

**IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA**

ANTHONY R. EDWARDS, *et al.*,

Plaintiffs,

v.

No. 1:16-cv-21224

PRICEWATERHOUSECOOPERS, LLP,

Defendant.

**THE FEDERAL HOUSING FINANCE AGENCY'S MOTION TO SUBSTITUTE AS
PLAINTIFF AND SUPPORTING MEMORANDUM OF LAW**

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INTRODUCTION

The Federal Housing Finance Agency (“FHFA” or the “Conservator”), as Conservator of the Federal Home Loan Mortgage Corporation (“Freddie Mac”), respectfully moves, pursuant to Local General Rule 7.1, for an order substituting the Conservator in the place of the shareholder plaintiffs in this action. When it was appointed as Conservator, FHFA “immediately succeed[ed] to . . . all rights, titles, powers, and privileges of [Freddie Mac], *and of any stockholder*” of Freddie Mac. 12 U.S.C. § 4617(b)(2)(A)(i) (emphasis added). In this case, Plaintiffs seek to assert their alleged rights as shareholders of Freddie Mac. But under the governing statutes, FHFA—not Plaintiffs—holds any and all such rights during conservatorship. As such, the Conservator is the only proper plaintiff, and the Court should grant FHFA’s motion to substitute.

Plaintiffs’ suit challenges the federal government’s response to the most serious economic crisis in generations and PricewaterhouseCoopers, LLP’s (“PwC”) alleged role in that response. FHFA was created by Congress in the wake of a national crisis in the U.S. housing market in 2008 as an independent federal agency to supervise and regulate Freddie Mac, the Federal National Mortgage Association (“Fannie Mae”), and certain other government-sponsored enterprises. During the fall of 2008, FHFA concluded that Freddie Mac and Fannie Mae were at risk of failure. Given their role in the national economy, and the systemic danger their potential collapse posed, FHFA’s Director placed Freddie Mac and Fannie Mae into conservatorship on September 6, 2008. Soon thereafter, the Conservator and the U.S. Department of Treasury (“Treasury”) entered into Preferred Stock Purchase Agreements (“PSPAs”), which made available to Freddie Mac and Fannie Mae a lifeline of hundreds of billions in capital.

Plaintiffs’ complaint alleges PwC, acting as Freddie Mac’s independent auditor, aided and abetted the Conservator and Treasury in breaching alleged fiduciary duties in connection with the operations of Freddie Mac in conservatorship undertaken pursuant to a federal statutory

regime. In particular, Plaintiffs allege the Conservator and Treasury improperly amended the PSPAs in the so called Third Amendment, which exchanged a fixed 10% dividend and periodic commitment fee for a variable dividend equal to Freddie Mac's net worth. *See* Compl. ¶¶ 31-43. Plaintiffs allege the Third Amendment harmed Freddie Mac and Plaintiffs' interests as shareholders of Freddie Mac. *Id.* ¶¶ 31-32, 38-40.

Plaintiffs also allege that the Conservator improperly wrote down the value of Freddie Mac's tax assets and loan loss reserves, forcing Freddie Mac to borrow money from Treasury and then pay larger dividends to Treasury, all with the alleged intent that FHFA and Treasury would use Freddie Mac's dividend payments "to bail out Wall Street banks." *Id.* ¶¶ 28, 59. Plaintiffs allege that the Conservator and Treasury could not have engaged in any of this alleged misconduct were it not for PwC's assistance. *Id.* ¶ 43. Additionally, Plaintiffs allege PwC violated federal auditing standards and prolonged the conservatorship in issuing its unqualified audit opinions on Freddie Mac's financial statements. *Id.* ¶¶ 44-97. According to Plaintiffs, PwC's misconduct harmed Freddie Mac and also Plaintiffs' interests as shareholders of Freddie Mac. *Id.* ¶¶ 37-38, 40-42. Further, Plaintiffs assert that, absent PwC's alleged misconduct, "Freddie Mac would have been able to exit the conservatorship," thus preventing the alleged harm to Plaintiffs. *Id.* ¶ 93.

Though the complaint is obviously premised upon a litany of alleged wrongdoing by the Conservator and Treasury, Plaintiffs have strategically elected not to sue those parties, but instead have asserted claims in this complaint solely against PwC.¹ But Plaintiffs' complaint, at its core, is a shareholder challenge to the Third Amendment, and it therefore raises factual and

¹ Plaintiffs also have filed a nearly identical action against Deloitte & Touche, LLP, the independent auditor for Fannie Mae. *See Edwards v. Deloitte & Touche, LLC*, No. 1:16-cv-21221 (S.D. Fla. removed Apr. 6, 2016).

legal issues that are materially identical to the issues raised in myriad other lawsuits already filed by other Freddie Mac (and Fannie Mae) shareholders against the Conservator and Treasury that likewise challenge the Third Amendment. Those suits consistently have been dismissed. *See Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208 (D.D.C. 2014), *appeal pending* No. 14-5243 (D.C. Cir.); *Cont'l W. Ins. Co. v. FHFA*, 83 F. Supp. 3d 828, 840 n. 6 (S.D. Iowa 2015). And the remaining suits are currently the subject of a motion to transfer pending before the U.S. Judicial Panel on Multidistrict Litigation (“JPML”). FHFA has likewise requested that the JPML transfer the present case to the proposed consolidated proceedings. *See infra* n.6.

This Court should substitute FHFA as Conservator in place of the shareholder Plaintiffs.

STATEMENT OF FACTS AND PROCEDURAL HISTORY

A. Freddie Mac, Fannie Mae, and the Housing and Economic Recovery Act of 2008

Freddie Mac, along with Fannie Mae (together, the “Enterprises”), is a federally-created enterprise that facilitates liquidity and efficiency in the housing market by purchasing loans from mortgage lenders, thereby freeing up capital for additional mortgage lending. In July 2008, in the wake of a national crisis in the U.S. housing market, Congress enacted the Housing and Economic Recovery Act of 2008 (“HERA”), Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008); *see* Compl. ¶ 20. HERA created FHFA, an independent federal agency, to supervise and regulate Freddie Mac, Fannie Mae, and certain other government-sponsored enterprises. 12 U.S.C. § 4501 *et seq.*; HERA also granted FHFA’s Director authority to place Freddie Mac and Fannie Mae in conservatorship or receivership in specific circumstances. *See* 12 U.S.C. § 4617(a).

B. FHFA is Appointed Statutory Conservator of Freddie Mac and Fannie Mae, Succeeding by Operation of Law to All Rights of the Enterprises and Their Shareholders

In September 2008, shortly after enactment of HERA and at a time when the national housing market was deteriorating, the Director of FHFA placed both of the Enterprises into conservatorships, “for the purpose of reorganizing, rehabilitating, or winding up the[ir] affairs.” 12 U.S.C. § 4617(a)(2); *see also* Compl. ¶ 21. Today, both Enterprises remain in conservatorships.

As Conservator, FHFA, “by operation of law, immediately succeed[ed] 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). The Conservator is responsible for the conduct of all aspects of each Enterprise’s business and affairs, and HERA authorizes it to take such action as may be “necessary to put the regulated entity in a sound and solvent condition” and “appropriate to carry on the business of the regulated entity.” *Id.* § 4617(b)(2)(D). FHFA as Conservator thus enjoys full authority to “operate the regulated entity” and “conduct all business of the regulated entity.” *Id.* § 4617(b)(2)(B)(i). HERA bars courts from granting any relief that would “restrain or affect” conduct undertaken within the Conservator’s expansive powers and functions. *Id.* § 4617(f).

Shortly after becoming Conservator, FHFA entered into the PSPAs with Treasury. *See* Compl. ¶ 22. Under the PSPAs, Treasury agreed to provide hundreds of billions of dollars for the Enterprises’ continued operations. In exchange, the PSPAs granted Treasury a comprehensive package of rights, including: (1) an initial senior liquidation preference of \$1 billion for each Enterprise; (2) warrants to acquire 79.9% of the Enterprises’ common stock for a nominal payment; (3) payment from each Enterprise of a mandatory dividend in the amount of

10% per year of the total amount of funds Treasury provided; and (4) a periodic commitment fee (“PCF”) “intended to fully compensate” taxpayers for the continuing Treasury commitment of hundreds of billions of dollars of taxpayer funds.²

Both Freddie Mac and Fannie Mae took their first Treasury draws shortly after their placement in conservatorships, and to date, they have drawn more than \$187 billion in funds from Treasury to cure negative net worth positions and avoid mandatory receivership under HERA. Freddie Mac has drawn approximately \$71.3 billion in funds from the Treasury commitment. *See* Compl. ¶ 27. Both Enterprises have also paid dividends to Treasury pursuant to the PSPAs. *Id.* ¶ 33.

On August 17, 2012, FHFA and Treasury executed a third amendment to the PSPAs (“the Third Amendment”) to (1) replace the annual, fixed-rate 10% cash dividend with a variable quarterly dividend equal to the net worth of the Enterprises, minus a prescribed capital reserve, and (2) waive the PCF for so long as the variable dividend is in place. *See* Compl. ¶¶ 31-43. Thus, under the Third Amendment, Treasury agreed to accept the risk that the Enterprises’ profits in any given year might be less than the fixed 10% dividend amount (\$18.9 billion per year), plus the amount of the PCF (which was intended to fully compensate the taxpayers for Treasury’s ongoing commitment to invest additional funds in the Enterprises, as necessary).

C. Plaintiffs File the Present Lawsuit

On March 9, 2016, Plaintiffs—a mixture of individual and institutional shareholders of Freddie Mac—filed the present complaint in the Circuit Court for the 11th Judicial Circuit in and for Miami-Dade County, Florida. Doc. # 1-1. The complaint asserts two claims on behalf of each plaintiff against PwC: (1) negligent misrepresentation, and (2) aiding and abetting alleged

² The PSPAs and each of their amendments are publicly available on FHFA’s website at www.fhfa.gov/conservatorship/pages/senior-preferred-stock-purchase-agreements.aspx.

breaches of fiduciary duties by FHFA, Treasury, and Freddie Mac's directors and officers.³ See, e.g., Compl. ¶¶ 98-116.

On April 6, 2016, PwC removed the action to this Court on the basis of federal question jurisdiction. See Notice of Removal (Doc. # 1).

D. FHFA's Pending Request That the JPML Transfer This and Other Third Amendment Cases for Coordinated Pretrial Proceedings

Freddie Mac and Fannie Mae shareholders have filed multiple actions in federal court seeking to challenge the Third Amendment. Accordingly, on March 15, 2016, FHFA filed a motion with the JPML to transfer four cases to the U.S. District Court for the District of Columbia for consolidated or coordinated pretrial proceedings pursuant to 28 U.S.C. § 1407.⁴ Additionally, on March 28, 2016, FHFA advised the JPML of two related shareholder actions (styled as demands for inspection by shareholders of Freddie Mac and Fannie Mae) and

³ Though Plaintiffs allege Freddie Mac's directors and officers breached fiduciary duties owed to Freddie Mac's shareholders (see, e.g., Compl. ¶ 111), those directors and officers have acted only through the authority expressly delegated to them by the Conservator, which has succeeded to "all rights, titles, powers, and privileges" of "any . . . officer, or director" of Freddie Mac. 12 U.S.C. § 4617(b)(2)(A)(i). As Freddie Mac disclosed in its SEC filings: "The Conservator has delegated certain authority to the Board of Directors to oversee, and management to conduct, day-to-day operations. The Conservator retains overall management authority, including the authority to withdraw its delegations of authority at any time." Freddie Mac, Annual Report (Form 10-K) (2008), at 20, available at <http://goo.gl/encrgA>. See also Fannie Mae, Annual Report (Form 10-K) (2008), at 20, available at <http://goo.gl/QxqVYi> ("Our directors do not have any duties to any person or entity except to the conservator. Accordingly, our directors are not obligated to consider the interests of the company, the holders of our equity or debt securities or the holders of Fannie Mae MBS unless specifically directed to do so by the conservator.").

⁴ See *In re: Federal Housing Finance Agency, et al. Preferred Stock Purchase Agreements Third Amendment Litigation*, MDL No. 2713 (J.P.M.L.). The four cases subject to the initial transfer motion are: *Saxton v. FHFA*, No. 1:15-cv-00047 (N.D. Iowa filed May 28, 2015); *Jacobs v. FHFA*, No. 1:15-cv-00708 (D. Del. filed Aug. 17, 2015); *Robinson v. FHFA*, No. 7:15-cv-00109 (E.D. Ky. filed Oct. 23, 2015); and *Roberts v. FHFA*, No. 1:16-CV-02107 (N.D. Ill. filed Feb. 10, 2016).

requested that they be transferred to the MDL proceeding.⁵ Plaintiffs' present complaint is based on the same, central factual allegations and raises common and dispositive legal issues with these other cases, including jurisdictional issues that must be resolved at the outset of these cases.

Thus, on April 7, 2016, FHFA further advised the JPML that the present suit is related to—and should be transferred to—that MDL proceeding.⁶ At the same time, FHFA advised the JPML of the parallel case filed by Plaintiffs against Deloitte & Touche, LLP, independent auditor of Fannie Mae, and requested that it be transferred as well. *Id.*

ARGUMENT

I. THE COURT SHOULD SUBSTITUTE FHFA, FREDDIE MAC'S CONSERVATOR, IN PLACE OF THE SHAREHOLDER PLAINTIFFS

HERA unambiguously provides that, as Conservator, FHFA alone possesses all “rights, titles, powers, and privileges” of Freddie Mac’s shareholders. 12 U.S.C. § 4617(b)(2)(A)(i). Accordingly, only the Conservator has standing to bring the shareholder complaint here.

A. HERA’s Plain and Unambiguous Language Mandates Substitution of the Conservator as Plaintiff

HERA’s succession provision is far-reaching and clear. During conservatorship, the Conservator “succeed[s] to . . . *all* rights, titles, powers, and privileges . . . of [Freddie Mac] and *of any stockholder* [of Freddie Mac].” *Id.* (emphasis added). By this provision, “Congress . . . transferred everything it could to the conservator.” *Kellmer v. Raines*, 674 F.3d 848, 851 (D.C. Cir. 2012) (quoting *Pareto v. FDIC*, 139 F.3d 696, 700 (9th Cir. 1998)) (alteration omitted). “[T]he plain meaning of the statute is that *all* rights previously held by Freddie Mac’s stockholders . . . now belong exclusively to the FHFA.” *In re Fed. Home Loan Mortg. Corp.*

⁵ See Notice of Related Actions, MDL No. 2713 (J.P.M.L. filed Mar. 28, 2016), Doc. # 9.

⁶ See Notice of Related Actions, MDL No. 2713 (J.P.M.L. filed Apr. 7, 2016), Doc. # 22.

Deriv. Litig., 643 F. Supp. 2d 790, 795 (E.D. Va. 2009) (“*In re: Freddie Mac*”), *aff’d sub nom La. Mun. Police Emps. Ret. Sys. v. FHFA*, 434 F. App’x 188 (4th Cir. 2011) (emphasis in original). HERA’s succession provision “clearly demonstrates Congressional intent to transfer as much control of [the Enterprises] as possible to the FHFA,” *In re: Freddie Mac*, 643 F. Supp. 2d at 797, and serves to “assure the expeditious and orderly protection of all who are interested in [Freddie Mac] by placing the pursuit of its rights, protection of its assets, and payment of its liabilities firmly in the hands of a single, congressionally designated agency.” *Pareto*, 139 F.3d at 700 (interpreting a materially-identical provision in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”), Pub. L. No. 101–73, 103 Stat. 183).

In light of HERA’s succession provision, courts consistently permit FHFA as Conservator to substitute itself in place of plaintiffs asserting claims based on their status as shareholders of Freddie Mac and Fannie Mae. *See Kellmer*, 674 F.3d at 850-51 (affirming FHFA’s substitution in place of Fannie Mae shareholder asserting claims against former officers and directors and various third parties for, *inter alia*, aiding and abetting breach of fiduciary duty and negligence); *Gail C. Sweeney Estate Marital Tr. v. U.S. Treasury Dep’t*, 68 F. Supp. 3d 116, 117 (D.D.C. 2014) (granting FHFA motion to substitute in place of a Fannie Mae shareholder asserting claims for breach of fiduciary duty, abuse of control, waste, and mismanagement); *Esther Sadowsky Testamentary Tr. v. Syron*, 639 F. Supp. 2d 347, 350 (S.D.N.Y. 2009) (same, for Freddie Mac shareholder asserting similar claims). For example, in *In re Federal Home Loan Mortgage Corporation Derivative Litigation*, shareholders of Freddie Mac brought claims against, *inter alia*, PwC for claims very similar to those asserted here: namely, aiding and abetting alleged breaches of fiduciary duties by Freddie Mac’s officers and directors and also for

professional malpractice. *In re: Freddie Mac*, 643 F. Supp. 2d at 793.⁷ Relying on HERA's succession provision, the Court granted FHFA's motion to substitute itself in place of these plaintiffs, observing that "the plain meaning of the statute is that *all* rights previously held by Freddie Mac's stockholders" can now be exercised only by the Conservator. *Id.* at 795. The Fourth Circuit affirmed. *See La. Mun. Police Emps. Ret. Sys.*, 434 F. App'x 188.

For the same reasons, courts also have dismissed shareholder claims for lack of standing in light of HERA's succession provision and FIRREA's materially-identical provision. *See Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 229 (D.D.C. 2014) (dismissing breach of fiduciary duty claims asserted by Fannie Mae and Freddie Mac shareholders for lack of standing in light of HERA's succession provision). For example, in *Lubin v. Skow*, the Eleventh Circuit interpreted FIRREA's succession provision to deprive shareholders of standing to assert derivative claims asserted by the shareholder-owner of a bank in receivership. 382 F. App'x 866, 871 (11th Cir. 2010); *see also Pareto*, 139 F.3d at 701 (affirming dismissal of claims asserted by shareholders of bank in receivership due to lack of standing).

In this case, Plaintiffs seek to assert their purported rights as shareholders of Freddie Mac—namely, the asserted rights to enforce alleged breaches of fiduciary duty committed by FHFA and Treasury (Compl. ¶¶ 98-109), and alleged misrepresentations by PwC (*id.* ¶¶ 110-116). Because FHFA has succeeded to "all rights, titles, powers, and privileges" of Freddie Mac and its shareholders—including Plaintiffs—during conservatorship, the FHFA as Conservator has succeeded to those rights Plaintiffs seek to assert through this suit. Accordingly, the Court

⁷ The complaint that asserted claims against PwC is available at *R.S. Bassman v. Syron*, No. 1:08-cv-1247 (E.D. Va.) (Doc. # 47 at ¶¶ 173-176).

should grant FHFA's motion and order the FHFA, as Conservator of Freddie Mac, be substituted in place of the shareholder Plaintiffs.

B. Congress's Grant of Authority Over "All" Shareholder Rights Is Not Limited to the Right to Bring Derivative Claims

Plaintiffs in other cases have opposed the Conservator's substitution by arguing—unsuccessfully—that HERA's succession provision applies only to *derivative* claims—*i.e.*, those claims asserted on behalf of the company—and not to *direct* claims—*i.e.*, those claims asserted on behalf of the shareholder itself. That argument fails.

By its plain text, HERA transfers "*all*" shareholder rights to the Conservator, not just the right to assert derivative claims. "It is well settled that the starting point for interpreting a statute is the language of the statute itself. When [a] statute's language is plain, the sole function of the courts . . . is to enforce it according to its terms." *Montgomery Cty. Comm'n v. FHFA*, 776 F.3d 1247, 1255 (11th Cir. 2015) (internal quotation marks and citations omitted). Accordingly, the only interpretative tool needed to analyze HERA's succession provision is to adhere to Justice Frankfurter's admonition: "(1) Read the statute; (2) read the statute; (3) read the statute!" *Kellmer*, 674 F.3d at 850. The statute provides that FHFA as Conservator succeeded to "*all* rights . . . of any stockholder" with respect to Freddie Mac and its assets. "[A]ll rights" means just that—*all* rights. *See Montgomery Cty.*, 776 F.3d at 1255 (holding the "straightforward interpretation" of HERA's exemption from "all taxation" was that the Enterprises are "exempt from *all* state taxation"). Furthermore, "courts must not interpret one provision of a statute to render another provision meaningless." *Huff v. DeKalb Cty.*, 516 F.3d 1273, 1280 (11th Cir. 2008). The Conservator already can pursue what would be derivative claims, as those claims belong to Freddie Mac, not any shareholder. *See* 12 U.S.C. § 4617(b)(2)(A)(i) (The Conservator "immediately succeed[s] to . . . all rights, titles, powers, and privileges of *the regulated entity*,

and of any stockholder . . . ”) (emphasis added)); *Ross v. Bernhard*, 396 U.S. 531, 538 (1970) (“The claim pressed by the stockholder against directors or third parties is not his own but the corporation’s.”) (internal quotation marks and citation omitted)). Because creating a “direct claims” exception would render part of the statute meaningless, such an exception should be rejected.⁸

C. In All Events, Plaintiffs’ Claims Are Derivative, Not Direct

While HERA’s plain text resolves the issue of whether the Conservator’s succession to “all” shareholder rights includes the right to assert direct claims, the Court need not even resolve that issue because the claims Plaintiffs assert are, in fact, derivative. The difference between direct and derivative claims is well-established and governed by two questions: “(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?” *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).⁹

⁸ In advocating for a direct claims exception, Plaintiffs may also cite *Lubin v. Skow*, 382 F. App’x 866 (11th Cir. 2010), an unpublished Eleventh Circuit decision in which the court held a shareholder plaintiff lacked standing to assert derivative claims in light of FIRREA’s succession provision. Although the court made a passing statement that “FIRREA would not be a bar to standing” if the shareholder had asserted direct claims, that statement was pure dicta: the court held all of the claims were derivative, not direct, and thus the court had no need to address FIRREA’s impact on possibly direct claims. *Id.* at 871; *see also Pretka v. Kolter City Plaza II, Inc.*, 608 F.3d 744, 762 (11th Cir. 2010) (defining dicta to include statements “not necessary to the decision of an appeal given the facts and circumstances of the case”). “[D]icta is not binding on anyone for any purpose.” *Edwards v. Prime, Inc.*, 602 F.3d 1276, 1298 (11th Cir. 2010).

⁹ The Enterprises must comply with federal law and their federal charters, which were created by Congress. *See* 12 U.S.C. § 1716 *et seq.*; *id.* § 1451 *et seq.*; 12 C.F.R. § 1710.10(a). For issues not addressed by federal law or their charters, the Enterprises may follow the applicable corporate governance practices and procedures of Delaware law, or the law of the jurisdiction in which the principal office of the Enterprise sits, but only to the extent that state law is not inconsistent with federal law or the charters. 12 C.F.R. § 1710.10(b). In its bylaws, Freddie Mac elected to follow the applicable corporate governance practices and procedures of Virginia law for such issues. *See* Freddie Mac Bylaws Section 11.3(a) (available at

(footnote continued on next page)

Here, Plaintiffs' claims are derivative on their face based on the harms they assert and relief they seek.

1. Plaintiffs' Aiding and Abetting Breach of Fiduciary Duty Claims Are Derivative

Plaintiffs allege that FHFA and Treasury breached fiduciary duties owed to Freddie Mac and its shareholders by executing the Third Amendment, and that PwC aided and abetted FHFA and Treasury in connection with their alleged breach. Compl. ¶¶ 31-43, 110-116.

Plaintiffs' aiding and abetting claims are derivative. To answer the first *Tooley* prong—which asks “who suffered the alleged harm (the corporation or the suing stockholders, individually)?”—the Court need look no further than Plaintiffs' own complaint, which alleges the Third Amendment was “detriment[al]” and “contrary to the best interests of Freddie Mac,” “offered no benefits whatsoever to Freddie Mac,” was “directly contrary” to putting Freddie Mac in a “sound and solvent condition,” was “not entirely fair to Freddie Mac,” and did not “further any valid business purpose of Freddie Mac.” Compl. ¶¶ 37-38, 40-42. Indeed, Plaintiffs' theory is that the Third Amendment allegedly depletes Freddie Mac's assets, thereby leaving no money to distribute to shareholders via dividends and/or liquidation preferences. Allegations regarding the depletion of corporate assets assert a “classically derivative” injury. *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 771 (Del. 2006). Where, as here, Plaintiffs cannot “prevail

(footnote continued)

<http://goo.gl/9S8jnf>). Here, for purposes of the present motion only, FHFA assumes without conceding that Virginia law concerning whether a claim is direct or derivative is not inconsistent with federal law, and thus could apply here. Moreover, while the Virginia Supreme Court has not adopted the *Tooley* test, it agrees with “[t]he overwhelming majority rule [] that an action for injuries to a corporation cannot be maintained by a shareholder on an individual basis and must be brought derivatively.” *Simmons v. Miller*, 544 S.E.2d 666, 674 (Va. 2001). Accordingly, for purposes of the present motion, FHFA assumes Virginia courts would look to Delaware's developed body of law distinguishing between direct and derivative claims.

without showing an injury to the corporation[s]”—indeed, they allege injury to the corporation—Plaintiffs’ claims are derivative. *Tooley*, 845 A.2d at 1036.

Further confirming Plaintiffs’ claims are based on alleged harm to Freddie Mac is the fact the complaint is predicated on allegations that the purported breaches of fiduciary duty caused Plaintiffs’ shares to lose “value.” *See* Compl. ¶¶ 5, 6, 31-32, 38-40, 66, 69-70, 95, 107. It is well established that a reduction in stock value is an “indirect injury” that is derived from—and derivative of—an injury to the company itself; “[i]t does not arise out of any independent or direct harm to the stockholders, individually.” *Tooley*, 845 A.2d at 1037. Accordingly, where, as here, alleged wrongdoing “deplete[d] corporate assets that might otherwise [have] be[en] used to benefit the stockholders, such as through a dividend,” the claims are derivative because the wrongdoing “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); *see also Perry Capital*, 70 F. Supp. 3d at 235 n.39 (claims alleging “damage to the price of their [Enterprise] shares, as valued by the market . . . are considered derivative”); *id.* 239 n.45 (claims alleging “present damage to the ‘value’ of the plaintiffs’ investment . . . [are] considered derivative and barred under HERA”).

Plaintiffs’ claims also are derivative under the second *Tooley* prong, which provides that a claim is direct only if the relief sought “flows directly to the stockholders, not to the corporation.” *Id.* The fact that Plaintiffs (wrongly) request direct money damages for their aiding and abetting claims does not transform those claims from derivative to direct. Instead, the court “should look to the nature of the wrong and to whom the relief *should* go.” *Tooley*, 845 A.2d at 1039 (emphasis added); *see also Chrystall v. Serden Techs.*, 913 F. Supp. 2d 1341, 1362 (S.D. Fla. 2012) (holding breach of fiduciary duty claim seeking money damages based on

“devaluation” of plaintiff’s stock to be derivative); *In re Ionosphere Clubs, Inc.*, 17 F.3d 600, 605 (2d Cir. 1994) (holding claim derivative because “payment of damages directly to the plaintiff-stockholders for the diminution in the value of their stock would be inappropriate”). Here, because the fundamental injury alleged constitutes harm to Freddie Mac—*i.e.*, the alleged improper “expropriation” of billions of dollars from Freddie Mac in the form of dividends to Treasury (Compl. ¶¶ 32-34)—the relief (if any) that would flow from such an alleged injury is a return of those dividends to Freddie Mac, not a direct payment to Plaintiffs.

2. Plaintiffs’ Negligent Misrepresentation Claims Are Derivative

Plaintiffs also allege PwC acted negligently and made a variety of untrue statements (or failures to disclose) in its audit reports, and that Plaintiffs relied on those allegedly deficient reports to their detriment. Compl. ¶ 98-109. However, where—as here—a shareholder alleges that an auditor’s (or other corporate representative’s) negligence concerning the company’s financial condition caused the shareholder to hold his stock, leading to alleged damages, such claims are derivative, not direct. For example, in *Stephenson v. PricewaterhouseCoopers, LLP*, 482 F. App’x 618, 621 (2d Cir. 2012), the Second Circuit, applying *Tooley*, held that a limited partner (akin to a shareholder) “lacks standing to assert a claim based on his decision to remain invested” in the company after receiving allegedly negligent statements by PwC, the company’s independent auditor. This was because the limited partner “cannot prevail [on his holding claim] without showing injury to the [partnership as a whole]: his holding claim involves no harm to an individual partner and seeks no recovery for any individual partner, distinct from other partners.” *Id.* The court thus found the claims were derivative, not direct. *Id.*¹⁰

¹⁰ See also *Smith v. Waste Mgmt., Inc.*, 407 F.3d 381, 385 (5th Cir. 2005) (holding shareholder claims of negligent misrepresentation that induced shareholder to hold stock were derivative); *Broyles v. Cantor Fitzgerald & Co.*, No. CIV.A. 10-857-JJB, 2013 WL 1681150, at (footnote continued on next page)

That Plaintiffs also tack on the conclusory and imprecise allegation that they relied on PwC's alleged misrepresentations in "*purchasing or holding*" their stock does not render their claims direct. *See, e.g.*, Compl. ¶ 103, 122, 141 (emphasis added). For example, in *Ernst & Young Ltd. v. Quinn*, No. CIV.A. 09-CV-1164JCH, 2009 WL 3571573, at *6 (D. Conn. Oct. 26, 2009), investors asserted claims of negligent misrepresentation against Ernst & Young, the company's auditor, alleging that, absent Ernst & Young's alleged misrepresentations, the investors—much like Plaintiffs here—"would not have purchased, continued to purchase, or retained their . . . investment interests in the [company]." The court held that such a claim was derivative because it was dependent upon injury to the company in the first instance. *See id.*¹¹

* * *

In sum, Plaintiffs' claims are derivative, not direct. But even if they are direct, the Court should nevertheless substitute the Conservator in place of Plaintiffs in light of HERA's plain and unambiguous language providing that the Conservator succeeds to "all" shareholder rights.¹²

(footnote continued)

*8 (M.D. La. Apr. 17, 2013) (holding claims that shareholders "held their shares . . . based on alleged misrepresentation . . . do not rise to a direct claim"); *In re Phar-Mor, Inc. Sec. Litig.*, 900 F. Supp. 777, 783-84 (W.D. Pa. 1994) (holding claim based on auditor's negligence to be derivative because it "resulted in, first and foremost, an injury to [the company], to-wit, a decline in corporate worth," and the shareholders' losses were "merely incidental to that decline")

¹¹ Additionally, to the extent Plaintiffs are attempting to assert claims based purely on a negligent inducement to purchase Freddie Mac stock, they have failed to plead such a claim by, *inter alia*, failing to allege the timing of any Plaintiff's purchase of Freddie Mac stock—*i.e.*, whether it was before or after the alleged misrepresentation, and based on which alleged misrepresentations. In fact, Plaintiffs allege that they all "were shareholders of Freddie Mac during all times relevant to this action." Compl. ¶ 11.

¹² Plaintiffs allege the Third Amendment was the result of a "manifest conflict of interest" by Treasury and FHFA. Compl. ¶¶ 39-40. To the extent Plaintiffs intend to ask the Court to create an exception to HERA's succession provision for a "manifest conflict-of-interest," such a request should also be rejected. As the District Court for the District of Columbia held: "HERA provides no qualification for its bar on shareholder derivative suits, and neither will this

(footnote continued on next page)

D. Permitting Plaintiffs to Proceed With Their Claims Would Violate 12 U.S.C. § 4617(f)

Finally, permitting Plaintiffs to continue to prosecute this action, despite the Conservator's succession to "all rights" of the shareholders, would run afoul of HERA's jurisdiction-withdrawal provision, 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 the [FHFA] as a conservator." The decision whether to pursue any of Plaintiffs' claims against PwC would fall within the Conservator's powers and functions, which specifically include authority to "operate [Freddie Mac] with all the powers of the shareholders, the directors, and the officers," to "conduct all business of [Freddie Mac]," and to "perform all functions of [Freddie Mac] consistent with the appointment as conservator," *id.* §§ 4617(b)(2)(B) (i),(iii). *See Sweeney Estate Marital Tr.*, 68 F. Supp. 3d at 125-26 (observing that "whether or not to spend Freddie Mac's assets on a lawsuit against Treasury is plainly the type of business decision Congress entrusted to the Conservator in HERA"). Thus, "to permit plaintiff to bring an action which the conservator has declined to bring would interfere with and potentially usurp precisely the powers granted to the FHFA by HERA." *Id.* at 126 (internal quotation marks and citation omitted).

Indeed, in numerous decisions granting FHFA's motions to substitute in place of Freddie Mac or Fannie Mae shareholder plaintiffs, courts have held that Section 4617(f) also bars the shareholder from continuing the action. *See, e.g., id.* at 119 (granting substitution in part because Section 4617(f) "suggests that the Court may not be empowered to authorize plaintiff to pursue litigation that the Conservator has declined to pursue"); *Sadowsky*, 639 F. Supp. 2d at 350

(footnote continued)

Court. . . . Therefore, the Court finds that HERA's plain language bars shareholder derivative suits, without exception." *Perry Capital*, 70 F. Supp. 3d at 231-32 (noting a conflict of interest exception "would swallow the rule").

(Without substitution, suit would violate Section 4617(f) “since maintenance of this suit with the shareholders acting as Plaintiffs would be inconsistent with the Conservator’s exercise of its statutory purposes.”); *In re Fed. Nat’l Mortg. Ass’n Sec., Deriv., & “ERISA” Litig.*, 629 F. Supp. 2d 1, 4 n.4 (D.D.C. 2009) (“[A]llowing plaintiffs to continue to pursue derivative claims independent of FHFA would require this Court to take action that would ‘restrain or affect’ FHFA’s discretion” in violation of § 4617(f).), *aff’d Kellmer*, 674 F.3d at 851; *In re: Freddie Mac*, 643 F. Supp. 2d at 797 (Section 4617(f) “clearly demonstrates Congressional intent to transfer as much control of Freddie Mac as possible to the FHFA, including any right to sue on behalf of the corporation.”). So too here: denying FHFA’s substitution and allowing Plaintiffs to continue prosecuting their claims would “be inconsistent with the Conservator’s exercise of its statutory power” and thus would violate Section 4617(f). *Sadowsky*, 639 F. Supp. 2d at 350.

CONCLUSION

For the foregoing reasons, the Court should substitute FHFA as Conservator in place of the current Plaintiffs in this suit.

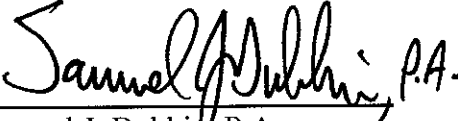
LOCAL RULE 7.1 CERTIFICATION

The undersigned certifies that counsel for the movant has conferred with counsel for plaintiffs in a good faith effort to resolve the issues raised in this motion, and plaintiffs do not agree with the relief requested.

Dated: April 12, 2016

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**Pro hac vice application pending*

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CERTIFICATE OF SERVICE

The undersigned certifies that, on April 12, 2016, a true and correct copy of the foregoing was filed electronically using the Court’s CM/ECF system, causing a true and correct copy to be served on all counsel of record. I also served the following counsel of record via e-mail:

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