Saxton*. Indeed, plaintiffs do not allege any injury to them that does not derive from injury the Third Amendment allegedly imposes in the first instance on the corporation. Thus, to the extent plaintiffs disclaim the derivative nature of their suit, they would lack Article III standing. *See, e.g., Taub v. Kentucky*, 842 F.2d 912, 916 (6th Cir. 1988) ("[A]n asserted right to have the Government act in accordance with law is not sufficient, standing alone, to confer jurisdiction on a federal court").[10]

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[10] A host of other courts have similarly rejected shareholder claims in other Third Amendment litigation that are derivative in nature, albeit without expressly addressing whether the claims at issue were derivative. *See Collins v. FHFA*, --- F. Supp. 3d ---, 2017 WL 2255564, at *4 (S.D. Tex. May 22, 2017) (Section 4617(f) barred shareholder claims seeking equitable relief to vacate the Third Amendment), *appeal*

C. The Claims in this Case Should Have Been Litigated in the Prior Actions, And There is Identity of the Causes of Action

The "third and fourth elements of the claim-preclusion test . . . in practice require much the same inquiry: whether the second action seeks remedies 'with respect to all or any part of the transaction, or series of connected transactions, out of which the [first] action arose.'" *Pram Nguyen ex rel. U.S. v. City of Cleveland*, 534 F. App'x 445, 451 (6th Cir. 2013) (unpublished) (quoting Restatement (Second) of Judgments § 24(1)). "If the two claims arise out of the same transaction, they share an 'identity,' and Plaintiff should have raised both in the first suit." *Id.*

In conducting this analysis, federal circuit courts—including the Sixth Circuit—follow the approach set forth in the Restatement (Second) of Judgments, pursuant to which res judicata extinguishes "all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of connected transactions, out of which the action arose." *J.Z.G. Resources*, 84 F.3d at 215 (quoting Restatement (Second) Judgments § 24 (1982)). Here, the relevant transaction is the Third Amendment—its execution unquestionably is the gravamen of the complaints filed to date in all of these cases. And, regardless of the label applied to the various claims, all seek precisely the same remedy—the vacating of the Third Amendment.

Indeed, all five counts in the Amended Complaint seek, first and foremost, to have the Third Amendment vacated. Am. Compl. ¶¶ 145, 151, 161, 169, 177. And Counts III (violation of the Appointments Clause), IV (violation of the nondelegation doctrine), and V (violation of the private nondelegation doctrine) seek no other remedy at all. *See id.* ¶¶ 161, 169, 177. The only

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docketed, No. 17-20364 (5th Cir. May 22, 2017); *Roberts v. FHFA*, --- F. Supp. 3d ---, 2017 WL 1049841 (N.D. Ill. Mar. 20, 2017) (same), *appeal docketed*, No. 17-1880 (7th Cir. April 27, 2017); *Robinson v. FHFA*, 223 F. Supp. 3d 659, 670-71 (E.D. Ky. 2016) (same), *appeal argued*, No. 16-6680 (6th Cir. July 27, 2017); *Cont'l W. Ins. Co. v. FHFA*, 83 F. Supp. 3d 828, 840 n.6 (S.D. Iowa 2015). Because the rulings in *Perry Capital* and *Saxton* are sufficient for purposes of establishing claim preclusion here, there is no need to consider whether the claims asserted in these other prior Third Amendment cases are derivative.

other relief sought anywhere in the Amended Complaint relates to FHFA's structure as an independent agency. But merely seeking additional relief is insufficient. *See Harnett v. Billman*, 800 F.2d 1308, 1314 (4th Cir. 1986) ("Claims may arise out of the same transaction or series of transactions even if they involve different harms or different theories or measures of relief." (citing Restatement (Second) of Judgments § 24 (1982), comment c)).[11]

The Amended Complaint simply asserts new legal theories to challenge the same underlying transaction, but "when applying the transactional approach to claim preclusion," courts "focus on the core of operative facts for the plaintiff's claims and causes of actions, not the legal labels attached to them." *Serna v. Holder*, 559 F. App'x 234, 237 (4th Cir. 2014) (unpublished) (citation and internal quotation marks omitted). Otherwise, "parties [could] frustrate the goals of [claim preclusion] through artful pleading and claim splitting given that [a] single cause of action can manifest itself into an outpouring of different claims, based variously on federal statutes, state statutes, and the common law." *Id.* at 237-38 (citation and internal quotation marks omitted). Accordingly, "[i]f distinct causes of action or legal theories are based on a 'common nucleus of operative facts,' they must be brought in the same suit." *Pram Nguyen*, 534 F. App'x at 451 (quoting *Mich. Bell Tel. Co. v. MCIMetro Access Transmission Servs., Inc.*, 323 F.3d 348, 362 (6th Cir. 2003)). "[T]his rule is intended to promote judicial economy by forcing plaintiffs to raise all claims arising from one event in a single complaint." *Id.*

The causes of action asserted in the Amended Complaint unquestionably could and should have been presented by the shareholder plaintiffs in the prior derivative actions. Nothing of substance has changed since that time, aside from the fact that other federal courts have now

[11] Plaintiffs' prayer for relief underscores this point. Putting aside the type of boilerplate requests that are included at the end of every complaint, three of the four listed requests focus on rescinding the Third Amendment. *See* Am. Compl., Wherefore Clause (a)-(c).

considered and rejected shareholder derivative claims challenging the Third Amendment. "At some point," however, "litigation must come to an end." *Consolidated Television Cable Serv., Inc. v. City of Frankfort*, 857 F.2d 354, 358 (6th Cir. 1988). The doctrine of claim preclusion is designed "to prevent the sort of dribbling of claims from earlier lawsuits to later ones that occurred here." *Serna*, 559 F. App'x at 238-39. Rather than permitting shareholders to attack the same core action in multiple suits under varying legal theories, this Court should apply the doctrine of claim preclusion to dismiss plaintiffs' Amended Complaint.

III. PLAINTIFFS' CLAIMS ARE BARRED BY HERA'S TRANSFER OF SHAREHOLDER-RIGHTS PROVISION

That plaintiffs' claims are derivative in nature creates yet another bar: FHFA as conservator has succeeded to plaintiffs' rights to assert them here. HERA's transfer of shareholder rights provision, 12 U.S.C. § 4617(b)(2)(A)(i), provides that FHFA "shall, as conservator or receiver, and by operation of law, immediately succeed to . . . all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity." The provision "plainly transfers [to FHFA the] shareholders' ability to bring derivative suits." *Perry Capital*, 864 F.3d at 623 (quoting *Kellmer v. Raines*, 674 F.3d 848, 850 (D.C. Cir. 2012)). As discussed above, *supra* Sec. II, plaintiffs' claims are derivative, and thus barred.

That plaintiffs are pursuing constitutional claims makes no difference. Whether a claim is direct or derivative turns on the nature of the plaintiffs' injury and the relief sought; it does not depend on the source of law on which a shareholder plaintiff relies. *See, e.g., Pagan v. Calderon*, 448 F.3d 16, 28-29 (1st Cir. 2006) (shareholders lacked standing to pursue substantive due process and equal protection claims because they had failed to allege that they "sustained a particularized, nonderivative injury" separate from any injury to the corporation); *Duran v. City of Corpus Christi*,

240 F. App'x 639, 642–43 (5th Cir. 2007) (concluding that "only the corporation [had] standing to seek redress" for an alleged First Amendment violation). Here, plaintiffs' claims are constitutional in name only, and they do not actually allege injury or request relief that is connected to any violation of any constitutional right. Because plaintiffs allege injury based on harm to the GSEs and seek relief that will accrue, if at all, first to the GSEs before any individual shareholder, their claims are derivative and barred by the shareholder succession provision.

CONCLUSION

For the reasons stated in the foregoing brief, the Court should dismiss the Amended Complaint.

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Respectfully submitted,

CHAD A. READLER
Acting Assistant Attorney General

ANDREW BYERLY BIRGE
Acting United States Attorney

DIANE KELLEHER
Assistant Branch Director

/s/ *R. Charlie Merritt*
R. CHARLIE MERRITT
Trial Attorney (VA Bar No. 89400)
U.S. Department of Justice
Civil Division, Federal Programs Branch
20 Massachusetts Ave. NW
Washington, DC 20530
(202) 616-8098
robert.c.merritt@usdoj.gov

Counsel for the United States Department of the Treasury