

**2020-2020**

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**IN THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT**

ARROWOOD INDEMNITY COMPANY, ARROWOOD SURPLUS LINES  
INSURANCE COMPANY, AND FINANCIAL STRUCTURES LIMITED,

*Plaintiffs-Appellants,*

-against-

UNITED STATES,

*Defendant-Appellee.*

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On Appeal from a Final Judgment of the United States Court of Federal Claims  
Case No. 1:13-cv-00698-MMS (Hon. Margaret M. Sweeney, Chief Judge)

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**SUPPLEMENTAL OPENING BRIEF OF PLAINTIFFS-APPELLANTS  
ARROWOOD INDEMNITY COMPANY, ARROWOOD SURPLUS LINES  
INSURANCE COMPANY, AND FINANCIAL STRUCTURES LIMITED**

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October 23, 2020

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**UNITED STATES COURT OF APPEALS  
FOR THE FEDERAL CIRCUIT**

**CERTIFICATE OF INTEREST**

**Case Number** 20-2020  
**Short Case Caption** Arrowood Indemnity Company v. US  
**Filing Party/Entity** Arrowood Indemnity Company, Arrowood Surplus Lines Insurance Company, Financial Structures Limited

**Instructions:** Complete each section of the form. In answering items 2 and 3, be specific as to which represented entities the answers apply; lack of specificity may result in non-compliance. **Please enter only one item per box; attach additional pages as needed and check the relevant box.** Counsel must immediately file an amended Certificate of Interest if information changes. Fed. Cir. R. 47.4(b).

I certify the following information and any attached sheets are accurate and complete to the best of my knowledge.

Date: 10/23/2020

Signature: /s/ Richard M. Zuckerman

Name: Richard M. Zuckerman

<b>1. Represented Entities.</b> Fed. Cir. R. 47.4(a)(1).	<b>2. Real Party in Interest.</b> Fed. Cir. R. 47.4(a)(2).	<b>3. Parent Corporations and Stockholders.</b> Fed. Cir. R. 47.4(a)(3).
Provide the full names of all entities represented by undersigned counsel in this case.	Provide the full names of all real parties in interest for the entities. Do not list the real parties if they are the same as the entities.	Provide the full names of all parent corporations for the entities and all publicly held companies that own 10% or more stock in the entities.
<input type="checkbox"/> None/Not Applicable	<input type="checkbox"/> None/Not Applicable	<input type="checkbox"/> None/Not Applicable
Arrowood Indemnity Company	Not Applicable	Arrowpoint Group, Inc.
"	"	Arrowpoint Capital Corp.
Arrowood Surplus Lines Insurance Company	Arrowood Indemnity Company	Transverse Insurance Group LLC
Financial Structures Limited	Not Applicable	Arrowood Indemnity Company

Additional pages attached

**4. Legal Representatives.** List all law firms, partners, and associates that (a) appeared for the entities in the originating court or agency or (b) are expected to appear in this court for the entities. Do not include those who have already entered an appearance in this court. Fed. Cir. R. 47.4(a)(4).

None/Not Applicable  Additional pages attached

Michael H. Barr	Sandra D. Hauser	Drew W. Marrocco
Kiran Patel		

**5. Related Cases.** Provide the case titles and numbers of any case known to be pending in this court or any other court or agency that will directly affect or be directly affected by this court's decision in the pending appeal. Do not include the originating case number(s) for this case. Fed. Cir. R. 47.4(a)(5). See also Fed. Cir. R. 47.5(b).

None/Not Applicable  Additional pages attached

Washington Fed. v. US, 13-385C (Fed. Cl.)	Fisher v. US, 13-608C (Fed. Cl.), 20-138 (Fed. Cir.)	Fairholme Funds v. US, 13-465C (Fed. Cl.), 20-1912, 1914 (Fed. Cir.)
Cacciapalle v. US, 13-466C (Fed. Cl.), on appeal, awaiting docketing (Fed. Cir.)	Reid v. US, 14-152C (Fed. Cl.), 20-139 (Fed. Cir.)	Rafter v. US, 14-740C (Fed. Cl.)
Owl Creek v. US, 18-281C (Fed. Cl.), 20-1934 (Fed. Cir.)	Akanthos Opp. v. US, 18-369C (Fed. Cl.), 20-1938 (Fed. Cir.)	Appaloosa Inv. v. US, 18-370C (Fed. Cl.), 20-1954 (Fed. Cir.)

**6. Organizational Victims and Bankruptcy Cases.** Provide any information required under Fed. R. App. P. 26.1(b) (organizational victims in criminal cases) and 26.1(c) (bankruptcy case debtors and trustees). Fed. Cir. R. 47.4(a)(6).

None/Not Applicable  Additional pages attached


**UNITED STATES COURT OF APPEALS  
FOR THE FEDERAL CIRCUIT**

**Attachment to Certificate of Interest**

**Case No. 20-2020**

**Short Case Caption: Arrowood Indemnity Company v. US**

**Filing Parties: Arrowood Indemnity Company, Arrowood Surplus Lines  
Insurance Company, Financial Structures Limited**

**5. Related Cases (cont'd)**

*CSS LLC v US*, 18-371C (Fed. Cl.), 20-1955 (Fed. Cir.)

*Mason Capital LP v. US*, 18-529C (Fed. Cl.), 20-1936 (Fed. Cir.)

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### STATEMENT OF RELATED CASES

(a) No other appeal in or from this civil action, *Arrowood Indemnity v. United States*, 13-698C (Fed. Cl.), 20-2020 (Fed. Cir.) was previously before this or any other appellate court.

(b) The following are “related cases” under Rule 47.5, pending in this Court: *Fairholme Funds, Inc. v. U.S.*, Nos. 20-1912 & -1914; *Owl Creek Asia I, L.P. v. U.S.*, No. 20-1934; *Mason Capital L.P. v. U.S.*, No. 20-1936; *Akanthos Opportunity Fund L.P. v. U.S.*, No. 20-1938; *Appaloosa Investment Limited Partnership I v. U.S.*, No. 20-1954; *CSS, LLC v. U.S.*, No. 20-1955 (*Owl Creek, Mason, Akanthos, Appaloosa*, and *CSS* are, together, the “*Owl Creek Actions*”); *Arrowood Indemnity Company v. U.S.*, No. 20-2020; *Cacciapalle v. U.S.*, No. 20-2037; and *Washington Federal v. U.S.*, No. 20-2190. These appeals are designated as companion cases, to be assigned to the same merits panel.

(c) The following are “related cases,” under Rule 47.5, pending in the Court of Federal Claims: *Fisher v. U.S.*, No. 13-608C, *pet. to appeal denied*, No. 20-138 (Fed. Cir.); *Reid v. U.S.*, No. 14-152C, *pet. to appeal denied*, No. 20-139 (Fed. Cir.); *Rafter v. U.S.*, No. 14-740C.

### JURISDICTIONAL STATEMENT

(a) The United States Court of Federal Claims (the “Court of Federal Claims”) had subject matter jurisdiction under 28 U.S.C. § 1491(a)(1) (the “Tucker

Act”).

(b) This Court has jurisdiction under 28 U.S.C. § 1295(a)(3).

(c) The Opinion and Order of the Court of Federal Claims granting the United States’ motion to dismiss the Complaint was entered May 15, 2020. Appx209-242. It is reported at *Arrowood Indem. Co. v. United States*, 148 Fed. Cl. 299 (2020). Final Judgment was entered in the Court of Federal Claims on May 15, 2020. Appx289. Notice of Appeal was filed in the Court of Federal Claims on June 29, 2020, which was within 60 days of the entry of Final Judgment. 28 U.S.C. § 2107(b)(1). Appx383-384.

(d) This is an appeal from a Final Judgment that disposes of all parties’ claims. Appx289.

**THIS SUPPLEMENTAL OPENING BRIEF**

Pursuant to this Court’s Order entered October 5, 2020:

(a) Plaintiffs-Appellants in this appeal, No. 20-2020, and all of the other appeals listed under related cases in this Court (except *Washington-Federal*, 20-2190) are filing a Joint Principal Opening Brief (the “Joint Brief”); and

(b) This Supplemental Opening Brief is filed by Arrowood Indemnity Company (“Arrowood Indemnity”), Arrowood Surplus Lines Insurance Company (“Arrowood Surplus Lines”), and Financial Structures Limited (“FSL”), Plaintiffs-Appellants in No. 20-2020.

## STATEMENT OF ISSUES PRESENTED FOR REVIEW

The issues presented for review are set forth in the Joint Brief.

### SUPPLEMENTAL STATEMENT OF THE CASE

#### A. Arrowood

Arrowood Indemnity, Arrowood Surplus Lines, and FSL (collectively, “Arrowood”) were, until early 2020, affiliated insurance companies, each of which was in “run-off.” Appx217-218, 736-737. Arrowood Indemnity and FSL continue to be affiliated companies in run-off. Insurance companies in run-off do not issue any new insurance policies, and have an obligation to manage their businesses, and conservatively invest their assets, so that funds will be available to fulfill their obligations to existing policyholders. *Id.*

Over a period of years prior to the imposition of the conservatorships in September 2008, Arrowood Indemnity, Arrowood Surplus Lines, and FSL each made substantial investments in Fannie Mae and Freddie Mac<sup>1</sup> (the “Companies”),<sup>2</sup> collectively acquiring an aggregate of \$42,297,500 (at par value) worth of shares of preferred stock. Appx217-218, 734-736. They continued to

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<sup>1</sup> Fannie Mae is also known as Fannie; its full name is Federal National Mortgage Corporation. Freddie Mac is also known as Freddie; its full name is Federal Home Loan Mortgage Corporation.

<sup>2</sup> Except as noted, this Supplemental Brief uses the same defined terms as the Joint Brief.

own that stock through August 2012 (when the Third Amendment, including the Net Worth Sweep, was imposed, making their holdings “junior preferred stock”), and through September 18, 2013, when they commenced this action. Thereafter, Arrowood Indemnity and Arrowood Surplus Lines each sold some of its stock; FSL did not sell any of its stock. In early 2020, Arrowood Surplus Lines transferred its holdings to its parent, Arrowood Indemnity. Arrowood Indemnity and FSL continue to own junior preferred stock in Fannie and Freddie.

**B. This Action**

Based on the imposition of the Net Worth Sweep and related events, as set forth in the Statement of the Case in the Joint Brief, Arrowood commenced this action on September 18, 2013.<sup>3</sup> After jurisdictional discovery in a related case, *Fairholme Funds, Inc. v. United States*, No. 13-465C (Fed. Cl.) (“*Fairholme*”), Arrowood served its Second Amended Complaint on September 17, 2018, asserting direct claims for takings, illegal exaction, breach of fiduciary duty, and breach of implied-in-fact contract. Appx789-798. Arrowood did not assert any derivative claims.

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<sup>3</sup> Two days later, on September 20, 2013, Arrowood filed an action related to the Net Worth Sweep in the United States District Court for the District of Columbia, *Arrowood Indem. Co. v. Fed. Nat’l Mortg. Ass’n*, No. 1:13-cv-01439-RCL (D.D.C.). That action remains pending in that court.

**C. The Opinion and Order Dismissing Arrowood's Complaint**

On October 1, 2018, the Government filed an omnibus motion to dismiss twelve related actions, including the *Fairholme* case and this *Arrowood* case. The motions to dismiss were briefed and heard together. Appx218.

The Court of Federal Claims treated *Fairholme* as the lead case and, on December 6, 2019, issued its Opinion and Order granting in part and denying in part the motion to dismiss the complaint in *Fairholme*, which was reissued for publication on December 13, 2019 and reissued again on March 9, 2020 after granting motions to certify for interlocutory appeal. *Fairholme*, Appx1-50 (“*Fairholme II*”). That court then went on to issue decisions on the motions to dismiss in the other related cases. On May 15, 2020, the Court of Federal Claims issued its decision granting the United States’ motion to dismiss this *Arrowood* case. The key holdings in its *Arrowood* Opinion were:

*First*, the court held (as it had held in *Fairholme II*) that it had subject matter jurisdiction because the Federal Housing Finance Agency (“FHFA” or the “Agency”), in its role as conservator (which the court abbreviated “FHFA-C”) “is the United States”:

The FHFA does not shed its government character when acting as conservator because it does not step into the shoes of the Enterprises. [*i.e.*, the Companies] Otherwise stated, the FHFA-C is the United States because it retains the FHFA’s government character. Plaintiffs’

claims, therefore, are against the United States for purposes of the Tucker Act.

Appx231-232; *Fairholme II*, Appx25. The court also considered, and either found academic or rejected, other bases on which subject matter jurisdiction had been asserted. Appx221-227.

*Second*, the court addressed whether Arrowood, which asserted only direct (not derivative) claims, had standing. In *Fairholme II*, the court had decided that, *if* direct takings claims could be asserted, they could only be asserted by those Fannie and Freddie shareholders who purchased their stock prior to August 17, 2012—when the Third Amendment, including the Net Worth Sweep, was put in place. The court thus held that those *Fairholme* plaintiffs who purchased their stock after the Third Amendment lack standing:

Plaintiffs [in *Fairholme*] acknowledge that a claimant must ordinarily own the property at the time of a taking to have standing. They assert, however, that the court should follow the conclusion in *Bailey [v. United States]*, 78 Fed. Cl. 239 (2007)], that a different standard applies in the context of a regulatory taking. Plaintiffs' reliance on *Bailey*, a decision issued by another judge on this court, is ill-considered. The Federal Circuit, when presented, post-*Bailey*, with an alleged regulatory taking, explained that “[i]t is axiomatic that only persons with a valid property interest at the time of the taking are entitled to compensation.” *Reoforce, Inc. v. United States*, 853 F.3d 1249, 1263 (Fed. Cir. 2017) (quoting *Wyatt v. United States*, 271 F.3d 1090, 1096 (Fed. Cir. 2001)); accord *id.* (“[P]recedent requires that the property owner prove its ownership at the time of the alleged taking . . . .”); *Wyatt*, 271 F.3d at 1096 (addressing regulatory takings). It follows that a “plaintiff [who] own[s] no shares of the subject stock on the date of taking . . . maintains no standing to sue.” *Maniere v. United States*, 31 Fed. Cl. 410, 421 (1994); .... Applying

that principle, the court concludes that any plaintiff who did not own stock at the time of the alleged taking lacks standing to assert a direct takings claim.<sup>30</sup>

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<sup>30</sup> Plaintiffs' approach would provide them with a windfall: They would acquire the stock at a price that reflects a discount for the property taken by the government and then obtain compensation from the government for the diminishment in value of their stock. That result is incompatible with the notion of just compensation that underlies the Fifth Amendment's Takings Clause.

*Fairholme II*, Appx37 and n. 30. Because Arrowood had purchased all of its stock prior to the Third Amendment, *if any shareholders had standing to assert direct claims, Arrowood did*.

As part of its recitation of the factual allegations in its *Arrowood* Opinion, the court noted that the Net Worth Sweep was alleged to have had “four significant effects”:

First, plaintiffs lost their economic interests in the Enterprises because, under the new terms, private shareholders can never receive dividends or liquidation distributions. [*Arrowood* Second Amended Complaint] ¶ 97; *see also id.* (alleging that, in the event of liquidation, private shareholders will receive nothing because an Enterprise will never have enough money to pay Treasury's dividend and liquidation preferences). Second, Treasury acquired plaintiffs' economic interests in the Enterprises because Treasury now “has the right to all residual profits, and it hence owns all the equity.” *Id.* ¶ 100. Third, Treasury reaped a windfall of \$124 billion in comparison to what it would have received absent changes to the [Preferred Stock Purchase Agreements (“PSPAs”)]. *Id.* ¶ 15; *see id.* ¶¶ 102-03 (alleging that the Enterprises paid Treasury \$223.7 billion under the PSPA Amendments but would have only paid Treasury \$99.5 billion under the previous terms). Fourth, the Enterprises can never be rehabilitated to a sound and

solvent condition because, by transferring their profits to Treasury, they will perpetually operate on the brink of insolvency. *Id.* ¶¶ 111-12.

Appx216. Thus, as recounted by the Court of Federal Claims, the first two (and perhaps the third) alleged “significant effects” of the Net Worth Sweep caused direct injury to Arrowood. Nevertheless, the court went on to hold (as it had held in *Fairholme II*) that no shareholders—even those, like Arrowood, who purchased before the Net Worth Sweep—could assert direct claims:

The gravamen of each claim is the same: The government, via the PSPA Amendments, compelled the Enterprises to overpay Treasury. Regardless of plaintiffs’ label (direct or derivative) or theory (taking, illegal exaction, breach of fiduciary duty, or breach of implied contract) for their claims, the claims are substantively derivative in nature because they are premised on allegations of overpayment. *See Gentile*, [*v. Rossette*, 906 A.2d 91, 99 (Del. 2006)]; *see also Roberts* [*v. Fed. Hous. Fin. Agency*, 889 F.3d 397, 409 (7th Cir. 2018)]

\* \* \*

[P]laintiffs’ purported “harms are ‘merely the unavoidable result . . . of the reduction in the value of the entire corporate entity.’” *Protas* [*v. Cavanagh*, No. CIV.A. 6555-VCG, 2012 WL 1580969, at \*6 (Del. Ch. May 4, 2012)] (quoting *Gentile*, 906 A.2d at 99); *see also Agostino v. Hicks*, 845 A.2d 1110, 1122 (Del. Ch. 2004) (“[T]he inquiry should focus on whether an injury is suffered by the shareholder that is not dependent on a prior injury to the corporation.”). Because plaintiffs’ claims are derivative in nature, plaintiffs lack standing to pursue those claims on their own behalf.

Appx240. *See also Fairholme II*, Appx40.

Because Arrowood brought only direct claims, and because the court held that only derivative claims could be brought, the court did not otherwise address the sufficiency of Arrowood’s takings or illegal exaction claims. However, in



*Fairholme II*, where both direct and derivative takings and illegal exaction claims were presented, the court denied the Government’s motion to dismiss the derivative takings and illegal exaction claims. *Fairholme II*, Appx46-47. The underlying factual allegations supporting the *Fairholme* derivative takings and illegal exaction claims are virtually identical to those supporting the direct takings and illegal exaction claims made by both the *Fairholme* plaintiffs and Arrowood. It is thus apparent that had the Court of Federal Claims addressed the sufficiency of Arrowood’s direct claims for takings and illegal exaction, it would have upheld those claims, for the same reasons that it upheld *Fairholme*’s derivative claims for takings and illegal exaction.

*Third*, the Court of Federal Claims held in its *Arrowood* Opinion (as it had held in *Fairholme II*) that “plaintiffs’ fiduciary duty claim is a tort claim because plaintiffs have not established that the FHFA-C or Treasury owed shareholders a fiduciary duty based on a statute or contract.” Appx235. The court therefore dismissed Arrowood’s fiduciary duty claim because “[t]he court, pursuant to the Tucker Act, lacks jurisdiction over tort claims. 28 U.S.C. § 1491(a)(1).” Appx232.

*Fourth*, the Court of Federal Claims addressed plaintiffs’ implied-in-fact contract claim. In *Fairholme II*, that court had denied the Government’s motion to dismiss a derivative implied-in-fact contract claim, holding that the Government “fail[ed] to establish that plaintiffs inadequately pleaded mutuality of intent to

contract.” *Fairholme II*, Appx47-48. Because Arrowood’s allegations as to the existence of an implied-in-fact contract were essentially the same as those upheld by the court in *Fairholme II*, had the court addressed that issue in its *Arrowood* Opinion, it would have been compelled to hold that Arrowood had adequately pleaded that there was an implied-in-fact contract. However, in its *Arrowood* Opinion, instead of addressing that issue, the court focused on whether the *Arrowood* plaintiffs were third party beneficiaries of that contract. The court held that whether or not there were “implied contracts, between the FHFA and each Enterprise’s board, in which the boards consented to the conservatorships in exchange for the FHFA-C operating the Enterprises as a fiduciary and returning them to sound condition,” plaintiffs are not “third party beneficiaries of those agreements.” Appx236-237.

The Court of Federal Claims thus dismissed all four counts of Arrowood’s Second Amended Complaint, dismissing (i) Count I, a takings claim, solely on the basis that no shareholder could bring direct takings claims, (ii) Count II, an illegal exaction claim, solely on the basis that no shareholder could bring a direct illegal exaction claim, (iii) Count III, a fiduciary duty claim, on the basis that, absent a statutory or contractual basis, a fiduciary duty claim sounds in tort, so that the Court lacked subject matter jurisdiction, and (iv) Count IV, a breach of implied contract claim, on the basis that shareholders such as Arrowood were not intended

third party beneficiaries of such a contract.

## SUPPLEMENTAL SUMMARY OF ARGUMENT

### I.

The Net Worth Sweep transferred all value of Fannie and Freddie from the junior preferred stock (held by private shareholders, including Arrowood) and common stock (also held by private shareholders) to the senior preferred stock (held exclusively by Treasury). That transfer of value caused direct injury to the holders of the junior preferred stock and the common stock. That injury gave rise to direct claims. The adoption of the Third Amendment caused that direct injury as soon as the Third Amendment was enacted—before a single dollar of dividends was paid to Treasury under the Net Worth Sweep. The actual application of the Net Worth Sweep that has been taking place since—the payment of billions of dollars in dividends from Fannie and Freddie to Treasury—is, for all practical purposes, an internal transfer within Treasury, moving assets from one pocket of Treasury (its holding of senior preferred stock in Fannie and Freddie) to another pocket of Treasury (cash in its general fund).

Under federal law, informed by Delaware law, one of the tests for whether a shareholder's claim is derivative or direct depends on:

(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) (*en banc*)). Application of this test to the allegations in the Complaint demonstrates that Arrowood's claims are substantively direct and were properly pled as direct claims.

*First*, the injury was sustained by Arrowood and other private shareholders of Fannie and Freddie when the full value of their stock was transferred to Treasury's senior preferred stock. The shareholders of Fannie and Freddie did not suffer indirect damage, in proportion to their ownership. To the contrary, Arrowood and the other private shareholders suffered direct damage when the value of the junior preferred stock and common stock was transferred to Treasury's senior preferred stock, and Treasury, as the sole shareholder of the senior preferred stock, received a benefit from that transfer (a benefit that was monetized when dividends were paid to Treasury under the Net Worth Sweep).

*Second*, Arrowood (and other private shareholders who have asserted direct claims) would receive the benefit of any recovery. Arrowood's Complaint explicitly seeks just compensation (or an award of damages) for Arrowood—not an award to Fannie and Freddie. Indeed, an award to Fannie and Freddie would be illusory because, with the Net Worth Sweep in place, any compensation (or damages) paid by the United States to Fannie or Freddie would swiftly be paid back to the U.S. Treasury as dividends.

There is also a contradiction between (a) the Court of Federal Claims' decision that, if the Net Worth Sweep gave rise to direct claims, those claims may only be brought by shareholders who held stock at the time of the Net Worth Sweep, because only those shareholders sustained injury, *Fairholme II*, Appx37, and (b) its decision that the Net Worth Sweep gave rise only to derivative claims.

If only derivative claims can be asserted, the only recovery would go to Fannie and Freddie, which would likely be futile because, if the Net Worth Sweep were still in place, the compensation (or damages) paid by the United States to Fannie and Freddie would be returned to Treasury as dividends within the quarter. And even if that result could somehow be avoided, the only shareholders of Fannie and Freddie who could possibly receive a benefit from a recovery on a derivative claim are the shareholders at the time of the recovery—not the shareholders who actually sustained injury because they held junior preferred stock when the Net Worth Sweep was imposed.

## II.

Each of the four claims asserted in Arrowood's Complaint—taking, illegal exaction, breach of fiduciary duty, and breach of implied-in-fact contract—should be reinstated by this Court, for the reasons set forth in the Joint Brief, and for the following additional reasons.

Because Arrowood brought only direct claims, and because the Court of

Federal Claims held (incorrectly) that only derivative claims could be brought, that court, in its *Arrowood* Opinion, did not otherwise address the sufficiency of Arrowood's takings or illegal exaction claims. However, in *Fairholme II*, where both direct and derivative takings and illegal exaction claims were presented, the court denied the motion to dismiss the derivative takings and illegal exaction claims. *Fairholme II*, Appx46-47. The underlying factual allegations supporting the Fairholme derivative takings and illegal exaction claims are virtually identical to those supporting the direct takings and illegal exaction claims made by both Fairholme and Arrowood. For the same reasons that the Court of Federal Claims sustained the derivative takings and illegal exaction claims by the Fairholme plaintiffs, this Court should sustain Arrowood's direct takings and illegal exaction claims, and reinstate those claims.

### III.

The Court of Federal Claims correctly held that it has subject matter jurisdiction because "FHFA-C [the Agency] is the United States." On this appeal, if the United States argues that the Court of Federal Claims lacked subject matter jurisdiction, this Court should consider the additional bases for subject matter jurisdiction, which are fully addressed in the Joint Brief, and should hold that the Court of Federal Claims has subject matter jurisdiction over all of Arrowood's claims.

**ARGUMENT**

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**THE DECISION DISMISSING THE COMPLAINT SHOULD BE REVERSED,  
BECAUSE THE ARROWOOD PLAINTIFFS-APPELLANTS PROPERLY  
ASSERTED DIRECT CLAIMS TO REDRESS THE DIRECT INJURY THEY  
SUSTAINED WHEN THE NET WORTH SWEEP TRANSFERRED THE  
VALUE OF THEIR JUNIOR PREFERRED STOCK TO TREASURY'S  
SENIOR PREFERRED STOCK**

As a holder of junior preferred stock in Fannie and Freddie, purchased years before the August 2012 Third Amendment, Arrowood sustained direct injury when the Third Amendment—without consideration paid to Fannie, Freddie, or their shareholders—transferred the full value of Arrowood’s junior preferred stock to Treasury’s senior preferred stock. Arrowood has standing to plead, and properly pled, direct claims for takings, illegal exaction, breach of fiduciary duty, and breach of implied-in-fact contract to recover the damages that it sustained when the Third Amendment was adopted. The Court of Federal Claims’ decision dismissing Arrowood’s Second Amended Complaint should be reversed.

**I. Standard of Review**

All issues raised on this appeal are subject to *de novo* review. *First Mortg. Corp. v. United States*, 961 F.3d 1331, 1338 (Fed. Cir. 2020), quoting *Prairie Cty., Mont. v. United States*, 782 F.3d 685, 688 (Fed. Cir. 2015), “We review the ... grant of a motion to dismiss for failure to state a claim *de novo*.”); *Eskridge & Assocs. v. United States*, 955 F.3d 1339, 1344 (Fed. Cir. 2020), quoting *Am. Fed’n of Gov’t Emps. v. United States*, 258 F.3d 1294, 1298 (Fed. Cir. 2001) (“Whether a

party has standing to sue is a question that [we] review *de novo*.”); *Northrop Grumman Computing Sys., Inc. v. United States*, 709 F.3d 1107, 1111 (Fed. Cir. 2013), quoting *Hewlett–Packard Co. v. Acceleron LLC*, 587 F.3d 1358, 1361 (Fed. Cir. 2009) (“We review a grant or denial of a motion to dismiss for lack of subject-matter jurisdiction *de novo*”).

## **II. Arrowood’s Claims Are Direct Because Arrowood, as a Shareholder of Fannie and Freddie, Suffered Direct Harm and Would Receive the Benefit of the Recovery**

Arrowood’s Second Amended Complaint asserts four causes of action, all of which are direct claims in both name and substance, as pled and based on the clear terms, intent, and effect of the Net Worth Sweep. This issue is reviewed in detail in the Joint Brief. Arrowood supplements that argument here.

As the Court of Federal Claims held:

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)?”

Appx239 (quoting *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004) (*en banc*)).<sup>4</sup> Application of this test to the allegations in the

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<sup>4</sup> The issue of whether Plaintiffs’ claims are substantively direct or derivative is governed by federal law, which is informed by Delaware law. Appx239 (citing *Starr Int’l Co. v. United States*, 856 F.3d 953, 965 (Fed. Cir. 2017); *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 97 (1991)).



Complaint demonstrates that Plaintiffs' claims are substantively direct. The court's decision that only derivative claims could be made, and thus dismissing Arrowood's Complaint, was in error and should be reversed.

**A. Arrowood and Other Private Shareholders Suffered Direct Harm When the Net Worth Sweep Transferred the Value of Their Stock to Treasury**

In assessing whether a claim is direct or derivative, courts look to the allegations in the body of the complaint. *Tooley*, 845 A.2d at 1036. Here, the allegations set forth by Arrowood satisfy both prongs of the *Tooley* test for direct claims. With respect to the first prong—who suffered the alleged harm—Plaintiffs make clear from the outset of their Complaint that they allege “the federal government took for itself the entire value of the rights held by Plaintiffs and Fannie’s and Freddie’s other private shareholders....” Appx726. Plaintiffs do not allege a harm to Fannie and Freddie that in turn caused consistent harm to all shareholders proportionally. To the contrary, Plaintiffs specifically allege that the Net Worth Sweep transferred value from the holders of junior preferred stock (including Arrowood) and the holders of common stock, to Treasury, as the sole holder of senior preferred stock. Indeed, as noted above, in recounting the allegations of Arrowood’s Complaint, the Court of Federal Claims specifically recited the pleading of direct injury:

First, plaintiffs lost their economic interests in the Enterprises because, under the new terms, private shareholders can never receive

dividends or liquidation distributions. [*Arrowood* SAC] ¶ 97 [Appx773]; *see also id.* (alleging that, in the event of liquidation, private shareholders will receive nothing because an Enterprise will never have enough money to pay Treasury’s dividend and liquidation preferences). Second, Treasury acquired plaintiffs’ economic interests in the Enterprises because Treasury now “has the right to all residual profits, and it hence owns all the equity.” *Id.* ¶ 100 [Appx774-775].

Appx216. To be sure, the Court of Federal Claims also recounted the allegations of the Complaint that, once the dividends had been paid to Treasury under the Net Worth Sweep, the Companies “can never be rehabilitated to a sound and solvent condition because, by transferring their profits to Treasury, they will perpetually operate on the brink of insolvency.” Appx216, citing Appx779-780. Even if that allegation describes an injury to Fannie and Freddie, and not a direct injury to Arrowood and other private shareholders, it does not negate the fact that the central allegation of the Complaint is the injury directly inflicted on Arrowood and other private shareholders when the value of their stock was transferred to Treasury’s senior preferred stock.

The Court of Federal Claims thus contradicted its own recitation of the allegations of the Complaint, and misconstrued both the Complaint and what actually happened, when the court stated:

In their complaint, plaintiffs focus on the expropriation of the Enterprises’ assets via compulsory payments of all profits. The gravamen of each claim is the same: The government, via the PSPA Amendments, compelled the Enterprises to overpay Treasury. Regardless of plaintiffs’ label (direct or derivative) or theory (taking, illegal exaction, breach of fiduciary duty, or breach of implied

contract) for their claims, the claims are substantively derivative in nature because they are premised on allegations of overpayment.

Appx240. Not so. The Complaint focuses on the transfer of value from the private shareholders that held junior preferred stock and common stock to Treasury, as the exclusive holder of senior preferred stock. The gravamen of the Complaint was not that the Third Amendment “compelled [Fannie and Freddie] to overpay Treasury,” *Id.* The gravamen of the Complaint is, instead:

- The Third Amendment “eliminated entirely the economic interests in Fannie and Freddie held by the Companies’ private shareholders.” Appx773.
- Because of the Third Amendment, “there never will be sufficient funds for the Companies to pay a dividend to private shareholders.” *Id.*
- The Third Amendment “ensures that private shareholders will receive nothing in the event of liquidation, as Treasury’s senior preferred stock entitles it to an additional dividend payment *plus* its liquidation preference in the event of liquidation.” *Id.*
- “[T]he Net Worth Sweep not only destroyed the economic interests of Fannie’s and Freddie’s private shareholders but also transferred their interests to the federal government, resulting in Fannie and Freddie being wholly nationalized entities.” Appx774-775.

- “After the Net Worth Sweep, Treasury has the right to all residual profits, and it hence owns all the equity. All other equity interests have been eliminated.” *Id.*
- “One federal agency—FHFA, supposedly acting as conservator for the Companies—struck a deal with a second federal agency—Treasury—to effectively confiscate the Common and Preferred Stock held by the Plaintiffs and other private investors in Fannie and Freddie.” Appx790.
- “Plaintiffs had both a property interest and a reasonable, investment-backed expectation in the economic interest in the Companies they held due to their ownership of Common and Preferred Stock. The Net Worth Sweep expropriated this economic interest by assigning the right to all of Fannie’s and Freddie’s equity to Treasury.” *Id.*
- “The Government, by operation of the Net Worth Sweep, has expropriated Plaintiffs’ property interests in their Preferred Stock and has destroyed Plaintiffs’ reasonable, investment-backed expectations without paying just compensation. As a result of the Net Worth Sweep, Plaintiffs have been deprived of all economically beneficial uses of their Preferred Stock in Fannie and Freddie.” Appx791.

These factual allegations are very different from the circumstances in *Starr Int’l Co. v. United States*, 856 F.3d 953 (Fed. Cir. 2017) and *El Paso Pipeline GP*

*Co., LLC v. Brinckerhoff*, 152 A.3d 1248 (Del. 2016), both relied upon by the Court of Federal Claims. Appx237-239. In *Starr*, this Court reasoned that claims of corporate overpayment

are not normally regarded as direct, because any dilution in value of the corporation's stock is merely the unavoidable result . . . of the *reduction in the value of the entire corporate entity, of which each share of equity represents an equal fraction.*

*Starr*, 856 F.3d at 967 (emphasis added). Similarly, in *El Paso Pipeline* the court found that the plaintiff's claims were derivative where the harm alleged was to a partnership and resulting harm to the plaintiff was "in the form of the *proportionally reduced value* of his units...." *El Paso Pipeline*, 152 A.3d at 1261 (emphasis added). The court reasoned that "[w]here all of a corporation's stockholders are harmed and would recover *pro rata* in proportion with their ownership of the corporation's stock solely because they are stockholders, then the claim is derivative in nature." *Id.* (internal quotations omitted). By contrast, here Plaintiffs do not allege that all shareholders were harmed proportionally. Rather, the Complaint alleges that Plaintiffs and the other private holders of junior preferred stock were harmed, while Treasury was not harmed and in fact received the benefit of the value taken from the private shareholders. *See, e.g.* Appx773-774 ("Treasury emphasized that the Net Worth Sweep would ensure that 'every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to

benefit taxpayers.’ ... The necessary corollary to this, of course, is that nothing would be left for private shareholders.”).

Here, Arrowood’s claims are not “‘merely the unavoidable result . . . of the reduction in the value of the entire corporate entity.’” Appx240, *quoting Protas v. Cavanagh*, No. CIV.A. 6555-VCG, 2012 WL 1580969, at \*6 (Del. Ch. May 4, 2012) (*quoting Gentile*, 906 A.2d at 99). Arrowood was injured when the value of its junior preferred stock was transferred to the senior preferred stock, before a single dividend was paid under the Net Worth Sweep, and thus before (and not the result of) a “reduction in the value of the entire corporate entity.”

**B. Arrowood Seeks Recovery For Itself—Not Recovery for the Companies**

The second prong of the test set forth in *Tooley* also supports the conclusion that Plaintiffs’ claims are direct, because the benefit of the recovery sought would go to the junior preferred shareholders individually, not to the Companies. The Complaint itself unambiguously seeks recovery for the Arrowood Plaintiffs individually:

WHEREFORE, Plaintiffs seek a judgment as follows:

A. *Awarding Plaintiffs just compensation* under the Fifth Amendment for the Government’s taking of their property;

B. *Awarding Plaintiffs damages* for the Government’s illegal exaction of their stock;

C. *Awarding Plaintiffs damages* for the Government's breach of fiduciary duty;

D. *Awarding Plaintiffs damages* for the Government's breach of implied-in-fact contract . . . .

Appx798 (emphasis added).

Plaintiffs do not seek a recovery for the Companies. Indeed, a recovery for the Companies would not be an appropriate remedy. If the Government were ordered to pay damages to Fannie and Freddie, whatever was paid would simply be swept back to Treasury by operation of the Net Worth Sweep in the following quarterly payment; the damages remedy would be futile unless the Net Worth Sweep were unwound. Rather than making Arrowood (and other junior preferred shareholders) whole, this process would only result in a temporary shuffling of funds from, and then back to, the U.S. Treasury. By contrast, what Arrowood seeks is a recovery of damages (or just compensation with respect to the takings claim) to be paid to the *Arrowood* Plaintiffs, as private holders of junior preferred stock. Accordingly, the second prong of the *Tooley* test for direct claims is satisfied because the recovery sought would go to the Plaintiffs-Appellants individually, not to the Companies.

Because both of the applicable *Tooley* requirements are present here, Plaintiffs' claims are substantively direct.

As noted above, while the central focus of the Complaint is the direct injury to Arrowood and other private shareholders of Fannie and Freddie, some of the allegations of the Complaint can fairly be read as also alleging injury to Fannie and Freddie themselves.<sup>5</sup> If seen in that manner, the Third Amendment caused successive injuries—*first* inflicting its principal injury, a direct injury on the private shareholders (including Arrowood) when the value of their stock was transferred to the Treasury’s senior preferred stock, and *later* inflicting a secondary injury when the dividends were paid on the senior preferred stock under the Net Worth Sweep. But that *later*, secondary injury—whether characterized as an injury to the Companies or to their shareholders—cannot and does not eliminate Plaintiffs’ right to bring direct claims for the direct injury they sustained when the Third Amendment seized the value of their stock.

The Court of Federal Claims quoted *Agostino v. Hicks*, 845 A.2d 1110, 1122 (Del. Ch. 2004), which stated that “[T]he inquiry should focus on whether an injury is suffered by the shareholder that is not dependent on a *prior injury* to the corporation.” Appx240 (emphasis added). Had the court followed that principle,

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<sup>5</sup> See, e.g., Appx776 (“the Companies have paid Treasury \$223.7 billion in ‘dividends’ under the Net Worth Sweep. Had they instead been paying 10% cash dividends, they would have paid Treasury \$99.5 billion by the end of the first quarter of 2018.”); Appx779 (“the Net Worth Sweep guarantees that Fannie and Freddie can never be rehabilitated to a sound and solvent condition, and it positions them to be wound down and eliminated”).



and focused on whether there was a “*prior injury* to the corporation” (emphasis added)—which signifies a derivative claim—it would have recognized that here there was *no prior injury* to Fannie and Freddie: Arrowood and other holders of junior preferred stock (as well as holders of common stock) were injured first, when the Third Amendment was signed; Fannie and Freddie were not injured until dividends were *later* paid under the Net Worth Sweep.

**C. Derivative Claims Offer No Prospect of Just Compensation To Those Actually Injured by the Net Worth Sweep**

There is also a contradiction between the Court of Federal Claims’ analysis of (a) whether the Net Worth Sweep gave rise to direct claims or only derivative claims and (b) whether, if the Net Worth Sweep gave rise to direct claims, those claims may only be brought by shareholders who held stock at the time of the Net Worth Sweep, or whether such direct claims could also be brought by shareholders who purchased stock after the Net Worth Sweep was adopted. On the latter issue, the court correctly held that, if direct claims could be brought, they could be brought only by shareholders who held stock at the time of the Net Worth Sweep, because only those shareholders sustained injury. *Fairholme II*, Appx37. The court held:

It follows that a “plaintiff [who] own[s] no shares of the subject stock on the date of taking . . . maintains no standing to sue.” *Maniere v. United States*, 31 Fed. Cl. 410, 421 (1994); *cf. Reoforce*, 853 F.3d at 1263 (concluding that the plaintiff had standing for a takings claim

despite relinquishing property owned on the date of the purported taking before filing the lawsuit).

*Id.* Permitting a shareholder who purchased stock after the Net Worth Sweep to assert direct claims, the court held,

would provide them with a windfall: They would acquire the stock at a price that reflects a discount for the property taken by the government and then obtain compensation from the government for the diminishment in value of their stock. That result is incompatible with the notion of just compensation that underlies the Fifth Amendment's Takings Clause.

*Id.* n. 30.

The same reasoning compels the conclusion that shareholders who held stock at the time of the Third Amendment should be permitted to bring direct claims for the injury they sustained. If only derivative claims can be asserted, the only recovery would go to Fannie and Freddie which, as noted above, would likely be futile, because, if the Net Worth Sweep were still in place, the compensation (or damages) paid by the Government to Fannie and Freddie would be returned to Treasury as dividends within the quarter. And even if that result could somehow be avoided, the only shareholders of Fannie and Freddie who could possibly receive a benefit from a recovery on a derivative claim are the shareholders at the time of the recovery. The Third Amendment was adopted in August 2012—over eight years ago. It is likely that a significant percentage of the shareholders who held Fannie and Freddie stock at the time of the Third Amendment have since sold

some or all of that stock (and more will likely sell their stock before a recovery in this case). That means that, not only would a recovery on a derivative claim likely merely shuffle money from Treasury to Treasury, but if any part of the recovery did benefit Fannie and Freddie shareholders, the benefit would in significant part go to shareholders who purchased their stock after the Third Amendment “at a price that reflects a discount for the property taken by the government.” *Id.* “That result is incompatible with the notion of just compensation that underlies the Fifth Amendment’s Takings Clause.” *Id.*

The only result compatible with the notion of just compensation that underlies the Fifth Amendment’s Takings Clause (and with the notion of awarding damages for illegal exaction or other claims made here) is to recognize that the Third Amendment caused direct injury to shareholders who held stock at the time of the Third Amendment, who therefore have standing to pursue direct claims to redress those direct injuries.

### **III. The Third Amendment Gave Rise to Claims for Takings, Illegal Exaction, Breach of Fiduciary Duty and Breach of Implied-in-Fact Contract**

Each of the four claims asserted in Arrowood’s Complaint—taking, illegal exaction, breach of fiduciary duty, and breach of implied-in-fact contract—should be reinstated by this Court, for the reasons set forth in the Joint Brief, and for these additional reasons.

**A. Takings and Illegal Exaction**

Because Arrowood brought only direct claims, and because the Court of Federal Claims held (incorrectly) that only derivative claims could be brought, that court, in its *Arrowood* Opinion, did not otherwise address the sufficiency of Arrowood's takings or illegal exaction claims. However, in *Fairholme II*, where both direct and derivative takings and illegal exaction claims were presented, the court denied the motion to dismiss the derivative takings and illegal exaction claims. *Fairholme II*, Appx46-47. The underlying factual allegations supporting the Fairholme derivative takings and illegal exaction claims are virtually identical to those supporting the direct takings and illegal exaction claims made by both Fairholme and Arrowood. It is thus apparent that, had the Court of Federal Claims recognized standing to bring direct takings and illegal exaction claims, it would have found Arrowood's takings and illegal exaction claims sufficient and properly pled.

Thus, for the same reasons that the Court of Federal Claims sustained the derivative takings and illegal exaction claims by the Fairholme plaintiffs, this Court should sustain Arrowood's direct takings and illegal exaction claims, and reinstate those claims.

**B. Breach of Fiduciary Duty and Breach of Implied-in-Fact Contract**

The reasons why the Court of Federal Claims erred in dismissing breach of

fiduciary duty and breach of implied-in-fact contract claims made by Arrowood and other Plaintiffs are set forth in full in the Joint Brief.

#### **IV. The Court of Federal Claims Had Subject Matter Jurisdiction**

The Court of Federal Claims correctly held that it has subject matter jurisdiction because “FHFA-C [the Agency] is the United States.” On this appeal, if the United States argues that the Court of Federal Claims lacked subject matter jurisdiction, this Court should consider the additional bases for subject matter jurisdiction, which are fully addressed in the Joint Brief.

#### **CONCLUSION**

The judgment of the Court of Federal Claims dismissing the Complaint should be **reversed**.

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Respectfully submitted,

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**UNITED STATES COURT OF APPEALS  
FOR THE FEDERAL CIRCUIT**

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**Case Number:** 20-2020

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