IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA
Civil No. 17-cv-02185 (PJS/HB)

ATIF F. BHATTI, TYLER D. WHITNEY, and MICHAEL F. CARMODY,

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.

MEMORANDUM IN OPPOSITION TO PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT AND IN REPLY SUPPORTING THE DEPARTMENT OF THE TREASURY'S MOTION TO DISMISS

INTRODUCTION

In 2012, the Department of the Treasury ("Treasury") and the Federal Housing Finance Agency ("FHFA"), acting as conservator for Fannie Mae and Freddie Mac (collectively, "the GSEs"), entered into an agreement to amend Preferred Stock Purchase Agreements between Treasury and FHFA (the "Third Amendment"). For years, GSE shareholders have engaged in near constant litigation directly attacking the Third Amendment. Rebuffed by every court to consider these challenges, the shareholders' strategy has shifted, nearly five years after the Third Amendment's execution, to an indirect attack on that amendment through a challenge to FHFA's structure and authority.

This action should be dismissed. Plaintiffs' claims, which are premised on the separation of powers and allocation of sovereign authority amongst co-equal branches of government, provide no basis for invalidating the Third Amendment – FHFA executed it

in its capacity as conservator for the GSEs and thus did not exercise governmental power, executive or otherwise. More fundamentally, plaintiffs fail to allege that Treasury engaged in any actionable conduct. In any event, their claims are derivative, and therefore barred by both claim preclusion (which requires suits arising out of the same transaction or occurrence to be brought together) and the Housing and Economic Recovery Act's ("HERA") shareholder succession provision (which transfers to FHFA as conservator GSE shareholders' right to assert derivative suits).

Accordingly, this case can be resolved (and dismissed) on the Complaint. Should the Court decide this case on the basis of plaintiffs' summary judgment papers, the result is the same. Nothing in those papers suggests that Treasury's structure or operations violate the Constitution, demonstrates that Treasury is responsible for FHFA's alleged violations, or provides any basis for invalidating the Third Amendment. Treasury is entitled to judgment as a matter of law.

I. PLAINTIFFS HAVE CONCEDED THAT THEY HAVE NO CLAIM AGAINST TREASURY

The heart of Treasury's motion to dismiss is that plaintiffs' Complaint does not allege that Treasury itself is liable for any of the five asserted counts. Nonetheless, plaintiffs' summary judgment motion and opposition brief, ECF No. 43 ("Pls.' Mem."), does not argue that Treasury itself violated the separation of powers, the Appointments Clause, or any nondelegation doctrine, or that Treasury in any respect facilitated FHFA's alleged violations. And plaintiffs devote only a footnote to Treasury's primary argument. *See* Pls.' Mem. at 50 n.6.

However, plaintiffs' arguments do not bear on whether they have stated a claim against Treasury, *i.e.*, whether the Complaint alleges that Treasury violated any legal prohibition and caused the plaintiffs concrete legal harm. Treasury need not show that FHFA can "immunize itself," *id*., from applicable constitutional requirements by contracting with Treasury. It is plaintiffs' pleading burden to allege plausibly that *Treasury's* actions violated those constitutional requirements, and without such allegations they cannot state a claim against Treasury. *See Carter v. Hassell*, 316 F. App'x 525, 526 (8th Cir. 2008) (complaint must "contain either direct or inferential allegations respecting all material elements necessary to sustain recovery under some viable legal theory" (citation omitted)). Moreover, Treasury argued (and continues to argue) that it must be dismissed because plaintiffs have failed to state a claim against it. This argument makes clear that Treasury is not a proper party to the claims asserted in this action and was improperly joined.[1]

Plaintiffs' opposition thus does not respond to Treasury's argument and concedes that dismissal is appropriate because the Complaint does not allege any claim against Treasury. *See Graham v. Rosemount, Inc.*, 40 F. Supp. 2d 1093, 1101 (D. Minn. 1999) (plaintiff's failure to respond to argument in motion to dismiss waives the claim to which that argument was directed). The Court should dismiss plaintiffs' claims and enter judgment for Treasury.

[1] Regardless, plaintiffs named Treasury as a defendant and alleged that Treasury is liable to the same extent as FHFA. Irrespective of whether Treasury was properly joined, plaintiffs, having attempted to state claims for relief against Treasury, must allege how Treasury is liable or have these claims dismissed.

II. PLAINTIFFS' CLAIMS DO NOT IMPLICATE THE SEPARATION OF POWERS OR THE APPOINTMENTS CLAUSE

Plaintiffs' constitutional claims fail because they attack the Third Amendment, which was executed by FHFA in its capacity as conservator and did not involve the exercise of executive power. Plaintiffs' attempt to circumvent the well-established rule that conservators are private, non-governmental actors lacks merit.

Plaintiffs argue that the private nature of a conservator's actions is irrelevant because "FHFA acted as regulator when it forced the [GSEs] into conservatorship" and the GSEs "remain subject to oversight by FHFA as regulator." Pls.' Mem. at 18. But plaintiffs challenge only FHFA's agreement to the Third Amendment, and FHFA took that action as conservator, not regulator. *Cf. United States v. Beszborn*, 21 F.3d 62, 68 (5th Cir. 1994) ("It is well settled in the law that the RTC may function in a corporate or regulatory capacity or in a capacity as receiver. The separateness of these dual identities has been well recognized in this circuit and others."). Plaintiffs do not challenge FHFA's appointment as conservator, nor could they now. HERA permits the GSEs to bring suit challenging FHFA's appointment as conservator "within 30 days of such appointment." 12 U.S.C. § 4617(a)(5). Neither the GSEs nor any of their shareholders brought such a suit within the 30-day window. Any challenge to FHFA's appointment as conservator is barred.

Plaintiffs' argument that FHFA's agreement to the Third Amendment was not the act of a private party because the agreement "expropriate[s] Plaintiffs' investments for the benefit of the federal government" is similarly unavailing. Pls.' Mem. at 19. The agreement involved an action that private fiscal managers typically undertake for the

benefit of the financial institutions they oversee—the renegotiation of an institution's financial obligations to its most significant investor. That the GSEs' dividend payments "go to the United States Treasury," *Beszborn*, 21 F.3d at 68, merely reflects Treasury's status as a GSE senior preferred stockholder.[2]

Nor are plaintiffs correct to suggest that FHFA as conservator is a governmental actor because it may take actions that it determines "promote the public interest." Pls.' Mem. at 20. That HERA allows the conservator to consider the impact of its actions on the agency (or the public) does not transform FHFA's actions here into those of the government. Indeed, the GSEs' statutory charters authorize the GSEs to act with certain public purposes in mind, *see* 12 U.S.C. §§ 1451, 1716, but that authority has never been deemed sufficient to render them government actors. *See Herron v. Fannie Mae*, 861 F.3d 160, 167–69 (D.C. Cir. 2017); *Mik v. FHLMC*, 743 F.3d 149, 168 (6th Cir. 2014). Similarly, FHFA's actions here are not governmental merely because Congress directed the conservator of an institution whose continuing viability has been enabled by an infusion of taxpayer money to take into account the interests of the GSEs and the public interest

[2] Similarly, plaintiffs' reliance on *Slattery v. United States*, 583 F.3d 800, 826 (Fed. Cir. 2009), is misplaced. The Federal Circuit emphasized that the FDIC's actions in the case—*i.e.*, its refusal to turn over the monetary surplus it obtained from the liquidation of the seized bank—were "unlike the standard receivership situation in which the receiver is enforcing the rights or defending claims and paying the bills of the seized bank." *Id.* at 827–28. By contrast, FHFA's negotiation of and agreement to the Third Amendment were "quintessential conservatorship tasks." *Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 607 (D.C. Cir. 2017), *petitions for cert. docketed* (Oct. 2017).

represented by the agency.[3] Because the actions FHFA takes as conservator are not governmental actions, plaintiffs' constitutional challenges fail.

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

Regardless, plaintiffs' claims are derivative and thus barred by HERA. Plaintiffs argue that their claims are direct as a matter of federal common law because treating them otherwise would "undermine th[e] important federal constitutional policy" underlying the claims. Pls.' Mem. at 38. But both federal law and applicable Delaware law have long "distinguish[ed] between derivative and direct actions." *Starr Int'l Co. v. United States*, 856 F.3d 953, 966 (Fed. Cir. 2017). Federal common law – which presumptively incorporates state law on issues, like this one, that "affect[] the allocation of governing power within the corporation," *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 100 (1991) – recognizes that whether a plaintiff's federal claim is direct or derivative turns on the nature of the plaintiff's harm and the relief sought. Thus, if plaintiffs are only indirectly affected, as a result of harm to the GSEs, by their alleged constitutional violations, and seek relief that accrues to the GSEs, their claims are derivative. *See Starr Int'l Co.*, 856 F.3d at 966 ("[o]nly 'shareholder[s] with a direct, personal interest in a cause of action,' rather than 'injuries [that] are entirely derivative of their ownership interests' in a

[3] *Perry Capital* concluded that FHFA's actions executing the Third Amendment were "quintessential conservatorship tasks." 864 F.3d at 607. Plaintiffs' reliance on that court's finding that FHFA's conservatorship powers generally exceed those of a common-law conservator, Pls.' Mem. at 20, thus provides no basis for concluding that the specific action challenged here – the conservator's execution of the Third Amendment – was governmental.

corporation, can bring actions directly." (citation omitted)); *Potthoff v. Morin*, 245 F.3d 710, 716 (8th Cir. 2001). Plaintiffs' opposition provides no support for setting aside these well-established principles.

Plaintiffs' claims are derivative because, in arguing that the Third Amendment has decreased the value of their shares, plaintiffs assert no injury and claim no entitlement to relief that would not accrue to the GSEs in the first instance.[4] Plaintiffs try to characterize their claims as direct because the Third Amendment allegedly altered the value of their shares in relation to Treasury's. But such claims for equity dilution are generally treated as derivative, *see, e.g.*, *Feldman v. Cutaia*, 956 A.2d 644, 655 (Del. Ch. 2007), and Delaware law only allows a shareholder to bring a direct claim based on the diversion of share value from one shareholder to another in the narrow circumstance where: "(1) a stockholder having majority or effective control causes the corporation to issue 'excessive' shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling shareholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders." *El Paso Pipeline GP Co. v. Brinckerhoff*, 152 A.3d 1248, 1263 (Del. 2016) (quoting *Gentile v. Rossette*, 906 A.2d 91, 100 (Del. 2006)). Absent allegation that a controlling shareholder extracted voting power from

[4] Plaintiffs' argument that courts are more receptive to characterizing claims as direct when they seek "only injunctive or prospective relief," is undermined by their recognition that "the only way to determine to whom the relief flows is to consider whose injury it remedies," Pls.' Mem. at 40-41. The harm plaintiffs assert flows from alleged harm to the GSEs, the relief they request remedies that harm, and the claims are derivative regardless of whether the remedy sought is damages or injunctive relief.

minority shareholders, and received an "exclusive benefit of increased equity ownership and voting power," *Feldman*, 956 A.2d at 657, the "expropriation" of "solely economic value" does not inflict direct injury. *El Paso Pipeline*, 152 A.3d at 1264.

None of these circumstances are present here. Treasury is not a controlling shareholder, the Third Amendment did not involve the issuance of new shares, and plaintiffs allege no injury to their voting power. Accordingly, plaintiffs' economic dilution claims are derivative. *See Saxton v. FHFA*, 245 F. Supp. 3d 1063, 1072 (N.D. Iowa 2017) (allegations that Third Amendment expropriated the value of shares in the GSEs did not state direct claim "absent additional allegations that [the shareholders'] voting rights have been diluted").[5]

Because plaintiffs' claims are derivative, their contention that their inability to sue "threatens to bar *anyone* from suing to remedy the violations of the separation of powers at issue here," Pls.' Mem. at 39, misses the mark. By definition, their claims assert harm on behalf of the GSEs, not direct, personal injury, and seek recovery that would accrue first to the GSEs. Enforcing traditional limitations on a shareholder's ability to assert such derivative claims does not prevent plaintiffs (or anyone else) from suing to remedy direct, personal harm resulting from the alleged constitutional violations. Indeed, it is fully

[5] In addition to a footnote in an unpublished, non-controlling Delaware Chancery Court opinion addressing a shareholder's right to compel inspection of corporate books and records, plaintiffs cite a Ninth Circuit decision that ultimately concluded that claims for "injury to [the corporation] itself, which ultimately reduced the value of the stock," were derivative. *Pareto v. FDIC*, 139 F.3d 696, 699 (9th Cir. 1998). *See* Pls.' Mem. at 40. Neither case supports plaintiffs' contention that their claims asserting purely economic injury in diluted share value are direct.

consistent with the rule that "[a]ctions to enforce corporate rights or redress injuries to the corporation cannot be maintained by a stockholder in his own name." *Potthoff*, 245 F.3d at 716 (citation omitted). If a party could allege direct and personal harm resulting from FHFA's alleged constitutional violations, as opposed to purely derivative harm resulting from a five-year old transaction which does not even implicate those constitutional theories, that party could seek redress. Because plaintiffs cannot do so, their claims are appropriately treated as derivative and dismissed under HERA's transfer of shareholder rights (or "shareholder succession") provision. *See id.* at 717 (applying shareholder standing rule to bar civil rights claim that did not allege any "direct, nonderivative injury").[6]

Finally, plaintiffs' argument that the Court should create a conflict-of-interest exception to HERA's bar on derivative suits lacks merit. HERA's succession provision by its terms admits of no exceptions, *see Kellmer v. Raines*, 674 F.3d 848, 851 (D.C. Cir. 2012), and, as the D.C. Circuit has recognized, creating a judicial conflict-of-interest exception would be inconsistent with that provision's purpose. *Perry Capital*, 864 F.3d at 625. The two appellate decisions that have recognized a conflict-of-interest exception to FIRREA's analogous provision did so on the ground that a receiver facing a conflict of interest might be "unable or unwilling to [file suit on a corporation's behalf], despite it

[6] Likewise, the Court should reject plaintiffs' argument that the constitutional nature of their claims creates a unique impediment to dismissal. The shareholder standing rule does not turn on the source of law on which a claim is based, and applying the shareholder succession provision here would not "be tantamount to eliminating any judicial forum in which [plaintiffs' claims] could be heard." Pls.' Mem. at 42. It would merely require those claims to be brought by a party capable of demonstrating direct, personal injury, as opposed to derivative harm to the corporation.

being in the best interests of the corporation." *First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279, 1295 (Fed. Cir. 1999); *see also Delta Sav. Bank v. United States*, 265 F.3d 1017, 1021–22 (9th Cir. 2001). Derivative actions have sometimes been permitted to address such concerns, but Congress, through HERA, has precluded such actions. "[I]t makes little sense to base an exception to the rule against derivative suits in the Succession Clause on the purpose of the derivative suit mechanism." *Perry Capital*, 864 F.3d at 625 (internal citation omitted).

Plaintiffs' purported "conflict of interest" is simply that FHFA would have to sue itself to challenge the Third Amendment. By this logic, every FHFA transaction could be challenged by shareholders. Even the two courts that have adopted a conflict-of-interest exception have rejected such a far-reaching rule. *See First Hartford Corp.*, 194 F.3d at 1295; *Delta Sav. Bank*, 265 F.3d at 1023.[7]

IV. PLAINTIFFS' CLAIMS ARE PRECLUDED BY PRIOR DERIVATIVE ACTIONS ARISING OUT OF THE THIRD AMENDMENT

A. The Rulings in *Saxton* and *Perry Capital* Were On The Merits

Plaintiffs' argument that *Perry Capital* and *Saxton* were not decisions on the merits is unavailing; both cases were decided on the basis of substantive statutory provisions foreclosing the derivative claims at issue, not any failure to comply with technical or procedural requirements of bringing suit. Plaintiffs ignore this point, citing preconditions

[7] Plaintiffs' contention that 12 U.S.C. § 4617(a)(5) supports a conflict-of-interest exception is meritless. That Congress granted the GSEs a narrow post-conservatorship right to challenge FHFA's appointment as conservator or receiver within thirty days of that appointment only underscores that the GSEs and their shareholders do not otherwise retain the right to bring suit on the GSEs' behalf during conservatorship.

not analogous to the substantive bars at issue here. *See* Wright & Miller, Fed. Prac. & Proc. § 4437 (citing, *inter alia*, cases involving procedural failures to exhaust administrative remedies, provide notice, and fulfill demand requirements).

It makes no difference that *Saxton* held that the claims were "jurisdictionally barred." *See* Pls.' Mem. at 46 n.5. The *Saxton* court analyzed the substance of plaintiffs' claims and determined that they were barred by HERA's anti-injunction provision because they sought to restrain or affect FHFA's action as conservator. That decision was on the merits, and it bars plaintiffs from litigating new claims premised on the Third Amendment which could have been, but were not, raised in *Saxton*. *See Mizokami Bros. of Ariz., Inc. v. Mobay Chem. Corp.*, 660 F.2d 712, 715 (8th Cir. 1981) (res judicata "encourages reliance on adjudication, bars vexatious litigation, and promotes economy of judicial resources").

B. Plaintiffs Are In Privity With The *Saxton* And *Perry Capital* Plaintiffs

Plaintiffs' privity arguments are in direct conflict with two federal appellate decisions. As plaintiffs acknowledge, the First Circuit has held that subsequent shareholders pursuing derivative claims were in privity with earlier shareholder plaintiffs who had pursued derivative claims, notwithstanding that the earlier claims were dismissed because the shareholders could not show that they should "be permitted to bring suit on behalf of the corporation." *In re Sonus Networks, Inc. S'holder Derivative Litig.*, 499 F.3d 47, 64 (1st Cir. 2007). The Ninth Circuit has similarly rejected a subsequent shareholder's attempt to avoid preclusion by arguing that "he was not in privity with the [earlier shareholder] plaintiffs because they failed to establish derivative standing" and therefore

had "fail[ed] to establish their representative capacity." *Arduini v. Hart*, 774 F.3d 622, 633 (9th Cir. 2014). Plaintiffs cite no contrary authority, but rather suggest, citing *Smith v. Bayer Corp.*, 564 U.S. 299, 314–18 (2011), that treating them as in privity with prior GSE shareholders would violate due process. This argument ignores a critical distinction between class actions—at issue in *Smith*—and derivative suits. Unlike a class representative, the derivative shareholder-plaintiff "is not seeking to enforce an individual right," but is instead "suing on behalf of the corporation," which is the real party in interest in both the earlier and any subsequent derivative suits. Wright & Miller, Fed. Prac. & Proc. § 1840; *see also Lewis v. Chiles*, 719 F.2d 1044, 1048 (9th Cir. 1983).[8]

C. This Suit Arises Out Of The Same Transaction That Gave Rise To The Claims Asserted in *Saxton* and *Perry Capital*

Claim preclusion 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." *Poe v. John Deere Co.*, 695 F.2d 1103, 1106 (8th Cir. 1982) ((quoting Restatement (Second) Judgments § 24(1) (1982))). Although plaintiffs focus on discrepancies between the types of legal claims they assert and those

[8] Plaintiffs attempt to undermine *Sonus* by citing a state trial court decision, *In re Wal-Mart Stores, Inc. Del. Derivative Litig.*, 167 A.3d 513 (Del. Ch. 2017). Pls.' Mem. at 47. But *Wal-Mart's* disagreement with *Sonus* rests on the same incorrect premise "analogiz[ing] stockholder derivative actions to class actions," and is, by the *Wal-Mart* court's concession, contrary to the "current state of the law" that when "a stockholder files a derivative action, he is deemed in most jurisdictions to be in privity with all the other stockholders of the corporation that he purports to represent." 167 A.3d at 524, 528. The *Wal-Mart* decision is currently on appeal before the Delaware Supreme Court. *See Cal. State Teachers' Retirement Sys. v. Alvarez*, No. 295 (Del. 2016).

asserted by previous GSE shareholders, the "legal theories of the two claims are relatively insignificant because 'a litigant cannot attempt to relitigate the same claim under a different legal theory of recovery.'" *United States v. Gurley*, 43 F.3d 1188, 1195 (8th Cir. 1994) (citation omitted)). Regardless of the nature of the claims asserted in two lawsuits, principles of *res judicata* make clear that plaintiffs' current claims are precluded because they and the derivative claims at issue in *Perry Capital* and *Saxton* arise out of the same transaction – the Third Amendment – and seek redress for the same harm allegedly inflicted by that transaction. *See id*. at 1196 (claim preclusion test based on "whether *the wrong for which redress is sought* is the same in both actions" (citation omitted)).

CONCLUSION

For the foregoing reasons, and those stated in Treasury's brief supporting its motion to dismiss, the Court should grant Treasury's motion to dismiss and deny plaintiffs' motion for summary judgment.

Dated: November 16, 2017

Respectfully submitted,

CHAD A. READLER
Acting Assistant Attorney General

GREGORY G. BROOKER
Acting United States Attorney

CRAIG R. BAUNE
Attorney ID No. 331727
600 US Courthouse
300 South Fourth Street
Minneapolis, MN 55415
(612) 664-5600

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

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CERTIFICATE OF COMPLIANCE

The undersigned attorney for the United States certifies this memorandum complies with the type-volume limitation of D. Minn. LR 7.1(f) and the type size limitation of D. Minn. LR 7.1(h). Cumulatively, this memorandum and the memorandum in support of the Department of the Treasury's motion to dismiss contain 9,997 words of type, font size 13. The memorandum was prepared using Microsoft Word 2013, which includes all text, including headings, footnotes and quotations in the word count.

Dated: November 16, 2017

Respectfully submitted,

CHAD A. READLER
Acting Assistant Attorney General

GREGORY G. BROOKER
Acting United States Attorney

CRAIG R. BAUNE
Attorney ID No. 331727
600 US Courthouse

300 South Fourth Street
Minneapolis, MN 55415
(612) 664-5600

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