

UNITED STATES COURT OF FEDERAL CLAIMS

ARWOOD INDEMNITY COMPANY,
ARWOOD SURPLUS LINES
INSURANCE COMPANY, and
FINANCIAL STRUCTURES LIMITED,

Plaintiffs,

v.

THE UNITED STATES OF AMERICA,

Defendant.

Case No. 1:13-cv-00698 MMS

**BRIEF OF PLAINTIFFS ARWOOD INDEMNITY COMPANY,
ARWOOD SURPLUS LINES INSURANCE COMPANY,
AND FINANCIAL STRUCTURES LIMITED
ON THE APPLICATION OF THE *FAIRHOLME* DECISION
TO DEFENDANT’S PENDING MOTION TO DISMISS THIS *ARWOOD* CASE**

Plaintiffs Arrowood Indemnity Company, Arrowood Surplus Lines Insurance Company, and Financial Structures Limited (“the Arrowood Plaintiffs” or “Arrowood”) respectfully submit this brief and the annexed proposed order in response to this Court’s Order of March 30, 2020 (*Arrowood* ECF 64). As requested by the Court, Arrowood sets forth its views on how this Court would decide Defendant’s motion to dismiss Arrowood’s Second Amended Complaint (“*Arrowood* SAC”) (*Arrowood* ECF 44), were this Court to apply the same reasoning that it applied in the *Fairholme* Opinion. (*Fairholme* ECF 462).¹

Applying the reasoning of the *Fairholme* Opinion would result in denying the Government’s motion to dismiss the Arrowood Takings and Illegal Exaction Claims, but

¹ Arrowood agrees with some portions of the *Fairholme* Opinion and respectfully disagrees with other portions. This brief and the attached proposed order are submitted without waiving any rights or arguments (including appellate rights or arguments) concerning the propriety of the reasoning or the result reached in the *Fairholme* Opinion.

granting the Government's motion to dismiss the Arrowood Breach of Fiduciary Duty and Implied-in-Fact Contract Claims.

ARROWOOD COUNT I: TAKINGS

There are two critical differences between the *Arrowood* Takings Claim (*Arrowood* SAC Count I) and *Fairholme's* first Takings Claim (*Fairholme* SAC, Count I) (*Fairholme* ECF 422), which was dismissed in the *Fairholme* Opinion. Even if it was correct to dismiss the *Fairholme* Takings Claim (a decision with which we respectfully disagree), these differences yield a different result; the Government's motion to dismiss the *Arrowood* Takings Claim should be denied.

First, the *Arrowood* SAC makes clear that its Takings Claim is pled as a direct claim and is in substance a direct claim, stating that to the extent the Net Worth Sweep "is authorized by law, the Fifth Amendment compels the Government to pay just compensation *to Plaintiffs* for the taking." (*Arrowood* SAC ¶ 16) (emphasis added). In contrast, the *Fairholme* SAC states that the Government must "pay just compensation *to Plaintiffs and the Companies* for the taking." (*Fairholme* SAC ¶ 16) (emphasis added).

This pleading that the Arrowood Plaintiffs are entitled to any recovery is consistent with their allegation as to who suffered the harm caused by the Net Worth Sweep. The *Arrowood* SAC alleges that, through the Net Worth Sweep,

the federal government took for itself the entire value of the rights held by Plaintiffs and Fannie's and Freddie's other private shareholders by forcing these publicly-traded, shareholder-owned Companies to turn over their entire net worth, less a small capital reserve, to the federal government on a quarterly basis forever—an action the government called the "Net Worth Sweep" and that effectively nationalizes the Companies. ***This action is brought by Plaintiffs,*** holders of non-cumulative preferred stock ("Preferred Stock") issued by Fannie and Freddie ***seeking just compensation for the taking of their property by the United States of America...***

(*Arrowood* SAC ¶ 1) (emphasis added). The *Fairholme* SAC contains a similar allegation, but with one critical difference: The *Fairholme* plaintiffs “seek[] just compensation *for the taking of* their property and *the property of Fannie and Freddie* by the United States of America.”

(*Fairholme* SAC ¶ 1) (emphasis added). As the Court noted in the *Fairholme* Opinion,

the test for whether a shareholder’s claim is derivative or direct depends on the answers to two questions: “(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who 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).

(*Fairholme* Opinion at 39-40). Under the *Tooley* test, the *Arrowood* Takings Claim is pled as a direct claim and is in substance a direct claim because (1) the *Arrowood* Plaintiffs “suffered the alleged harm” and (2) the *Arrowood* Plaintiffs—not Fannie or Freddie, and not any other shareholder—“would receive the benefit of any recovery.”

Second, because the *Arrowood* Plaintiffs purchased their preferred stock before the Net Worth Sweep (*Arrowood* SAC ¶¶ 19-23), they may assert their direct Takings Claim under *First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279 (Fed. Cir. 1999). The *Arrowood* Plaintiffs join in the arguments on this issue in the supplemental brief filed March 26, 2020 by the plaintiffs in *Owl Creek*, who also purchased their shares before the Net Worth Sweep. (*Owl Creek* ECF 57 at 1, 5).

ARROWOOD COUNT II: ILLEGAL EXACTION

Similarly, there are critical differences between *Arrowood’s* Illegal Exaction Claim (*Arrowood* SAC Count II) and *Fairholme’s* first Illegal Exaction Claim (*Fairholme* SAC, Count IV), which was dismissed in the *Fairholme* Opinion. Even if it was correct to dismiss the *Fairholme* Illegal Exaction Claim (a decision with which we respectfully disagree), those

differences similarly compel a different result; the Government’s motion to dismiss Arrowood’s Illegal Exaction Claim should be denied.

The *Arrowood* SAC makes clear that its Illegal Exaction Claim is pled as a direct claim and is in substance a direct claim, stating that “To the extent [the Net Worth Sweep] is not authorized [by law], the Fifth Amendment compels the Government to pay damages *to Plaintiffs* for the illegal exaction.” (*Arrowood* SAC ¶ 16) (emphasis added).² In contrast, the *Fairholme* SAC states that the Government must “pay damages *to Plaintiffs and the Companies* for the illegal exaction.” (*Fairholme* SAC ¶ 16) (emphasis added).³ And, as noted above, the *Arrowood* SAC pleads that “the federal government took for itself *the entire value of the rights held by Plaintiffs*” (*Arrowood* SAC ¶ 1) (emphasis added). That allegation is equally applicable to both the Takings Claim and the Illegal Exaction Claim.⁴

Thus, under the *Tooley* test, the *Arrowood* Illegal Exaction Claim is pled as a direct claim and is in substance a direct claim because (1) the *Arrowood* Plaintiffs “suffered the alleged harm” and (2) the *Arrowood* Plaintiffs—not Fannie or Freddie, and not any other shareholder—“would receive the benefit of any recovery.”

² See also *Arrowood* SAC ¶ 1 (the *Arrowood* Plaintiffs “seek damages for themselves for an illegal exaction”).

³ See also *Fairholme* SAC ¶ 1 (The *Fairholme* Plaintiffs “seek damages for themselves and the Companies for an illegal exaction”).

⁴ *Arrowood* notes that the *Fairholme* Opinion did not address the issue of whether after-the-Sweep purchasers were barred from pursuing a direct claim for illegal exaction. *Fairholme* Opinion at 36 n. 29. Were after-the-Sweep purchasers so barred, *First Hartford*, discussed above, would warrant denial of the Government’s motion to dismiss *Arrowood*’s Illegal Exaction Claim because the *Arrowood* Plaintiffs purchased their stock before the Net Worth Sweep.

ARROWOOD COUNT III: BREACH OF FIDUCIARY DUTY

Applying the reasoning (with which we respectfully disagree) which led this Court to dismiss *Fairholme* Count VII would lead this Court to dismiss *Arrowood* Count III: Breach of Fiduciary Duty.

ARROWOOD COUNT IV: IMPLIED-IN-FACT CONTRACT

Applying the reasoning (with which we respectfully disagree) which led this Court to dismiss *Fairholme* Count X would lead this Court to dismiss *Arrowood* Count IV: Implied-in-Fact Contract.

Respectfully submitted,

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**POTENTIAL ORDER [SUBMITTED BY ARWOOD]
APPLYING FAIRHOLME OPINION TO ARWOOD ACTION**

I. As to Count I (Takings):

- a. The government's motion under *Rule 12(b)(1)* is **DENIED**:
 - i. The claim is against the United States. *See Fairholme Op. § IV(B)*.
 - ii. The claim does not sound in tort. *See Fairholme Op. § IV(D)(2)*.
- b. The government's motion under *Rule 12(b)(6)* is **DENIED**:
 - i. The *Arrowood* Plaintiffs' claim is pleaded as direct, and is direct in substance.
 - ii. Thus, the Second Amended Complaint in *Arrowood* states "To the extent this ongoing expropriation is authorized by law, the Fifth Amendment compels the Government to pay just compensation *to Plaintiffs* for the taking." *Arrowood SAC ¶ 16* (emphasis added). In contrast, the *Fairholme SAC* states that the Government must "pay just compensation *to Plaintiffs and the Companies* for the taking." *Fairholme SAC ¶ 16* (emphasis added). The *Arrowood SAC* pleads that "the federal government took for itself the entire value of the rights held by Plaintiffs" *Arrowood SAC ¶ 1*.
 - iii. Because the *Arrowood* Plaintiffs purchased before the Net Worth Sweep, they have standing under *First Hartford*.
 - iv. Allegations of illegal conduct do not defeat this claim. *See Fairholme Op. § VI(A)*.

II. As to Count II (Illegal Exaction):

- a. The government's motion under *Rule 12(b)(1)* is **DENIED**:
 - i. The claim is against the United States. *See Fairholme Op. § IV(B)*.
 - ii. The claim does not sound in tort. *See Fairholme Op. § IV(D)(2)*.
- a. The government's motion under *Rule 12(b)(6)* is **DENIED**:
 - i. The *Arrowood* Plaintiffs' claim is pleaded as direct, and is direct in substance.
 - ii. The *Arrowood SAC* states "To the extent [this expropriation] is not authorized [by law], the Fifth Amendment compels the Government to pay damages to Plaintiffs for the illegal exaction." *Arrowood SAC ¶ 16* (emphasis added). In contrast, the *Fairholme SAC* states that the Government must "pay damages *to Plaintiffs and the Companies* for the illegal exaction." *Fairholme SAC ¶ 16* (emphasis added). The *Arrowood SAC* pleads that "the federal government took for itself the entire value of the rights held by Plaintiffs" *Arrowood SAC ¶ 1*.
 - iii. Although the Sweep Amendment was not illegal under the Recovery Act, the claim may proceed because the government did not respond to other arguments for why the Sweep Amendment was illegal. *See Fairholme Op. § VI(B)*.

III. As to Count III (Breach of Fiduciary Duty):

- a. The government's motion under *Rule 12(b)(1)* is **GRANTED**, because the claim sounds in tort. *See Fairholme Op. § IV(D)(1)*.
- b. Accordingly, Count III is **DISMISSED** for lack of jurisdiction.

IV. As to Count IV (Breach of Implied-in-Fact Contract Between the U.S. and the Companies):

- a. The government's motion under *Rule 12(b)(1)* is **GRANTED**. The Complaint sufficiently alleges an implied-in-fact contract with the U.S. *See Fairholme Op. § VI(C)*. But it does not sufficiently allege that Plaintiffs are third-party beneficiaries of that contract. *See id. § IV(E)*; *Arrowood SAC ¶¶ 161-170*.
- b. Accordingly, Count IV is **DISMISSED** for lack of jurisdiction.