ORAL ARGUMENT SCHEDULED FOR APRIL 15, 2016

Nos. 14-5243 (L), 14-5254 (con.), 14-5260 (con.), 14-5262 (con.)

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

IN RE FANNIE MAE/FREDDIE MAC SENIOR PREFERRED STOCK PURCHASE AGREEMENT CLASS ACTION

On Appeal from the United States District Court
For the District of Columbia, No. 13-mc-01288
(Royce C. Lamberth, District Judge)

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GLOSSARY

Term	Abbreviation
Certificates of Designation of each series of preferred and common stock of Fannie Mae and Freddie Mac	Certificate
American European Insurance Company, Joseph Cacciapalle, John Cane, Francis J. Dennis, Marneu Holdings, Co., Michelle M. Miller, United Equities Commodities, Co., 111 John Realty Corp., Barry P. Borodkin and Mary Meiya Liao	Class Plaintiffs
Initial Opening Brief of Class Plaintiffs, filed with this Court on June 30, 2015	COB
Class Plaintiffs' Consolidated Amended Class Action and Derivative Complaint, filed in the District Court on December 3, 2013	Consolidated Class Complaint
Federal National Mortgage Association ("Fannie Mae) and Federal Home Loan Mortgage Corporation ("Freddie Mac")	The Companies
Appellees Fannie Mae, Freddie Mac, Treasury, Jacob J. Lew, Melvin L. Watt and FHFA	Defendants
United States District Court for the District of Columbia (Lamberth, J.)	District Court
Federal Deposit Insurance Corporation	FDIC
Federal Housing and Finance Agency	FHFA

Answering Brief of Appellees Federal Housing Finance Agency, Melvin L. Watt, Fannie Mae, and Freddie Mac, filed with this Court on December 21, 2015	FHFA Br.
The Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989)	FIRREA
Senior Preferred Stock	Government Stock
Government Sponsored Enterprises	GSEs
The Housing and Economic Recovery Act of 2008, Pub. L. 110-289, 122 Stat. 2654 (2008)	HERA
Appellants Perry Capital LLC, Arrowood Indemnity Co., *et al.*, and Fairholme Funds Inc., *et al*.	Institutional Plaintiffs
Class Plaintiffs' Omnibus Memorandum of Law in Opposition to Defendants' Motions to Dismiss the Consolidated Class Complaint, filed with the District Court on March 21, 2014 [13-mc-1288 (RCL), ECF. No. 33]	MTD Opp. Br.
The Third Amendment to the Senior Preferred Stock Purchase Agreements between the United States Department of the Treasury and the Federal Housing Finance Agency, as conservator to Fannie Mae and Freddie Mac, dated August 17, 2012, and the declaration of dividends pursuant to the Third Amendment beginning January 1, 2013	The Net Worth Sweep, or the Third Amendment
Senior Preferred Stock Purchase Agreements	Government Stock Agreements
United States Department of Treasury	Treasury

Answering Brief of the Treasury Department, filed with this Court on December 21, 2015	Treasury Br.

PRELIMINARY STATEMENT

Defendants focus much of their briefing on the anti-injunctive provision of HERA §4617(f). But Defendants do not dispute the District Court's conclusion that this provision does not apply to damage claims, such as the common law claims brought by Class Plaintiffs. For this reason, and because the majority of Defendants' briefing is devoted to the Administrative Procedure Act claims, most of that briefing is irrelevant to the common law damage claims brought by Class Plaintiffs.[1] To the extent Defendants do address Class Plaintiffs' arguments, they either misstate the law or ignore the legal points demonstrating that the District Court's decision must be reversed.[2]

What the Court should never overlook is the simple fact of what happened here. In September 2008, the Government made a deal to provide funding to Fannie Mae and Freddie Mac in exchange for Government Stock with a 10% cumulative cash dividend (or a 12% stock dividend), plus the right to acquire 79.9% of all common stock for a nominal price. Four years later, when the

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[1] While Class Plaintiffs also sought injunctive relief pursuant to their common law claims, we rely on the briefing by the Institutional Plaintiffs on that issue.

[2] Notably, the Government is asserting in the Court of Federal Claims ("CFC") that FHFA is "not the United States" and therefore its actions in imposing the Net Worth Sweep cannot give rise to a Taking of private property under the Fifth Amendment. [CFC Case 1:13-cv-00466-MMS Document 41, at 13-16]. This underscores the need to permit private common law causes of action to proceed against FHFA and against Treasury, which now is trying to raise immunity defenses that were not addressed below.

housing market recovered and Fannie Mae and Freddie Mac started making billions of dollars in profits, the Government *changed the deal*. It was no longer satisfied with its negotiated dividend rights, or its contractual warrant to acquire 79.9% of all common stock for nominal value. It wanted *everything*—all the profits, forever—without regard to the rights of the owners of Fannie Mae and Freddie Mac's publicly traded preferred and common stock. That is precisely what the Net Worth Sweep gives the Government.[3] Thus far, this unilateral rewriting of the deal has worked: Fannie Mae has paid Treasury $144.8 billion (as compared to total Treasury investments of $116.1 billion); and Freddie has paid Treasury $96.5 billion (as compared with total Treasury investments of $71.3 billion)—for a net profit to Treasury of $54 billion beyond the recovery of its investment, which is treated as if it has not even been repaid.[4] The big losers are the private shareholders who relied on the plain text of their contractual stock Certificates and the notion that the Government actors would follow basic norms of good faith and

[3] *See, e.g.*, Consolidated Class Complaint, ¶¶15-18, 69-77; *see also*, Fairholme Mot. for Jud. Not. at 14-17; *id.* at A260 (UST00532144); *id.* at A46, A50; *id.* at A350.

[4] *See* Fannie Mae November 5, 2015 Press Release, available at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2015/q32015_release.pdf (last visited February 2, 2016); Freddie Mac November 3, 2015 Press Release, available at http://www.freddiemac.com/investors/er/pdf/2015er-3q15_release.pdf (last visited February 2, 2016). The Court can take judicial notice of these documents. *See* COB at 10 n.4.

fair dealing. It is up to this Court to vindicate the rights of those shareholders by allowing them to proceed with common law claims based on well-established law.

ARGUMENT

I. SECTION 4617 OF HERA DOES NOT BAR ANY OF CLASS PLAINTIFFS' CLAIMS.

A. Section 4617(b)(2)(A) Does Not Bar Direct Shareholder Claims.

HERA §4617(b)(2)(A) provides that FHFA as conservator "immediately succeed[s] to … all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of the regulated entity *with respect to the regulated entity and the assets of the regulated entity*." 12 U.S.C. §4617(b)(2)(A) (emphasis added). While this Court has recognized that "absent a manifest conflict of interest … the statutory language bars shareholder *derivative* actions," *Kellmer v. Raines*, 674 F.3d 848, 850 (D.C. Cir. 2012) (emphasis added), no court has held that it bars *direct* shareholder claims.

The Court of Appeals for the Seventh Circuit recently rejected the very argument that FHFA advances here, correctly observing that "*[n]o federal court has read the statute that way.*" *Levin v. Miller*, 763 F.3d 667, 672 (7th Cir. 2014) (emphasis added). Although *Levin* was addressing the provision of FIRREA that is analogous to HERA §4617(b)(2)(A), those two provisions are essentially

identical.[5] No court has read either provision to bar direct shareholder claims. Instead, courts have read these provisions as *not* barring direct shareholder claims.[6]

Indeed, FHFA itself argued in the *Kellmer* litigation that §4617 does not bar direct shareholder claims. There were both derivative and direct claims in that litigation, and FHFA expressly *disclaimed* any conservator interest in the direct claim:

> "Plaintiff in *Agnes v. Raines* … has sued both derivatively and in his individual capacity. … *FHFA moves to substitute only with respect to the derivative claims asserted by Fannie Mae shareholders*. Accordingly, FHFA seeks to substitute for plaintiff Agnes only insofar as he asserts derivative claims; *Agnes's individual claims should be consolidated with the other non-derivative securities actions against Fannie Mae that are pending before this Court*."

Kellmer v. Raines, No. 7-1173 (D.D.C.), ECF No. 68 (Motion of FHFA as Conservator to Substitute For Shareholder Derivative Plaintiffs), at 1 n.1 (emphasis added). FHFA offers no explanation for its about-face here, and there is none.

Defendants rely on HERA's use of the word "all," but they ignore that HERA only transfers shareholder rights "*with respect to the regulated entity and the assets of the regulated entity*"—"in other words, those that investors . . . would

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[5] *Compare* 12 U.S.C. §1821(d)(2)(A)(i) *with* 12 U.S.C. §4717(b)(2)(A)(i); 12 U.S.C. §1821(d)(2)(B)(i) *with* 12 U.S.C. §4717(d)(2)(B)(i).

[6] *See id.*; *Barnes v. Harris*, 783 F.3d 1185, 1193, 1195 (10th Cir. 2015); *In re Beach First Nat'l Bancshares, Inc.*, 702 F.3d 772, 778, 780 (4th Cir. 2012); *Lubin v. Skow*, 382 F. App'x 866, 870 (11th Cir. 2010); *Plaintiffs in All Winstar-Related Cases v. United States*, 44 Fed. Cl. 3, 9-10 (1999); *Perry Capital v. Lew*, 70 F. Supp. 3d 208, 229 n.24 (D.D.C. 2014).

pursue *derivatively*." *Levin*, 763 F.3d at 672 (emphasis added). Defendants also ignore that straining to read this language to usurp direct shareholder claims "would pose the question whether … stockholders would be entitled to compensation for a taking; our reading … avoids the need to tackle that question." *Id*. The canon of constitutional avoidance precludes Defendants' interpretation. *See Clark v. Martinez*, 543 U.S. 371, 381-82 (2005).[7] Thus, Class Plaintiffs are entitled to pursue their direct shareholder claims.

FHFA's assertion that Class Plaintiffs somehow "waived" their direct contractual claims by not discussing footnote 39 of the District Court's decision is absurd. *See* FHFA Br. at 44, 55. Footnote 39 stated in subjunctive terms that "even if" plaintiffs had otherwise stated a valid contract claim, such claims "would be" derivative not direct, and hence barred by §4617. Class Plaintiffs appealed the dismissal of the contractual claims; that is all that is required. *See, e.g.*, *U.S. v. Harrison*, 204 F.3d 236, 241 (D.C. Cir. 2000); *Brown v. Nucor Corp.*, 785 F.3d 895, 917-19 (4th Cir. 2015). As articulated in our opening brief, the contractual claims are based on injuries that were suffered directly by the private shareholders, not by the Companies. COB at 35-47. Our brief was unambiguous in presenting

[7] The concurring judge in *Levin* did *not* state that the "plain text" of the statute "applies to direct claims." *Cf.* FHFA Br. at 47. Instead, the concurrence found the language "ambiguous." *Levin*, 763 F.3d at 674. Any such ambiguity should be resolved in a manner that does not trigger a constitutional claim, as FHFA's reading would. *Id*. at 672.

these claims as direct claims. Likewise, our Statement of Issues on appeal expressly included the issue "Whether [HERA's] provision that FHFA as conservator succeeds to 'all rights, titles, powers, and privileges' ***of shareholders*** with respect to Fannie Mae, Freddie Mac, and their assets bars ***any*** of Appellants' claims in this action." Doc. 1523585 at ¶6 (emphasis supplied). The District Court's dismissal of the direct contractual claims, therefore, is squarely before this Court.

In any event, footnote 39 of the District Court's decision is demonstrably wrong. There is not a single Delaware case holding that shareholder claims based entirely on the breach of shareholder contracts are somehow derivative claims owned by the company, and any such conclusion defies common sense. *See e.g. Winston v. Mador,* 710 A.2d 835, 840-43 (Del. Ch. 1997) (preferred shareholder stated ***direct contract claim*** for breach of a certificate of designation, and distinguishing derivative claims); *In re El Paso Pipeline Partners, L.P.*, 2015 WL 7758609, at *18 (Del. Ch. Dec. 2, 2015) (recognizing that breach of a certificate of designation "gives the investor a claim for breach of contract that the investor can assert directly"); *Matulich v. Aegis Commc'ns Grp., Inc.*, 942 A.2d 596, 600 (Del. 2008) ("[R]ights of preferred shareholders are primarily contractual in nature. The construction of preferred stock provisions are matters of contract interpretation for the courts.").

B. Section 4617(b)(2)(A) Does Not Bar Derivative Claims When There Is A Manifest Conflict of Interest.

In *Kellmer*, this Court recognized the potential "conflict of interest" exception adopted by other courts to allow shareholders of institutions under Government control to bring derivative suits where the Government's conflicted interests make it unlikely to bring suit itself. 674 F.3d at 850 (citing *First Hartford Pension Plant & Trust v. U.S.*, 194 F.3d 1279, 1294-95 (Fed. Cir. 1999); *Delta Savings Bank v. U.S.*, 265 F.3d 1017, 1023-24 (9th Cir. 2001)). Although the facts of *Kellmer* did not require a holding on this issue, this case does.

Defendants argue that the exception recognized in *First Hartford* and *Delta Savings* applies only in the context of receivership, not conservatorship, since only in receivership do "shareholders gain the ability to assert claims based on their contingent rights through the administrative and judicial claims process." FHFA Br. at 49-50; Treasury Br. at 24. But *First Hartford* and *Delta Savings* are not based upon that distinction, and that distinction is illogical. If a manifest conflict exists that precludes FHFA from pursuing certain claims on behalf of the enterprise, that same conflict exists regardless of whether the enterprise is in conservatorship or receivership. It would therefore be illogical to allow a shareholder the ability to overcome that conflict of interest by bringing a derivative claim in one situation, but not the other. Indeed, that would only compound the conflict of interest: under HERA, the Director of FHFA has the statutory discretion

to appoint FHFA as "conservator *or* receiver." 12 U.S.C. §4617(a)(1),(2) (emphasis added). If FHFA faces a conflict of interest over whether to bring a lawsuit on behalf of the enterprise, that same conflict of interest would infect FHFA's ability to determine whether to continue the conservatorship or convert to a receivership if that decision would (as FHFA argues) somehow dictate whether shareholders could bring a derivative claim to avoid the conflict of interest. The exception recognized by *Kellmer*, *First Hartford*, and *Delta Savings*, therefore, would be meaningless if FHFA retained the ability to control whether to allow the "exception" to be triggered upon conversion to a receivership.[8] For example, Defendants' construction of HERA would allow FHFA to strategically prolong a conservatorship to prevent any derivative claims that trigger a governmental conflict of interest, and to declare a receivership only after the statute of limitations on such claims had expired. Such a bizarre and corrupt result cannot be found in the statute or in any case law, and would raise serious constitutional issues.

FHFA also argues that *First Hartford* and *Delta Savings* are distinguishable because they both involve actions of the regulator that allegedly contributed to the imposition of a receivership. FHFA Br. at 50-51. Yet *First Hartford*'s conclusion that private shareholders were entitled to bring derivative claims was not based

[8] Under certain narrow circumstances, receivership is mandatory. 12 U.S.C. §4617(a)(4)(D). Generally, however, HERA provides the Director of FHFA with discretion in this regard. 12 U.S.C. §4617(a)(1),(2),(3).

upon *how* the alleged breach occurred, but rather rested "most significantly, upon the conflict of interest faced by the FDIC in determining whether to bring suit." 194 F.3d at 1295; *see also Delta Savings*, 265 F.3d at 1023-24 (same). It is the conflict of interest itself, rather than the details of how or when the conflict of interest originated, that gives rise to the exception.

FHFA then claims that *First Hartford* and *Delta Savings* were wrongly decided because HERA "broadly transfers ***all*** shareholder rights, titles, powers, and privileges" to FHFA. FHFA Br. at 51 (emphasis in original). But FHFA admits that shareholders are entitled to prosecute certain claims during receivership, thereby implicitly admitting that the language of 12 U.S.C. §4617(b)(2)(A)(i) is not as absolute as it argues. FHFA Br. at 52-53. FHFA has no answer to the basic fact that shareholders retain a contingent right to residual assets. "[T]his Court cannot conclude that Congress intended to preserve shareholders' rights to the residual assets of the failed financial institution, yet terminate the shareholders' ability to protect the failed institution's interests"—specifically with regard to those residual assets. *Branch v. FDIC*, 825 F. Supp. 384, 404 (D. Mass. 1993).[9]

[9] Treasury tries to rely on what "Congress anticipated" when it enacted HERA, but this argument fails because when Congress enacted HERA, it was aware that the statutory language it was adopting from FIRREA had previously been interpreted by two courts of appeal as including the conflict of interest exception.

Defendants also have no answer to 12 U.S.C. §4617(b)(2)(K)(i), which provides that the appointment of a receiver "shall terminate all rights and claims that the stockholders and creditors of the regulated entity may have against the assets or charter of the regulated entity or the Agency arising as a result of their status as stockholders or creditors, except for their right to payment, resolution, or other satisfaction of their claims" via HERA's statutory claims process. This termination of "rights and claims" once a conservatorship ends and a receivership begins would be meaningless unless stockholders retained some "rights and claims" during conservatorship, but before receivership.

II. THIS COURT SHOULD REVERSE THE DISMISSAL OF THE BREACH OF CONTRACT CLAIMS.

A. Defendants Ignore Class Plaintiffs' Contractual Voting Rights.

The Third Amendment "materially and adversely affects" the "interests" of the private shareholders without the two-thirds approval from each class of shareholders as expressly required by the Certificates that constitute the contracts governing the shareholders' rights. COB §III.C. *See also* Consolidated Class Complaint, ¶¶84-85, 143, 149, 155. The Third Amendment thereby breached this clear contractual voting requirement. The District Court's Memorandum Opinion did not address this claim. And Defendants ignore this claim as well. They have no answer to it.

The Certificates provide that Class Plaintiffs "will be entitled to receive" dividends when and as declared by Fannie Mae and Freddie Mac's Boards of Directors and "will be entitled to receive" the specified liquidation preferences upon dissolution, liquidation, or winding up of Fannie Mae and Freddie Mac. Consolidated Class Complaint, ¶¶84-85. The Certificates are also crystal clear that their terms "may be amended, altered, supplemented, or repealed only with the consent of the Holders of at least two-thirds of the shares of [each series] then outstanding," at least whenever proposed changes to the terms would "***materially and adversely affect the interests of the Holders***." *Id*. (emphasis added).

The Third Amendment "materially and adversely affects" the interests of Class Plaintiffs by nullifying their right ever to receive a dividend or liquidation distribution. The Third Amendment was never put to a vote of any class of shareholders. The Third Amendment therefore violated the contractual voting rights of Class Plaintiffs.

Even if Class Plaintiffs have no "present and absolute right" to dividends or liquidation preferences, they do have a "present and absolute right" *to vote* on changes to the dividend and liquidation preference provisions that would materially and adversely affect their "interests" (*i.e.*, by nullifying any and all rights to such dividends and liquidation preferences). Defendants offer no argument to the contrary.

B. The Third Amendment's Total Nullification Of Class Plaintiffs' Dividend Rights Was A Breach of Contract.

Defendants do not dispute that the Certificates are binding contracts between the Companies (now FHFA) and Class Plaintiffs. *See* COB 34-35. Nor do they dispute that the Third Amendment eliminated Class Plaintiffs' right to receive dividends regardless of how profitable the Companies became, regardless of how much the Companies distribute to Treasury in dividends, and regardless of what else they choose to do with the cash. Instead, FHFA merely posits that usually apart from special situations, shareholders "have no right to dividends until they are declared." FHFA Br. at 56-57 (quoting *Pa. Co. for Ins. on Lives & Granting Annuities v. Cox*, 199 A. 671, 673 (Del. Ch. 1938)). This misses the point. Class Plaintiffs challenge not the refusal to pay undeclared dividends, but the action by FHFA and Treasury to rewrite Class Plaintiffs' contracts to prohibit Class Plaintiffs from *ever* receiving dividends. This appeal therefore presents a most *unusual* "special situation" in which *all* dividend rights have been completely nullified.

The relevant issue is not, as Defendants suggest, whether a shareholder has some kind of absolute right to receive discretionary dividends. Rather, the issue is whether Defendants violated Class Plaintiffs' contractual rights by agreeing upon the Net Worth Sweep that will prevent funds from *ever* becoming "legally available" to pay dividends to private shareholders. There is no case holding that

such a complete nullification is consistent with even the most contingent or conditional of stockholder dividend rights.

To the contrary, under both Delaware and Virginia law, corporate directors may not eliminate shareholders' right to receive dividends, and their discretion to refuse to declare dividends is not absolute. *See, e.g. Litle v. Waters*, 1992 WL 25758 (Del. Ch. Feb. 11, 1992) (allowing shareholder to proceed with claim that the board's decision not to pay dividends and hoard cash violated the shareholder's rights); *Penn v. Pemberton & Penn, Inc.*, 189 Va. 649 (1949) ("Ordinarily, the stockholders have no power to control the directors in the exercise of their discretion in determining whether they will declare a dividend. But if their action in refusing to declare a dividend when there are sufficient earnings or surplus not necessarily needed in the business is so arbitrary or so unreasonable as to amount to a breach of trust, their action is subject to judicial review."). The Net Worth Sweep goes far beyond anything addressed in these cases. It absolutely and forever precludes Class Plaintiffs from *ever* being eligible to receive a dividend. It thereby nullified the contractual dividend rights held by Class Plaintiffs.

Moreover, the Third Amendment constitutes an anticipatory repudiation of the contractual provisions governing both dividends and liquidation distributions, and Class Plaintiffs are entitled to treat that repudiation as a breach of the Certificates. *See, e.g.*, *Systems Council EM-3 v. AT&T Corp.*, 159 F.3d 1376, 1383

(D.C. Cir. 1998) ("[I]f a performing party unequivocally signifies its intent to breach a contract, the other party may seek damages immediately under the doctrine of anticipatory repudiation."); *MCI Commc'ns. Servs. v. FDIC*, 808 F. Supp.2d 24, 28 (D.D.C. 2011) ("Repudiation is treated as a breach of contract giving rise to an ordinary contract claim for damages."); *AMTRAK v. ExpressTrak, L.L.C.*, 2006 U.S. Dist. LEXIS 74923, at *30 (D.D.C. Oct. 16, 2006) ("When a non-repudiating party is confronted with an anticipatory repudiation," the party may "elect to treat the repudiation as an anticipatory breach and seek damages for breach of contract.…").

Finally, Defendants have no answer to the point that the substantive economic effect of the Net Worth Sweep is to breach the *mandatory* dividend rights of Class Plaintiffs. The preferred shareholders had a contractual right to mandatory dividends before Treasury received any dividends on the 80% of the Companies' common stock it had a right to acquire for nominal value if it wanted to receive more than the 10% coupon on its Government Stock, and the common shareholders had a contractual right to mandatory dividends that would be paid ratably with any dividends paid to Treasury on such common stock. The Net Worth Sweep nullifies these contractual rights to mandatory dividends through the disguise of a "substance over form" transaction in which it receives the equivalent of 100% of all stock dividends of any kind, well in excess of its 10% dividend on

the Government Stock, simply by writing that into an amendment to its Government Stock Agreements. Defendants only response is to say, in effect, that "form governs over substance," and that the Net Worth Sweep is still just paying dividends on the Government Stock—even though those dividends now equal *the entire net worth of the Companies*, and *no other dividend on any other class of stock can ever again be possible.* These assertions do not change the fact that Treasury leap-frogged the junior preferred shareholders and the common shareholders, and allocated all of their future dividends to Treasury.

C. The Claim For Breach Of Class Plaintiffs' Liquidation Rights Is Ripe.

Defendants never address the case law cited by Class Plaintiffs demonstrating that the immediate nullification of all rights to a liquidation preference gives rise to an immediate claim that is ripe for adjudication. *See* COB at 41 (citing *Quadrangle Offshore (Cayman) LLC v. Kenetech Corp.*, 1998 WL 778359, at *7 (Del. Ch. Oct. 21, 1998) (holding that plaintiff shareholders could bring a breach of contract suit for liquidation preference even though the company was not yet in liquidation at the time of the alleged breach)). Defendants also never address the case law holding that the mere possibility of an additional amendment, as speculated by the District Court, is not a basis for holding a claim unripe. *See* COB at 42 (citing *Am. Petroleum Inst. v. EPA*, 906 F.2d 729, 739-40

(D.C. Cir. 1990) (possibility of future agency action is not sufficient to foreclose judicial review of a definitive action)).

Defendants never address these cases because they have no answer to them. They have *no case* that supports their position that even when a shareholder's contractual liquidation rights are completely nullified, that shareholder has no ripe claim to bring unless and until there is an actual liquidation.

Moreover, Defendants have repudiated their contractual obligations by unequivocally committing that the Companies will not make liquidation distributions to private shareholders. Consolidated Class Complaint, ¶¶94-95. Thus, Class Plaintiffs' have ripe claims to bring right now. *See, e.g., Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240 (1937) (insureds had ripe contract claims in light of insurer's repudiation).

D. Class Plaintiffs Stated A Valid Claim For Breach Of The Implied Covenant Of Good Faith And Fair Dealing.

FHFA does not address the merits of the implied covenant claim, but merely asserts that the implied covenant of good faith and fair dealing does not apply where there is no underlying contractual right and cannot be used to impose a "free floating duty." FHFA Br. at 57-58. This is irrelevant because (as shown above and in our opening brief) Class Plaintiffs have valid contractual rights. And Class Plaintiffs do not seek to impose a "free floating duty." Rather, Class Plaintiffs present a classic case showing that the implied covenant has been breached: FHFA

deliberately deprived Class Plaintiffs of *any* fruits of their bargain. *See, e.g., QVT Fund v. Eurohypo Capital Funding LLC*, 2011 WL 2672092, at *14-15 (Del. Ch. July 8, 2011); *Quadrangle*, 1998 WL 778359, at *6.

III. THIS COURT SHOULD REVERSE THE LOWER COURT'S DISMISSAL OF THE FIDUCIARY BREACH CLAIMS.

A. Class Plaintiffs Are Permitted To Bring Both Derivative and Direct Fiduciary Breach Claims.

1. Class Plaintiffs Are Entitled To Bring Derivative Fiduciary Breach Claims On Behalf Of Both Fannie Mae And Freddie Mac.

Class Plaintiffs are entitled to bring derivative claims where there is a "manifest conflict of interest" preventing FHFA from bring those claims. *See* Section I, *supra*. FHFA simply cannot bring the claims asserted by Class Plaintiffs without being confronted with manifest conflicts of interest every step of the way: it would have to sue its sister Government agency, Treasury, and itself; it would have to allege that by agreeing to the Net Worth Sweep, both it and Treasury funneled billions of dollars to Treasury that belonged to private shareholders; and it would have to allege this violated fiduciary duties owed both by it and by its sister agency Treasury; and it would then have to seek maximum damages for that breach.

2. Class Plaintiffs Are Entitled To Bring Direct Fiduciary Breach Claims On Behalf of Fannie Mae Shareholders.

Even if the Court holds there is no "conflict of interest" exception, Class Plaintiffs representing Fannie Mae shareholders also assert direct claims against Defendants for breach of their fiduciary duties. *See* COB §II.B.1. Under Delaware law, minority shareholders have the right to advance ***both*** direct and derivative claims where a fiduciary exercises its control "to expropriate, for its benefit, economic value and voting power from the public shareholders." *Gatz v. Ponsoldt*, 925 A.2d 1265, 1280-81 (Del. 2007); *see also Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006); *Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 655 (Del. Ch. 2013) (collecting cases). That test is met here. The Net Worth Sweep expropriates economic value from the shares owned by private shareholders. By sidestepping the voting provisions in the preferred stockholders' Certificates, the Net Worth Sweep effectively expropriated the preferred stockholders' voting powers as well.

Defendants argue Class Plaintiffs' claims are solely derivative under the two-part test set forth in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). As a preliminary matter, it is not clear that the *Tooley* test need even be applied in a dual-injury case applying *Gatz* and *Gentile* (both of which post-date *Tooley*). *See Starr Int'l Co. v. U.S.*, 106 Fed. Cl. 50, 62 (Fed. Cl. 2012) (noting distinction between *Tooley* standard and *Gatz* dual-injury standard).

Nonetheless, Class Plaintiffs' claims do satisfy the *Tooley* test. *First*, Class Plaintiffs have suffered injuries that are "independent of any alleged injury to the corporation," and can prevail on those claims "without showing an injury to the corporation." *Tooley*, 845 A.2d at 1039. Class Plaintiffs' loss of their voting rights and liquidation preferences inflicted no harm on the corporation whatsoever. Also, to the degree the Net Worth Sweep affected the distribution of dividends by allowing Treasury to capture dividend payments that otherwise would have gone to Fannie Mae's private shareholders, this also would be an injury borne solely by those shareholders and not by the corporation. *Second*, some portion of the relief sought would flow "directly to the stockholders, not the corporation." *Tooley*, 845 A.2d at 1036. Rescission of the Net Worth Sweep would restore the preferred stockholders' voting rights, dividend rights, and liquidation preferences.

Defendants also argue that a transaction presents dual direct and derivative claims only under a narrow set of circumstances wherein a company issues excessive shares, thereby increasing the shareholder's voting power. FHFA Br. at 46-47; Treasury Br. at 20-21. Not so. Such corporate overpayment claims are merely an example of "one transactional paradigm … that Delaware case law recognizes as being both derivative and direct in character." *Gentile*, 906 A.2d at 99; *see also El Paso*, 2015 WL 7758609, at *28 ("Subsequent cases have recognized that the principle recognized in *Gentile* was not limited to dilutive

issuances involving majority stockholders[.]"). Because the Net Worth Sweep had the effect of transferring the public stockholders' economic and voting interests to Treasury, it fits within the paradigm of dual-injury cases that involve both harm to a corporation and direct harm to corporate shareholders under Delaware law. *See, e.g.*, *Starr*, 106 Fed. Cl. 64-65 (holding that under Delaware law, stockholders were entitled to assert direct claims in connection with the illegal exaction of their economic and voting power resulting from the Government bail-out of AIG).

Finally, Class Plaintiffs' direct fiduciary claims were appropriately pled, presented to the Court below, and preserved for appeal. The direct claims were pled in the Consolidated Class Complaint because the count for breach of fiduciary duty repeatedly makes reference to Defendants' fiduciary duties owed directly to Fannie Mae shareholders, and to the breach of those duties.[10] The direct claims were presented to the District Court, since Class Plaintiffs argued that Defendants had violated their fiduciary duties not only to Fannie Mae but also to its

[10] Consolidated Class Complaint, ¶176 ("FHFA was and is required to act in the best interests of Fannie Mae *and its shareholders* so as to benefit all shareholders equally,"); *id*. ¶177 ("As controlling stockholder of Fannie Mae, Treasury owed fiduciary duties of due care, good faith, loyalty, and candor, to Fannie Mae *and its other stockholders*."); *id*. ¶178 (the Net Worth Sweep was implemented to "the detriment of Fannie Mae *and its stockholders other than Treasury*."); *id*. ¶180 (the Net Worth Sweep did not "reflect a good faith business judgment as to what was in the best interests of Fannie Mae *or its shareholders*.") (emphasis added).

shareholders.[11] Thus, the issue is properly before this Court. (At worst, Class Plaintiffs should be entitled to a remand to allow them to amend if deemed necessary).

B. Class Plaintiffs Are Entitled To Pursue Their Fiduciary Breach Claims Against Treasury As Well As FHFA.

Treasury disputes its role as a fiduciary, arguing that it is not a controlling shareholder because it "is not and has never been a majority shareholder, [as it] does not have voting rights in the GSEs" and "[i]ts rights as a senior preferred shareholder are entirely contractual." Treasury Br. at 49-50. The argument ignores Treasury's *de facto* control over the Companies. *See Ivanhoe Partners v. Newmont Min. Corp.*, 535 A.2d 1334, 1344 (Del. 1987); *Parsch v. Massey*, 2009 WL 7416040, at *11 (Va. Cir. Ct. Nov. 5, 2009). In addition to obtaining 100% of the Government Stock and the right to acquire 79.9% of the common stock of both companies for nominal value, Treasury also obtained extraordinary control over the day-to-day affairs of the Companies. The Companies cannot, without Treasury's consent, *inter alia*: (1) issue capital stock; (2) pay dividends to any shareholder other than Treasury; (3) enter into any new or adjust any existing compensation agreements with officers; and (4) sell, convey or transfer any of its assets outside the ordinary course of business. COB at 18. Thus, Treasury

[11] *See, e.g.*, MTD Op. Br. at 43-44 ("FHFA and Treasury have violated their fiduciary duties to Fannie Mae *and its shareholders*.") (emphasis added).

exercises *de facto control* over the Companies. *See Williamson v. Cox Commc'ns, Inc.*, 2006 WL 1586375, at *5 (Del. Ch. June 5, 2006) (finding plaintiffs alleged "actual control" where corporation relied on the allegedly controlling shareholders to stay in business and the allegedly controlling shareholders had ability to veto board actions).[12] None of the cases cited by Treasury address facts where the defendant had the same control as Treasury has over the day-to-day affairs of the Companies, rendering those cases inapposite.

Treasury contends "the duty of loyalty applies only when a controlling shareholder stands on both sides of a transaction and dictates its terms." Treasury Br. at 51. That is what happened here. On one side of the transaction, Treasury was the *de facto* controlling shareholder and the voice of the Government to which FHFA answers, and on the other side of the transaction Treasury was the recipient of the multi-billion dollar Net Worth Sweep.

Treasury also invokes the inapposite decision in *Starr Int'l Co. v. Fed. Reserve Bank of New York*, 742 F.3d 37, 42 (2d Cir. 2014). That case addressed fiduciary duty claims relating to actions undertaken during "exigent" circumstances when a failure to seize control of AIG threatened cascading losses and collapses throughout the financial system. *See id.* (holding that federal

[12] Treasury incorrectly argues "Plaintiffs assert that the potential to exercise stock rights creates a duty as a controlling shareholder." Treasury Br. at 51. Rather, Class Plaintiffs contend that the potential to exercise stock rights is a *factor* for the court to consider.

common law preempted state fiduciary duty law under the unique facts of that case).[13] By contrast, here, the Companies were in a stable and profitable financial position when the Third Amendment was imposed, four years after the financial crisis of September 2008.

CONCLUSION

The District Court's decision should be reversed.

Dated: February 2, 2016

Respectfully submitted,

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[13] Treasury wrongly asserts Plaintiffs waived any argument for jurisdiction under the Federal Tort Claims Act ("FTCA"). Treasury Br. at 50 n.10. The District Court never discussed the FTCA; instead, it incorrectly concluded these claims were derivative and barred by HERA. Plaintiffs had no obligation to address an issue not addressed below.

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C) and this Court's May 6, 2015 Order, I hereby certify that this brief complies with the type-volume limitation because it contains 5,445 words, excluding the parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii). I further certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the typeface style requirements of Fed. R. App. P. 32(a)(6) because the brief was prepared in 14-point Times New Roman font using Microsoft Word.

CERTIFICATE OF SERVICE

I hereby certify, pursuant to Fed. R. App. P. 25(c) and Cir. R. 25, that on February 2, 2016, the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system, which will send a notification to the attorneys of record in this matter who are registered with the Court's CM/ECF system.

DATED: February 2, 2016

/s/ *Hamish P.M. Hume*
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