No. 20-122

In the United States Court of Appeals for the Federal Circuit

FAIRHOLME FUNDS, INC., THE FAIRHOLME FUND, ACADIA INSURANCE COMPANY, ADMIRAL INDEMNITY COMPANY, ADMIRAL INSURANCE COMPANY, BERKLEY INSURANCE COMPANY, BERKLEY REGIONAL INSURANCE COMPANY, CAROLINA CASUALTY INSURANCE COMPANY, CONTINENTAL WESTERN INSURANCE COMPANY, MIDWEST EMPLOYERS CASUALTY INSURANCE COMPANY, NAUTILUS INSURANCE COMPANY, PREFERRED EMPLOYERS INSURANCE COMPANY, AND ANDREW T. BARRETT,

Plaintiffs-Respondents,

v.

THE UNITED STATES,

Defendant-Petitioner.

PLAINTIFFS' ANSWER TO UNITED STATES' PETITION TO APPEAL AN INTERLOCUTORY ORDER OF THE COURT OF FEDERAL CLAIMS DATED MARCH 9, 2020, IN CASE NO. 13-465C, PURSUANT TO 28 U.S.C. § 1292(d)

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FORM 9. Certificate of Interest **Form 9**
Rev. 10/17

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

Fairholme Funds, Inc., et al. **v.** United States

Case No. 20-122

CERTIFICATE OF INTEREST

Counsel for the:
☐ (petitioner) ☐ (appellant) ■ (respondent) ☐ (appellee) ☐ (amicus) ☐ (name of party)

Fairholme Funds, Inc., et al. (see attachment)

certifies the following (use "None" if applicable; use extra sheets if necessary):

1. Full Name of Party Represented by me	2. Name of Real Party in interest (Please only include any real party in interest NOT identified in Question 3) represented by me is:	3. Parent corporations and publicly held companies that own 10% or more of stock in the party
Fairholme Funds, Inc.	None	None
The Fairholme Fund	Fairholme Funds, Inc.	None
Acadia Insurance Company	None	W.R. Berkley Corporation
Admiral Indemnity Company	None	W.R. Berkley Corporation
Admiral Insurance Company	None	W.R. Berkley Corporation
Berkley Insurance Company	None	W.R. Berkley Corporation
(see attachment for additional parties)		

4. The names of all law firms and the partners or associates that appeared for the party or amicus now represented by me in the trial court or agency or are expected to appear in this court **(and who have not or will not enter an appearance in this case)** are:

FORM 9. Certificate of Interest **Form 9 Rev. 10/17**

5. The title and number of any case known to counsel to be pending in this or any other court or agency that will directly affect or be directly affected by this court's decision in the pending appeal. *See* Fed. Cir. R. 47. 4(a)(5) and 47.5(b). (The parties should attach continuation pages as necessary).

Washington Federal v. United States, No. 13-385 (Fed. Cl.); Cacciapalle v. United States, No. 13-466 (Fed. Cl.); Fisher v. United States, No. 13-608 (Fed. Cl.); Arrowood Indem. Co. v. United States, No. 13-698 (Fed. Cl.); Reid v. United States, No. 14-152 (Fed. Cl.); Rafter v. United States, No. 14-740 (Fed. Cl.); Owl Creek Asia I, L.P. v. United States, No. 18-281 (Fed. Cl.); Akanthos Opportunity Master Fund, L.P. v. United States, No. 18-369 (Fed. Cl.); Appaloosa Inv. Ltd. P'ship I v. United States, No. 18-370 (Fed. Cl.); CSS, LLC v. United States, No. 18-371 (Fed. Cl.); Mason Capital L.P. v. United States, No. 18-529 (Fed. Cl.)

4/6/2020
Date

/s/ Charles J. Cooper
Signature of counsel

Please Note: All questions must be answered

Charles J. Cooper
Printed name of counsel

cc: _____

Reset Fields

Certificate of Interest – Additional Parties

Name of Parties, continued:

The Fairholme Fund, Acadia Insurance Company, Admiral Indemnity Company, Admiral Insurance Company, Berkley Insurance Company, Berkley Regional Insurance Company, Carolina Casualty Insurance Company, Continental Western Insurance Company, Midwest Employers Casualty Insurance Company, Nautilus Insurance Company, Preferred Employers Insurance Company, and Andrew T. Barrett

1. Full Name of Party Represented by me	2. Name of Real Party in interest represented by me is:	3. Parent corporations and publicly held companies that own 10% or more of stock in the party
Berkley Regional Insurance Company	None	W.R. Berkley Corporation
Carolina Casualty Insurance Company	None	W.R. Berkley Corporation
Continental Western Insurance Company	None	W.R. Berkley Corporation
Midwest Employers Casualty Insurance Company	None	W.R. Berkley Corporation
Nautilus Insurance Company	None	W.R. Berkley Corporation
Preferred Employers Insurance Company	None	W.R. Berkley Corporation
Andrew T. Barrett	None	None

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ANSWER TO UNITED STATES' PETITION FOR PERMISSION TO APPEAL

Plaintiffs agree with the Government that an immediate appeal of the Court of Federal Claims' ruling on the Government's motion to dismiss would advance the ultimate termination of this litigation, and Plaintiffs have separately petitioned the Court for interlocutory review. *See Fairholme Funds, Inc. v. United States*, No. 20-121 (Fed. Cir. March 19, 2020). In this short answer, Plaintiffs will not burden the Court with a reprisal of the facts and argument presented in Plaintiffs' separate petition. Instead, the purpose of this filing is to alert the Court to recent developments in the trial court that further underscore the need for interlocutory review and to respond briefly to some of the arguments presented in the Government's petition.

I. Recent Developments in the Trial Court Further Underscore the Need for Interlocutory Review.

On the same day that the Government and Plaintiffs filed petitions for interlocutory review in this case, the Court of Federal Claims lifted the stays in several other cases that concern the Net Worth Sweep and directed the parties in those cases to submit supplemental briefs. *See, e.g.*, Order, Doc. 99, *Cacciapalle v. United States*, No. 13-466 (Fed. Cl. March 19, 2020); Order, Doc. 56, *Owl Creek Asia I, L.P. v. United States*, No. 18-281 (Fed. Cl. March 19, 2020). The supplemental briefing will address how to apply the trial court's ruling in this case to the other cases, and it is scheduled to be complete on April 9. Importantly, the plaintiffs in several

of the other cases press only direct claims—claims that appear unlikely to survive under the trial court's reasoning in this case. The Court of Federal Claims' decision to lift the stays in those cases thus raises the prospect that this Court may soon be presented with several appeals as of right that will require it to decide whether direct (but not derivative) shareholder claims challenging the Net Worth Sweep fail as a matter of law.

This development enhances the need for interlocutory review in this case, for interlocutory review is the only mechanism that would enable the Court to rule on the legal viability of *both* the direct and the derivative claims in a single appeal. Plaintiffs respectfully submit that rendering a single decision on the legal merits of both sets of claims would facilitate the correct resolution of some of the key issues in this litigation because the direct and derivative shareholder claims are obviously interrelated in important respects.

More broadly, it would make little sense for the Court to rule on the viability of the direct claims without simultaneously deciding whether the derivative claims may go forward. As a practical matter, denying the petitions in this case while hearing appeals that concern only direct claims would mean ruling on the legal issues in the Net Worth Sweep litigation in precisely the sort of piecemeal fashion that the final judgment rule is intended to prevent. Thus, to the extent the trial court enters

final judgment in some of the other Net Worth Sweep cases, that will only increase the need for interlocutory review in this case.

II. The Government's Arguments for Dismissal of Plaintiffs' Derivative Claims Lack Merit.

As noted, Plaintiffs believe that both their petition and the Government's petition should be granted, as the case for interlocutory review of the trial court's entire decision on the Government's motion to dismiss is a compelling one. Our agreement with the Government that its petition should be granted, however, should not be taken as agreement with the Government's characterization of Plaintiffs' claims or the Court of Federal Claims' decision allowing the derivative claims to proceed. Plaintiffs will comprehensively present their position on the issues in merits briefing if the Court grants the petitions for interlocutory review, but below Plaintiffs offer a short response to the arguments in the Government's petition so that the Court may more fully understand the issues that the parties would brief if the petitions are granted.

A. Parts of the Government's petition create the misimpression that Fannie and Freddie would have failed without the federal government's help—both when the Net Worth Sweep was imposed in 2012 and when the original Preferred Stock Purchase Agreements were signed in 2008. The Government's made-for-litigation narrative contradicts the well-pleaded allegations in the operative complaint, which

both the Court of Federal Claims and this Court must take as true at this stage of the litigation.

Regarding 2012, the Government asserts that the Net Worth Sweep was needed to "end[ ] the cycle of the enterprises paying dividends by drawing on Treasury's commitment." Pet. to Appeal Interlocutory Order at 7 (March 19, 2020) ("Gov't Pet"). But the dividends the Companies owed under the original arrangement never threatened to exhaust Treasury's funding commitment; as the Government's own documents repeatedly acknowledge, the Companies could end the supposed "cycle" at any time by simply declining to declare cash dividends on Treasury's stock. *See* Second Am. Compl., Doc. 422 ¶¶ 77–79 (Fed. Cl. Oct. 2, 2018).

More importantly, the most senior federal officials involved in imposing the Net Worth Sweep knew and discussed the fact that, by the summer of 2012, the Companies were poised to report the largest earnings in their history—earnings that guaranteed they would be able to pay 10% cash dividends on Treasury's stock long into the future. As the operative complaint notes, among the documents the Government produced in discovery in this case is a memorandum that summarizes a conversation between FHFA's acting director and the Secretary of the Treasury less than eight weeks before the Net Worth Sweep was announced. During that conversation, FHFA's acting director said that Fannie and Freddie would "be generating large revenues over the coming years, thereby enabling them to pay the 10% annual dividend

well into the future." Second Am. Compl. ¶ 142. A few weeks later, Fannie's Chief Financial Officer told other senior Treasury officials that her company would soon reverse earlier write-downs of assets and that this accounting adjustment would immediately increase Fannie's net worth by approximately $50 billion. *Id.* ¶ 102. In the face of these and the other facts detailed in the complaint, the Government cannot credibly argue that it imposed the Net Worth Sweep out of genuine concern that under the prior arrangement the Companies would exhaust Treasury's funding commitment by making draws to pay dividends on Treasury's stock.

With respect to 2008, the Government argues that it is implausible for Plaintiffs to allege that federal officials made any promises about how the Companies would be managed in exchange for their boards' agreement to conservatorship. Without citing any evidence, the Government says that it could have "place[d] the enterprises in conservatorship without the boards' consent." Gov't Pet. 22. But less than three weeks before the conservatorships began, FHFA sent both Companies letters saying that they were adequately capitalized—letters that no doubt would have been the centerpiece of protracted litigation if the Companies had decided to fight the federal takeover. Second Am. Compl. ¶ 45. And although the Companies reported substantial losses in the quarters that followed, those losses were driven by accounting decisions made under FHFA's control that generated paper losses that were later reversed. *Id.* ¶¶ 85–87, 97–99. Financial institutions that were more

distressed than Fannie and Freddie but that remained under private control throughout the crisis did not make similar accounting decisions. *Id.* ¶ 88. In sum, contrary to the arguments in the Government's petition, it is doubtful that in 2008 regulators could have forced Fannie and Freddie into conservatorship without their consent, and the Government had compelling reasons to prefer avoiding litigation over this issue.

B. The Court of Federal Claims held that Plaintiffs may sue derivatively notwithstanding the Succession Clause, 12 U.S.C. § 4617(b)(2)(B), because FHFA faces a conflict of interest when deciding whether to sue itself. The trial court thought itself bound to reach this conclusion by *First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279 (Fed. Cir. 1999). In that case, this Court interpreted a materially identical statute on which the Succession Clause was modeled to include a conflict-of-interest exception to the general prohibition on shareholder derivative suits during conservatorship.

The Government does not ask this Court to review the trial court's ruling on the Succession Clause en banc, and *First Hartford* is no less binding precedent for a three-judge panel of this Court than it was for the Court of Federal Claims. Thus, the critical question for present purposes is not whether *First Hartford* is right but whether it can be distinguished. In attempting to distinguish *First Hartford*, the Government first argues that the case's "reasoning about [12 U.S.C. § 1821(d)(2)(A)]

cannot properly be extended to [12 U.S.C. § 4617(b)(2)(B)]." Gov't Pet. 17. But the text of the former provision, interpreted by this Court in *First Hartford*, is in all material respects identical to the latter. The Succession Clause was modeled on the statutory text this Court interpreted in *First Hartford*, and Congress plainly expected the two provisions to be interpreted in the same way. Indeed, in enacting the Succession Clause after this Court's ruling in *First Hartford*, Congress should be understood to have ratified this Court's interpretation. *See Bragdon v. Abbott*, 524 U.S. 624, 645 (1998) ("When administrative and judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its administrative and judicial interpretations as well.").

The Government also argues that *First Hartford* is distinguishable because it concerned conduct that occurred "before the relevant federal regulator was appointed receiver." Gov't Pet. 18. Although the Seventh Circuit embraced this argument in *Roberts v. FHFA*, 889 F.3d 397, 409 (7th Cir. 2018), it rests on a highly strained reading of this Court's decision. The question under *First Hartford* is whether the conservator faces a conflict of interest in deciding whether to pursue a claim on the financial institution's behalf—not when the claim arose.

This is not the place for a full exposition of Plaintiffs' arguments concerning the Succession Clause—arguments based upon not only this Court's precedent but

also statutory text, due process, and constitutional avoidance. *See* Pls.' Omnibus Resp. To Def.'s Mot. To Dismiss, Doc. 428 at 27–29 (Fed. Cl. Nov. 2, 2018) ("MTD Opp'n"). Although Plaintiffs do not disagree with the Government that there are grounds for a difference of opinion on this issue and that it is the proper subject for an interlocutory appeal, Plaintiffs also submit that they have the better of the argument.

C. The Court of Federal Claims ruled that the Net Worth Sweep is attributable to the Government for purposes of the Tucker Act because, unlike when FHFA acts as receiver, when FHFA acts as conservator it does not assume the obligations of the financial institution under its care and thus retains its distinct, governmental identity. Am. Order, Doc. 462 at 24 (March 9, 2020) ("MTD Order"), Gov't Pet. Appx58–59 (discussing *Sisti v. FHFA*, 324 F. Supp. 3d 273, 282–83 (D.R.I. 2018)). The Government says that the trial court "failed to explain why this supposed distinction between conservators and receivers" should make a difference, Gov't Pet. 20–21, but that is not correct. A receiver "'step[s] into the shoes' of the entity by assuming the fiduciary duties <u>of</u> the entity, but the conservator does not: it remains distinct, and rather owes a duty <u>to</u> the entity." MTD Order 24, Gov't Pet. Appx.58. Although this

reasoning conflicts with dicta in *Herron v. Fannie Mae*, 861 F.3d 160, 169 (D.C. Cir. 2017),[1] it is correct and ought to be affirmed.

Furthermore, wholly apart from the basis upon which the trial court ruled that the Net Worth Sweep is attributable to the Government, there are several persuasive alternative grounds for affirmance. In *Slattery v. United States*, 583 F.3d 800, 826–29 (Fed. Cir. 2009), for example, this Court explained that "whether the FDIC as receiver is 'the government' depends on the context of the claim" and held that the FDIC as receiver could be sued under the Tucker Act for a taking when it retained a failed bank's liquidation surplus for the Government rather than distributing the surplus to shareholders. The receiver's decision to expropriate shareholders' property made *Slattery* "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. Applying the same analysis to this case, the expropriative nature of FHFA's decision to impose the Net Worth Sweep makes FHFA's actions attributable to the Government. Notably, the en banc Fifth Circuit relied heavily upon this Court's decision in *Slattery* when it recently held that shareholders complaining

[1] The Government is wrong when it says that the trial court's reasoning conflicts with the Sixth Circuit's unpublished decision in *Federal Home Loan Mortgage Corporation v. Gaines*, 589 F. App'x 314, 316 (6th Cir. 2014). *Gaines* held that conservatorship does not transform Freddie Mac into a state actor; it did not address whether during conservatorship FHFA retains a governmental identity that is distinct from that of Fannie and Freddie.

about the Net Worth Sweep could sue FHFA for violating the separation of powers. *Collins v. Mnuchin*, 938 F.3d 553, 590 (5th Cir. 2019) (en banc) (following *Slattery* and observing that when FHFA imposed the Net Worth Sweep it was "a federal agency, empowered by a federal statute, enriching the federal government").

This Court has also recognized that "the government may be liable" for a taking when it acts through a private third party if the third party acts "as the government's agent" or under governmental influence that is "coercive rather than merely persuasive." *A&D Auto Sales, Inc. v. United States*, 748 F.3d 1142, 1154 (Fed. Cir. 2014). Unlike the FDIC in the *Winstar* litigation, FHFA does not maintain a firewall that separates its regulatory and conservatorship operations. *See Pls. in All Winstar-Related Cases v. United States*, 44 Fed. Cl. 3, 7 (1999). In imposing the Net Worth Sweep, the conservator was subject to undue influence by both FHFA as regulator and the Treasury Department. Second Am. Compl. ¶¶ 63, 119, 135, 146–147. It follows that the Net Worth Sweep is legally attributable to the Government.

For these reasons and others outlined in Plaintiffs' briefing below, the Court of Federal Claims was correct to hold that it had jurisdiction over Plaintiffs' claims. *See* MTD Opp'n 10–21.

CONCLUSION

The Court should grant the petitions for leave to file interlocutory appeals.

Dated: April 6, 2020

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

The undersigned attorney certifies that this answer complies with the length limitation set forth in FED. R. APP. P. 5(c) and 32(c)(2) because it contains 2,431 words, excluding those parts of the petition exempted by FED. R. APP. P. 5(c) and 32(f). The undersigned attorney further certifies that the petition complies with the typeface requirements of FED. R. APP. P. 32(a)(6) because this petition has been prepared in a proportionally spaced typeface, Times New Roman, 14-point font, using Microsoft Word.

Dated: April 6, 2020

/s/Charles J. Cooper
Charles J. Cooper

Counsel for Plaintiffs-Respondents

CERTIFICATE OF SERVICE

I hereby certify that on April 6, 2020, I filed the foregoing answer with the United States Court of Appeals for the Federal Circuit using the appellate CM/ECF system. I further certify that, consistent with an agreement between the parties, on April 6, 2020, I caused copies of the answer to be served on the following counsel for the United States by electronic mail:

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U.S. DEPT. OF JUSTICE

/s/Charles J. Cooper
Charles J. Cooper