

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE**

DAVID JACOBS and GARY HINDES, on)
behalf of themselves and all others similarly)
situated, and derivatively on behalf of the)
Federal National Mortgage Association and)
Federal Home Loan Mortgage Corporation,)
)
Plaintiffs,)
)
v.)
)
THE FEDERAL HOUSING FINANCE)
AGENCY, *et al.*,)
)
Defendants.)

C.A. No. 15-708

**REPLY BRIEF IN SUPPORT OF MOTION TO DISMISS OF
THE DEPARTMENT OF THE TREASURY**

Dated: July 17, 2017

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INTRODUCTION

The Court should dismiss this case for any one of the following purely legal reasons. First, Section 4617(f) of the Housing and Economic Recovery Act (“HERA”) bars plaintiffs’ claims for injunctive relief seeking to reverse a transaction by which the Department of the Treasury and FHFA, as conservator of Fannie Mae and Freddie Mac (“the GSEs” or “the enterprises”), agreed to provide the GSEs with hundreds of billions of dollars in capital, “[i]n an effort to keep Fannie Mae and Freddie Mac afloat.” *Perry Capital LLC v. Mnuchin*, 848 F.3d 1072, 1079 (D.C. Cir. 2017).

Second, HERA provides that during conservatorship shareholders such as plaintiffs cannot exercise the right to bring derivative claims on behalf of the GSEs. *See* 12 U.S.C. § 4617(b)(2)(A)(i); *see also Perry Capital*, 848 F.3d at 1104. Plaintiffs’ claims are classically derivative: They allege that the GSEs are overpaying for the capital support provided by Treasury, and seeks relief on behalf of the GSEs. The ability to bring these claims has been transferred to FHFA, and plaintiffs cannot present them.

Third, plaintiffs have yet to explain how any of the counts of the amended complaint against Treasury fall within the waiver of sovereign immunity in Section 702 of the APA. This waiver of sovereign immunity contemplates that a court will order the disbursement of funds from the federal government only where a plaintiff seeks to enforce a federal statutory mandate for the payment of money. Plaintiffs do not identify a federal statute at issue, let alone an entitlement. Further, their attempts to characterize these claims as “illegal exaction” claims represent a significant concession on this point, as illegal exaction claims are money damages claims that can be brought only pursuant to the Tucker Act.

Fourth, the claims presented in the amended complaint fail as a matter of law under the doctrines of preemption, intergovernmental immunity, and fail to state a claim. Plaintiffs allege that the dividend terms of the senior preferred stock that Treasury holds in the GSEs violate statutory restrictions found in state corporate law, and allege that Treasury has been unjustly enriched as a result of these supposed violations. These claims are barred by preemption, because HERA, an act of Congress, authorized the preferred stock purchase agreements at issue in this case. These claims against Treasury are also barred by the doctrine of intergovernmental immunity, because states have no power to regulate the operations of the federal government. And even if state law did apply, plaintiffs' claims fail on their own terms because the Third Amendment complies with state law.

Fifth, the doctrine of issue preclusion bars the plaintiffs from re-litigating in this shareholder derivative action any issue which was litigated and resolved in the previous, unsuccessful shareholder derivative actions, including the applicability of Section 4617(f), and the transfer of shareholder rights under Section 4617(b)(2)(A)(i). Plaintiffs seek to avoid dismissal due to issue preclusion by arguing that due process considerations should bar its application here, but the precedents they cite deal with class action litigation, not shareholder derivative litigation, where issue preclusion is routinely applied to avoid needless, repetitive litigation.

Ultimately, this case is one in a series of lawsuits brought by GSE shareholders trying to challenge the terms of the senior preferred stock. Every suit seeking injunctive relief to void or reverse the Third Amendment has been dismissed.¹ Indeed, while plaintiffs were drafting their

¹ See *Perry Capital, LLC v. Mnuchin*, 848 F.3d 1072, 1080 (D.C. Cir. 2017) (affirming in pertinent part *Perry Capital v. Lew*, 70 F. Supp. 3d 208, 246 (D.D.C. 2014)); *Saxton v. FHFA*, No. 15-cv-47(LRR), 2017 WL 1148279, at *10 (N.D. Iowa Mar. 27, 2017), *appeal docketed* No. 17-1727 (8th Cir. 2017); *Roberts v. FHFA*, 2017 WL 1049841, at *2 (N.D. Ill. Mar. 20, 2017), *appeal docketed* No. 17-1880 (7th Cir. 2017); *Robinson v. FHFA*, 2016 WL 4726555, at *5-8 (E.D. Ky.

opposition brief, yet another federal court dismissed yet another shareholder suit. *See Collins v. FHFA*, No. CV H-16-3113, 2017 WL 2255564, at *3-*4 (S.D. Tex. May 22, 2017), *appeal docketed* No. 17 -20364 (5th Cir. 2017). The plaintiffs' suit contains the same flaws as its predecessors, and the Court should dismiss the amended complaint with prejudice.

DISCUSSION

I. Plaintiffs' Claims Against Treasury Are Barred by HERA's Anti-Injunction Provision.

Plaintiffs' suit is barred by 12 U.S.C. § 4617(f), which provides that “no court may take any action to restrain or affect the exercise of powers or functions of [FHFA] as a conservator” of the GSEs. “The plain statutory text draws a sharp line in the sand against litigative interference – through judicial injunctions, declaratory judgments, or other equitable relief – with FHFA’s statutorily permitted actions as conservator or receiver.” *Perry Capital*, 848 F.3d at 1087. Like its analogue under the Financial Institutions Reform, Recovery and Enforcement Act (“FIRREA”), *see* 12 U.S.C. § 1821(j), this provision “effect[s] a sweeping ouster of courts’ power to grant equitable remedies” to parties challenging actions taken by a conservator. *Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995) (interpreting FIRREA’s equivalent anti-injunction provision); *Town of Babylon v. FHFA*, 699 F.3d 221, 228 (2d Cir. 2012) (section 4617(f) “excludes judicial review of ‘the exercise of powers or functions’ given to the FHFA as a conservator”).

In their opposition brief, plaintiffs attempt to stave off dismissal by adopting a reading of the anti-injunction provision that is internally inconsistent and in any event would render the provision superfluous. They acknowledge precedent from the Third Circuit and other courts of appeal setting forth the broad scope of the anti-injunction provision, but assert that “[t]hese cases

Sept. 9, 2016), *appeal docketed* No. 16-6680 (6th Cir. 2016); *Cont’l W. Ins. Co. v. FHFA*, 83 F. Supp. 3d 828, 840 n.6 (S.D. Iowa 2015).

are best understood to mean only that Section 1821(j) applies even when a conservator or receiver violates some law *other* than FIRREA.” Plaintiffs’ Brief in Opposition at 40 n.37, D.I. 69 (“Opp.”). Their own amended complaint, however, asserts violations of Delaware and Virginia state corporate law – that is, two sources of law “other than” HERA. To transform a supposed violation of state corporate law into a violation of HERA, they argue that HERA should be read as incorporating all of the legal restrictions that are otherwise applicable to the GSEs outside of conservatorship. Opp. at 36-37 (FHFA “must comply with the same state corporate laws that governed these entities’ prior to the conservatorship.”). This reading of the anti-injunction provision – which would make injunctive relief against the conservator available in every situation in which it would be available against the GSEs – would make the provision superfluous. For that reason, the Third Circuit and the other federal courts of appeal have squarely rejected plaintiffs’ interpretation. *See Gross v. Bell Sav. Bank PaSA*, 974 F.2d 403, 407 (3d Cir. 1992) (“where the RTC performs functions assigned it under the statute, injunctive relief will be denied even where the RTC acts in violation of other statutory schemes”); *see also Rosa v. Resolution Trust Corp.*, 938 F.2d 383, 397 (3d Cir. 1991); *Nat’l Trust for Historic Pres. in U.S. v. FDIC*, 995 F.2d 238, 240 (D.C. Cir.), *reh’g granted, judgment vacated*, 5 F.3d 567 (D.C. Cir. 1993), *and opinion reinstated in part on reh’g*, 21 F.3d 469 (D.C. Cir. 1994) (“We do not think it possible, in light of the strong language of § 1821(j), to interpret the FDIC’s ‘powers’ and ‘authorities’ to include the limitation that those powers be subject to – and hence enjoined for non-compliance with – any and all other federal laws.”).

Plaintiffs’ argument is also inconsistent with the purpose and plain text of HERA, which “endows FHFA with extraordinarily broad flexibility to carry out its role as conservator.” *Perry Capital*, 848 F.3d at 1087. These broad, flexible powers include the authority to “take over the

assets of and operate [the GSEs],” to “conduct all business of the regulated entit[ies],” to “preserve and conserve the assets and property of the [enterprises],” and to “transfer or sell any asset or liability of the regulated entity.” 12 U.S.C. § 4617(b)(2)(B),(G). “FHFA’s execution of the Third Amendment falls squarely within its statutory authority to ‘[o]perate the [Companies],’ 12 U.S.C. § 4617(b)(2)(B); to ‘reorganiz[e]’ their affairs, *id.* § 4617(a)(2); and to ‘take such action as may be . . . appropriate to carry on the[ir] business,’ *id.* § 4617(b)(2)(D)(ii).” *Perry Capital*, 848 F.3d at 1088 (alterations in original). Congress’ decision to confer this expansive authority upon FHFA when operating as conservator or receiver belies plaintiffs’ contention that the statute does no more than make FHFA identically situated to the GSEs in their pre-conservatorship form, and it is FHFA’s exercise of these powers or functions that Section 4617(f) protects. *Cf. id.* at 1094 (“Congress made clear in [HERA] that FHFA is not your grandparents’ conservator. For good reason.”).

Plaintiffs offer no response to Treasury’s argument that Section 4617(f) prohibits relief directed at a contractual counter-party, such as Treasury, where such relief would also serve to restrain or affect the conservator. *See* Treasury Opening Br. at 13-14, D.I. 66. “[T]he effect of any injunction or declaratory judgment aimed at Treasury’s adoption of the Third Amendment would have just as direct and immediate an effect as if the injunction operated directly on FHFA.” *Perry Capital*, 848 F.3d at 1096; *Hindes v. FDIC*, 137 F.3d 148, 160 (3d Cir. 1998) (Section 1821(j) “by its terms, can preclude relief even against a third party”); *see also Roberts*, 2017 WL 1049841, at *6 (“It takes two to tango, and undoing one side of the Third Amendment against Treasury necessarily affects FHFA, which is, after all, the other party to the Third Amendment.”); *see also Collins*, 2017 WL 2255564, at *4; *Saxton*, 2017 WL 1148279, at *11; *Robinson*, 2016 WL 4726555, at *3. Section 4617(f) thus bars all of the counts of plaintiffs’ amended complaint,

which seek in various ways to enjoin and unwind the Third Amendment. *See* Treasury Opening Br. at 10.

II. Plaintiffs' Claims Against Treasury Are Not Within Section 702's Waiver of Sovereign Immunity.

The United States has sovereign immunity from the claims presented. Plaintiffs cannot use the APA's waiver of sovereign immunity, 5 U.S.C. § 702, to seek a judicial order mandating that Treasury disburse billions of dollars to the GSEs. Plaintiffs continue to insist that *Bowen v. Massachusetts*, 487 U.S. 879 (1988), allows them to pursue their state corporate law and state law unjust enrichment counts. Opp. at 29-30. *Bowen*, however, stands only for the proposition that an order requiring the payment of money can fall within the waiver of sovereign immunity under Section 702 when it seeks to enforce a federal statutory mandate for the payment of money. *Bowen*, 487 U.S. at 900-01; *see also Zellous v. Broadhead Assocs.*, 906 F.2d 94, 97 (3d Cir. 1990) (*Bowen* applies to suits that seek to “enforce the statutory mandate itself, which happens to be one for the payment of money.”); *America's Cmty. Bankers v. FDIC*, 200 F.3d 822, 829 (D.C. Cir. 2000) (“[w]here a plaintiff seeks an award of funds to which it claims *entitlement under a statute*, the plaintiff seeks specific relief, not damages.”) (emphasis added); *Hubbard v. EPA*, 982 F.2d 531, 536, 538 (D.C. Cir. 1992) (en banc) (describing money relief as appropriate in a “suit to enforce a statutory *entitlement*” or where litigants are “statutorily entitled” to certain costs). More importantly, the Supreme Court has held that Section 702's waiver of sovereign immunity cannot be read as “waiving immunity from all actions that are equitable in nature.” *Dep't of the Army v. Blue Fox*, 525 U.S. 255, 261 (1999). As the Supreme Court noted in *Blue Fox*, “our precedent establish[es] that sovereign immunity bars creditors from attaching or garnishing funds in the Treasury, or enforcing liens against property owned by the United States,” and that nothing in Section 702 expressed an intent to overrule this precedent. *Id.* at 264 (citation omitted). Plaintiffs

are thus swimming upstream from the start by seeking to force any disbursement of funds from the Treasury.

Neither plaintiffs' amended complaint nor their opposition brief demonstrate the requisite statutory entitlement to money that would make Section 702 applicable. Rather, they characterize their claim as a "request for restitution in the form of disgorgement of the monies that *never should have been distributed to Treasury.*" Opp. at 30 (emphasis added). A suit to enforce state law prohibitions on dividend terms is not a suit to enforce a statutory entitlement to the payment of money, a fact that plaintiffs concede by relying on equitable principles of "unjust enrichment" in order to obtain the relief that they seek. The fact that plaintiffs label their claim as one for "restitution," Opp. at 30, does not alter this conclusion. *See Hubbard*, 982 F.2d at 538 ("Whether we or someone else call a remedy restitutionary, equitable or anything else, it fits within § 702's waiver only if it gives the plaintiff *the specific thing to which he was originally entitled.*") (emphasis added).

Plaintiffs' requested remedy is not that they be given money to which they were individually entitled, but that Treasury return "*to the Companies* the monies it unlawfully extracted from them." Opp. at 29 (emphasis added). Plaintiffs are seeking equitable relief to unwind a transaction to which they were not parties because the transaction allegedly does not comply with state law; nothing in Section 702, or the case law applying it, suggests that the waiver of sovereign immunity can be stretched so far.

Any relief requiring the payment of money by Treasury based on a state law violation would run afoul of the "explicit rule of decision" of the Appropriations Clause, which is that "no money can be paid out of the Treasury unless it has been appropriated *by an [A]ct of Congress.*" *OPM v. Richmond*, 496 U.S. 414, 424 (1990) (emphasis added). Despite the Supreme Court's

admonition that this rule applies to “a claim for money from the Federal Treasury,” *id.*, plaintiffs insist that the Appropriations Clause “has nothing to do with this case.” Opp. at 31. The only support they can muster for that proposition is a 44-year old, out-of-circuit district court decision, which was decided before the Supreme Court’s decision in *Richmond*. See *id.* (citing *La. v. Weinberger*, 369 F. Supp. 856, 860 (E.D. La. 1973)). In any event, *Weinberger* involved a congressional appropriation, see 369 F. Supp. at 860, and so cannot stand for the proposition that a plaintiff can seek the payment of money from Treasury on state law or equitable principles.²

Plaintiffs also argue that the Appropriations Clause does not bar a claim “to recover an illegal exaction made by officials of the Government.” Opp. at 31 (quoting *Eastport S.S. Corp. v. United States*, 372 F.2d 1002, 1008 (Fed. Ct. Cl. 1967)). But “illegal exaction” claims are cognizable only as claims for *money damages* and must be brought under the Tucker Act. See *Ontario Power Generation, Inc. v. United States*, 369 F.3d 1298, 1301 (Fed. Cir. 2004) (holding that the Tucker Act’s waiver of sovereign immunity includes illegal exaction claims); see also *Ecco Plains, LLC v. United States*, 728 F.3d 1190, 1202 (10th Cir. 2013) (illegal exaction claim brought in district court should have been dismissed for lack of jurisdiction under the Tucker Act).³ Plaintiffs’ reliance on this line of authority is a significant concession, as it acknowledges that their

² Furthermore, the principle cited by the court in *Weinberger*, “that lapse of appropriation, failure of appropriation, exhaustion of appropriation, do not of themselves preclude recovery for compensation otherwise due,” is inapposite. “Its validity flows not from an inherent judicial power to order the obligation of public money but from the fact that the courts do not deal with questions of appropriations at all.” *Nat’l Ass’n of Reg’l Councils v. Costle*, 564 F.2d 583, 590 n.16 (D.C. Cir. 1977). Moreover, it does not alter the rule that “[i]f there is no such appropriation out of which a judgment can be paid, the courts still cannot order that it be satisfied.” *Id.*

³ In fact, other shareholders in the GSEs are currently pursuing such illegal exaction claims in the Court of Federal Claims. See Am. Verified Compl. at 35–36, ECF No. 19, *Rafter v. United States*, No. 1:14-cv-740-MMS (Ct. Fed. Cl. Sept. 2, 2015); Compl. at 61–63, ECF No. 1, *Washington Federal v. United States*, No. 1:13-cv-385-MMS (Fed. Cl. June 10, 2013).

“unjust enrichment” claims are, in fact, money damages claims that do not seek to enforce a statutory mandate and can be brought, if at all, only under the Tucker Act. That concession requires the dismissal of their claims.

III. HERA’s Transfer of Shareholder Rights Provision Bars Plaintiffs’ Claims.

HERA transferred all stockholder rights, including the right to bring the claims presented to FHFA for the duration of the conservatorships, providing that “[FHFA] shall, as conservator or receiver, and by operation of law, immediately succeed to . . . all rights, titles, powers, and privileges of the regulated entity, and of any stockholder, officer, or director of such regulated entity with respect to the regulated entity and the assets of the regulated entity.” 12 U.S.C. § 4617(b)(2)(A)(i). This provision, by its terms, bars any suit predicated on plaintiffs’ status as shareholders brought “with respect to the regulated entity and the assets of the regulated entity.” It also “plainly transfers [to FHFA the] shareholders’ ability to bring derivative suits’ on behalf of the companies.” *Perry Capital*, 848 F.3d at 1104 (quoting *Kellmer v. Raines*, 674 F.3d 848, 850 (D.C. Cir. 2012)). Plaintiffs try to escape Section 4617(b) by arguing that their claims are direct because they have suffered “distinct, individual harm” and therefore have not been transferred to FHFA. *Opp.* at 49. However, the Amended Complaint expressly labels each of plaintiffs’ four counts as “direct and derivative claims,” *see* Am. Compl. at 26-31, D.I. 62, asserts harm to the GSEs, *see, e.g., id.* ¶ 18, and seeks relief against Treasury – the return of dividends paid under the Third Amendment upon a finding that the Amendment is void – that would flow directly to the GSEs. As such, their claims are solely derivative.

Plaintiffs’ claims are derivative because they are based on alleged harm to the GSEs, not the shareholders individually. *See Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004). Plaintiffs’ theory is that the Third Amendment deprives the GSEs of funds that

could otherwise be used to pay dividends to them, thereby diminishing the value of plaintiffs' shares. As plaintiffs' assert in opposition, the Third Amendment harmed them insofar as it "implemented the government's self-dealing expropriation of the remaining value of the private investors' stock," and made it "impossible for either [GSE] to ever have a positive net worth, to ever pay a dividend on other classes or series of stock, or to ever emerge from conservatorship." Opp. at 11. It is black letter law that such claims are derivative, not direct, because reduction in stock value is an "*indirect injury*" that is contingent upon an injury to the company itself. *Tooley*, 845 A.2d at 1037. Indeed, an alleged "deplet[ion of] corporate assets that might otherwise [have] be[en] used to benefit stockholders, such as through a dividend," "harms the stockholders only derivatively so far as their *stock loses value*." *Protas v. Cavanagh*, No. Civ. A. 6555-VCG, 2012 WL 1580969, at *6 (Del. Ch. May 4, 2012) (emphasis added).

Plaintiffs cannot recast their claims as direct by including the additional allegations that the Third Amendment harmed their purported contract rights as shareholders. See Opp. at 46-47. As the Delaware Supreme Court held in *El Paso Pipeline GP Co. v. Brinckerhoff*, 152 A.3d 1248, 1259 (Del. 2016), Delaware law "does not support the proposition that *any* claim sounding in contract is direct by default, irrespective of *Tooley*." Plaintiffs' reference to their "contract rights" under the GSEs' corporate charters and bylaws is just another means of alleging harm to the value of their shares resulting from the Third Amendment. See *In re Ionosphere Clubs, Inc.*, 17 F.3d 600, 606-07 (2d Cir. 1994) (rejecting similar argument and holding claims are derivative where "[t]he injury to the Preferred holders' contractual rights to receive dividend and sinking fund payments was not inflicted 'directly' or 'independently of the corporation'").

Plaintiffs acknowledge that their claims allege harm to the GSEs and are thus properly derivative claims; indeed they explicitly "bring[] this action derivatively on behalf of and for the

benefit of” the GSEs, Am. Compl. ¶ 68, and allege that demand is excused in this case, *id.* ¶ 74. Demand is relevant only for derivative actions. *See* Fed. R. Civ. P. 23(b)(3). Their contention that they assert direct claims based on the Third Amendment’s alleged “extraction” of value from plaintiffs’ shares and “redistribution” of that value to Treasury, Opp. at 48, is based upon a narrow exception that has no application here. As explained in Treasury’s opening brief, plaintiffs’ claims do not fit the demanding criteria for asserting a “dual-natured claim” under Delaware law, *i.e.* that “(1) a stockholder having majority or effective control causes the corporation to issue ‘excessive’ shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling shareholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders.” *El Paso Pipeline*, 152 A.3d at 1262 (quoting *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006)). The actions of the controlling shareholder must dilute the voting rights of the minority shareholders; absent such vote dilution, claims of “extraction of solely economic value from the minority by a controlling stockholder” do not constitute direct injury. *Id.* at 1264.

This case features none of the elements of a dual-natured claim. Treasury is not a controlling shareholder and even if it were, the Third Amendment merely altered the way Treasury’s dividends are calculated under the existing stock. It “did not involve the issuance of any new shares let alone ‘excessive’ shares. Nor did the [Amendment] cause an increase in the percentage of outstanding shares owned by the Treasury” or by private investors. *Edwards v. Deloitte & Touche, LLP*, No. 16-21221-CIV, 2017 WL 1291994, at *7 (S.D. Fla. Jan. 18, 2017), *appeal docketed* No. 17-12852 (11th Cir. 2017). Further, “the Third Amendment in no way affected the Treasury’s or the Plaintiffs’ voting power.” *Id.* Indeed, Treasury has no voting rights at all. Plaintiffs thus cannot meet the requirements of this exception. *See Saxton*, 2017 WL

1148279, at *6 (alleged expropriation of stock value “does not support a direct claim, absent additional allegations that [the shareholders’] voting rights have been diluted”); *Edwards*, 2017 WL 1291994, at *7 (declining to apply *Gentile* exception and holding Third Amendment-related claims to be derivative); *Innovative Therapies, Inc. v. Meents*, Civ. A. No. 12–3309, 2013 WL 2919983, at *5 (D. Md. June 12, 2013) (declining to apply the exception where the “allegations rest solely on a purported loss in the economic value of [plaintiff’s] ownership stake rather than any loss of voting power”).

As to the second prong of the *Tooley* test, plaintiffs argue that they and the GSEs were injured by the Third Amendment in “independent and distinct ways,” and that they could thus be paid directly if successful in this suit. Opp. at 49-50. As described above, however, plaintiffs’ amended complaint asserts injury on the basis of diminution in share value stemming from a contract to which they were not a party. The relief they seek – the rescission of that contract and a return of dividends paid – flows not to plaintiffs directly, but to the GSEs (and only then through the FHFA, their conservator). See *Saxton*, 2017 WL 1148279, at *6 (finding that similar claim for relief “would flow to the GSEs, insofar as it would return paid dividends to the GSEs and eliminate the Third Amendment, which implicates the GSEs and not Plaintiffs individually”). Notwithstanding plaintiffs’ contention that relief should be granted “at the stockholder level,” Opp. at 49, the court’s inquiry is into “the nature of the wrong and to whom the relief *should go*.” *Tooley*, 845 A.2d at 1039 (emphasis added). Here, because the fundamental injury alleged is harm to the GSEs, the relief (if any) that would flow from such injury is to the GSEs, not the plaintiffs. *Edwards*, 2017 WL 1291994, at *7.

Finally, plaintiffs cannot circumvent the bar on derivative suits through a purported “conflict of interest” exception. Opp. at 52-55. No such exception exists. See FHFA Reply Section II; see also *Perry Capital*, 848 F.3d at 1106; *Saxton*, 2017 WL 1148279, at *12.

IV. Federal Law, Not State Law, Governs the Taxpayers’ Investments in the Enterprises.

Plaintiffs argue that state corporate law applies to the preferred stock held by Treasury because, prior to the passage of HERA and the commencement of the conservatorships, Fannie Mae’s and Freddie Mac’s corporate bylaws designated the corporate law of Delaware and Virginia, respectively, to apply to some aspects of their corporate governance. Opp. at 14. Plaintiffs’ argument assumes, without support, that state law applies of its own force to the property of the federal government. Plaintiffs are mistaken and cannot rely on state law to compel the result they seek.

As demonstrated in Treasury’s opening brief, the constitutional doctrine of intergovernmental immunity prevents a state from regulating the federal government directly. Treasury Opening Br. at 24; see also *Rousseau v. U.S. Dep’t of Treasury*, Civ. A. No. 04-4368 (MLC), 2010 WL 457702, at *10 (D.N.J. Feb. 5, 2010) (“In the absence of Congressional consent, ‘there is an implied constitutional immunity of the national government from . . . state regulation of the performance, by federal officers and agencies, of governmental functions.’” (quoting *Penn Diaries, Inc. v. Milk Control Comm’n*, 318 U.S. 261, 269 (1943))). Declaring a security held by the federal government, and authorized by federal law, “void *ab initio* and unenforceable” based on state law, as plaintiffs request, Opp. at 24, is the type of direct regulation of the federal government that the Supremacy Clause forbids.⁴

⁴ Plaintiffs argue that Treasury agreed to be bound by state law in the stock certificates. Opp. at 19-20. Not so. The stock certificates designate state law “as the federal rule of decision” only

Plaintiff does not address this argument in opposition, or provide any indication that Congress intended to have Delaware and Virginia state corporate law apply against Treasury and the property it acquired in its stock purchase agreements with FHFA. *See Hancock v. Train*, 426 U.S. 167, 179 (1976) (“[W]here Congress does not affirmatively declare its instrumentalities or property subject to regulation, the federal function must be left free of regulation.” (citation omitted)); *Ariz. v. Bowsher*, 935 F.2d 332, 334 (D.C. Cir. 1991). On the contrary, federal law affirmatively grants Treasury broad authority and discretion to purchase securities issued by the GSEs. *See* 12 U.S.C. § 1455(l)(1)(A); *id.* § 1719(g)(1)(A). For this reason alone – because plaintiffs cannot show that Treasury’s intergovernmental immunity against state law regulation has been overcome – plaintiffs’ state law claims against Treasury fail.

Despite plaintiffs’ tortured attempts to prove otherwise, state law simply does not govern stock purchase agreements between an agency of the United States and a conservator acting pursuant to a federal statute and issuing securities on behalf of federally-chartered entities. As mentioned above, federal law authorized the GSEs to issue the senior preferred stock at issue in this case and expressly permitted Treasury to establish the terms of those investments. *See* 12 U.S.C. 1455(l)(1)(A); *id.* 1719(g)(1)(A). Nothing in the corporate charters of the GSEs or their bylaws requires that state law should nonetheless apply. Those charters are creations of federal, not state, law, and authorize the GSEs to issue common and preferred stock “on such terms and conditions as the board of directors shall prescribe.” 12 U.S.C § 1718(a); *id.* § 1455(f). Moreover, the bylaws expressly provide that they only apply “to the extent not inconsistent with . . . Federal

insofar as federal law leaves a gap, and expressly provide that state law does not apply “where such [state] law is inconsistent with the Company’s enabling [federal] legislation, its public purposes or any provision of this Certificate.” Treasury Opening Br. Ex. B, § 10(e) (emphasis added). State law thus cannot be used to invalidate the preferred stock’s dividend terms.

law, rules, and regulations.” Fannie Mae Bylaws § 1.05; *see also* Freddie Mac Bylaws § 11.03. Given the federal nature of the corporate charters, and the bylaws’ expressly disclaimed intent to override federal law, plaintiffs can rely on neither document to override HERA and intergovernmental immunity and regulate directly the property of the federal government.

Moreover, even assuming *arguendo* that plaintiffs are correct in their understanding of Delaware and Virginia corporate law –*i.e.* that it imposes restrictions on dividends that make the Third Amendment illegal – this would establish that the state law upon which they rely is preempted by HERA. Under settled principles of preemption, state law is inapplicable if it conflicts with federal law. Conflict preemption exists where, as here, the challenged state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” *Arizona v. United States*, 567 U.S. 387, 399 (2012). As discussed above, HERA commits the terms of Treasury’s investments in the GSEs to the discretion of the Secretary of the Treasury, providing that the “obligations or securities” held by Treasury are to be made “on such terms and conditions *as the Secretary may determine*,” provided that Treasury and the GSEs reach a mutual agreement on those terms. 12 U.S.C. §§ 1455(l)(1)(A), 1719(g)(1)(A) (emphasis added); *cf. Am. Legion v. Derwinski*, 54 F.3d 789, 799 (D.C. Cir. 1995) (finding similar language to confer “broad discretion” upon an agency).

The purpose of this discretion is to protect the taxpayers and the broader financial markets, not to serve the interests of the GSEs’ shareholders. HERA directed that Treasury’s investment in the GSEs be preceded by a determination that such investments are necessary to protect the financial markets, preserve the availability of mortgage finance, and protect the taxpayers. 12 U.S.C. §§ 1455(l)(1)(B); 1719(g)(1)(B). HERA also sets forth various “considerations” governing Treasury’s initial investment decision, including “[t]he need for preferences or priorities regarding

payments to the Government,” and “[r]estrictions on the use of Corporation resources, including limitations on the payment of dividends . . .” *Id.* §§ 1455(l)(1)(C); 1719(g)(1)(C). These considerations are expressly included in the statute “to protect the taxpayers.” *Id.*

Plaintiffs protest that it would not be *impossible* for Treasury to protect the taxpayers’ investment in the GSEs and comply with the limitations on dividends that plaintiffs purport to find in state law. *Opp.* at 15. But “impossibility” preemption is only one of the forms of conflict preemption analysis, and the plaintiffs’ state corporate law claims are instead barred under principles of “obstacle preemption.” *See Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (state law is preempted where it “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress”). Where, as here, federal law contemplates that Treasury will act to protect the taxpayers when formulating policy and in making investment decisions, a state law restriction on the types of “preferences or priorities,” or “[r]estrictions on the use of corporation resources,” 12 U.S.C. §§ 1455(l)(1)(C)(i), 1719(g)(1)(C)(i), that Treasury may negotiate in order to protect the taxpayers’ investment “would interfere with the careful balance struck by Congress,” and thus would stand as an obstacle to the accomplishment of Congress’s objectives. *Arizona*, 567 U.S. at 406; *see also Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 12 (2007) (“[W]hen state prescriptions significantly impair the exercise of authority, enumerated or incidental under [the federal statute], the State’s regulations must give way.”).⁵

Finally, in any event, plaintiffs are wrong about the requirements of Delaware and Virginia

⁵ Plaintiffs’ argument that HERA does not specifically “authorize[.]” an agreement that does not comport with state corporate law, *Opp.* at 20, gets the inquiry backwards. “[S]tate law is naturally preempted to the extent of any conflict with a federal statute.” *Crosby v. Nat’l Foreign Trade Council*, 530 U.S. 363, 372 (2000). Federal law need not include such authorization because the Constitution provides that every federal enactment is superior to every state law or constitutional article. U.S. Const. art. VI, cl. 2.

law – neither prohibits the dividend terms of the Third Amendment – and thus the complaint fails to state a claim for violation of state law even if it is applied. *See* FHFA Reply Br. Section III.B.⁶

V. Plaintiffs’ Arguments Against Issue Preclusion Fail.

In two prior decisions – *Perry Capital* and *Saxton* – the courts dismissed derivative claims brought on behalf of the Enterprises on a variety of grounds. Here, the plaintiffs likewise are attempting to pursue derivative claims on behalf of the Enterprises. Plaintiffs are bound by the courts’ resolution of the issues raised by the derivative plaintiffs in these prior decisions; plaintiffs may not relitigate the very same issues here. Plaintiffs argue that issue preclusion should not apply because the defendants “have failed to establish the necessary elements of identity of issues and parties.” *Opp.* at 55. Plaintiffs assert that “[n]one of the plaintiffs in *Perry Capital* or *Saxton* asserted” the state law claims at issue here. *Opp.* at 56. This argument misunderstands the nature of both issue preclusion and derivative suits and ignores black letter law.

Issue preclusion bars relitigation of issues, even if those issues occur in the context of different claims. *Taylor v. Sturgell*, 553 U.S. 880, 892 (2008) (observing “‘successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment,’ *even if the issue recurs in the context of a different claim.*”) (emphasis added);

⁶ Counts III and IV are unjust enrichment claims, predicated on the violations of state law alleged in Counts I and II. *Am Compl.* ¶¶ 96, 99, 103, 106. If those counts are dismissed, then dismissal of Counts III and IV necessarily follows. It is thus difficult to fathom plaintiffs’ claim, in a footnote of their opposition brief, that “Defendants have not moved to dismiss Counts III and IV of the amended complaint pursuant to Rule 12(b)(6), and have presented no arguments for dismissal of those claims for failure to state a claim.” *Opp.* at 22 n.19. Defendants noted that, “all of plaintiffs’ claims are premised on the assertion that the variable dividend structure was invalid under state law,” *Treasury Opening Br.* at 28, and moved to dismiss the entire amended complaint. With respect to counts III and IV, defendants argued that those counts are barred by intergovernmental immunity, *see id.* at 23-25, preemption, *id.* at 27, and the express terms of the preferred stock purchase agreements, *id.* at 25-27, as well as incorporating FHFA’s arguments on state law, *id.* at 27. Each of these arguments pertains to Rule 12(b)(6).

see also Peloro v. United States, 488 F.3d 163, 174 (3d Cir. 2007) (same). As described in Treasury's opening brief, the *Perry Capital* and *Saxton* decisions specifically addressed (1) whether HERA bars all claims seeking equitable relief that would have the effect of undoing the Third Amendment; (2) whether FHFA acted within its statutory authority as conservator when it executed the Third Amendment; (3) whether HERA bars derivative claims by GSE shareholders, and (4) whether a conflict of interest exception to application of HERA's shareholder succession provision exists. These issues were actually litigated and necessary for the courts' dismissal of derivative claims in each case. *See Perry Capital*, 848 F.3d at 1097–1114 (breach of fiduciary duty claim was expressly derivative); *Saxton*, 2017 WL 1148279, at *5-7 (holding APA claim as derivative). Thus, plaintiffs are barred from re-litigating those issues here, even under the guise of different derivative claims.

Similarly, Plaintiffs' argument that they cannot be bound by judgments rendered in actions to which they were not a party lacks merit. In general, "a nonparty may be bound by a judgment" where their interests are "adequately represented by someone with the same interests who [was] a party' to the suit." *Taylor*, 553 U.S. at 894 (citations omitted). Moreover, "[i]t is a matter of black-letter law that the plaintiff in a derivative suit represents the corporation, which is the real party in interest." *In re Sonus Networks, Inc. Shareholder Derivative Litig.*, 499 F.3d 47, 63 (1st Cir. 2007); *see also Cottrell v. Duke*, 737 F.3d 1238, 1242 (8th Cir. 2013). As described above, plaintiffs here assert purely derivative claims, *see supra* Section III, on behalf of the GSEs. As such, they are bound by the courts' resolution of the disputed issues in *Perry Capital* and *Saxton* notwithstanding the fact that plaintiffs weren't individually parties to those actions. *See Sonus*, 499 F.3d at 64; *Arduini v. Hart*, 774 F.3d 622, 633–34 (9th Cir. 2014) (same).

Because they pursue derivative claims on behalf of the GSEs, rather than suits asserting their own individual rights, plaintiffs' alleged "due process" concerns are misplaced. Plaintiffs sue not in their own interest, but in the interest of the GSEs, and thus cannot complain that they have not had their "own day in court." Opp. at 57. As such, the due process concerns raised in *Smith v. Bayer Corp.*, 131 S. Ct. 2368 (2011), and the other class action cases on which plaintiffs rely, are not present in the context of a shareholder derivative action.⁷ See *Lewis v. Chiles*, 719 F.2d 1044, 1048 (9th Cir. 1983) (class actions are "not brought on behalf of the corporation but rather to assert primary individual rights"); *Anwar v. Fairfield Greenwich Ltd.*, 676 F. Supp. 2d 285, 297 (S.D.N.Y. 2009). Absent a serious contention that the earlier shareholders did not adequately represent their interests, federal courts have not found a due process problem in applying issue preclusion to derivative suits. See *Cramer v. Gen. Tel. & Elecs. Corp.*, 582 F.2d 259, 269 (3d Cir. 1978) ("Nonparty shareholders are usually bound by a judgment in a derivative suit on the theory that the named plaintiff represented their interests in the case."); *Arduini*, 774 F.3d at 634-36. Moreover, the due process concerns expressed in those cases were premised on the potential for collusive litigation between the parties. See *Cramer*, 582 F.2d at 269. No such concern is present here, where the previous dismissals were court-ordered and on the merits.

Plaintiffs argue that the *Perry Capital* and *Saxton* shareholder plaintiffs' alleged noncompliance with Federal Rule of Civil Procedure 23.1 prevents the current plaintiffs from being bound by the prior judgments. Opp. at 59. Rule 23.1 is merely a pleading rule and compels no such result. See *Blasband v. Rales*, 971 F.2d 1034, 1047 (3d Cir. 1992). Here, the courts in

⁷ Plaintiffs also cite *In re Ezcorp Inc. Consulting Agreement Deriv. Litig.*, 130 A.3d 934, 948 (Del. Ch. 2016), a trial court-level state court decision, but that case does not discuss the precedent from the federal courts of appeals applying issue preclusion to shareholder derivative claims.

both *Perry Capital* and *Saxton* determined, upon assessment of the relevant pleadings, that the litigation involved derivative claims. *See Perry Capital*, 848 F.3d at 1106-1108; *Saxton*, 2017 WL 1148279, at *5-7. To avoid applying issue preclusion in these circumstances merely because the prior shareholder suits did not make specific reference to Rule 23.1 would exalt style over substance and ascribe the Rule a needlessly formalistic interpretation.⁸ Plaintiffs assert claims on behalf of the GSEs, on whose behalf the plaintiffs in *Perry Capital* and *Saxton* litigated claims that the courts expressly recognized were derivative.

Finally, Plaintiffs are incorrect that the prior dismissals are not “on the merits” and do not bar subsequent derivative suits. *Opp.* at 60. “It has long been the rule that principles of res judicata apply to jurisdictional determinations – both subject matter and personal.” *Ins. Corp. of Ireland v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 702 n.9 (1982); *see also Bromwell v. Mich. Mut. Ins. Co.*, 115 F.3d 208, 212–13 (3d Cir. 1997) (“A dismissal for lack of subject-matter jurisdiction . . . is . . . conclusive as to matters actually adjudged.” (citation omitted)).

CONCLUSION

For the foregoing reasons, and for those stated in the reply brief of FHFA, the Court should grant the motions to dismiss.

⁸ In any case, courts “routinely permit a shareholder to bring a derivative suit where those in control of the corporation refuse to assert a claim belonging to it.” *Blasband*, 971 F.2d at 1047; *see also Sonus*, 499 F.3d at 67. Whether or not the shareholder plaintiffs in *Perry Capital* and *Saxton* mentioned Rule 23.1 by name, they both argued that a conflict of interest prevented the GSEs from pursuing claims on their own behalf against Treasury and FHFA, *see* Initial Opening Br. for Class Pls. at 23-34, *Perry Capital LLC v. Mnuchin*, 848 F.3d 1072, No. 14-5243 (D.C. Cir. 2017); Pls.’ Resp. to Defs.’ Mots. to Dismiss at 75-79, ECF No. 86, *Saxton v. FHFA*, No. 15-CV-47-LRR, 2017 WL 1148279 (N.D. Iowa March 27, 2017), thus making clear that in their estimation demand would have been futile.

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