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T R O U B L E D C O M P A N Y R E P O R T E R

Wednesday, April 20, 2016, Vol. 20, No. 110

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FANNIE MAE & FREDDIE MAC: Josh Angel Sends Directors Draft Complaints

Joshua J. Angel sent draft complaints to all Fannie Mae and Freddie Mac directors yesterday to give them a peek at the specific claims and causes of action for which he can recover damages from them individually. Copies of Mr. Angel's draft complaints are available at <http://bankrupt.com/misc/JoshAngelFNMADraftComplaint.pdf> and <http://bankrupt.com/misc/JoshAngelFMCCDraftComplaint.pdf> at no charge.

It's important to understand that Mr. Angel does not challenge or contest the imposition of the conservatorship in 2008 nor does he want to unwind the Net Worth Sweep imposed in 2012. The conservatorship and Third Amendment make no difference to Mr. Angel. He wants the government to honor its promises. He wants Fannie and Freddie's directors to do their jobs and fulfill their fiduciary duties to preferred shareholders, and he's preparing to sue them individually if they don't.

The Implicit Guarantee

As we've previously reported, Mr. Angel asserts that:

- (A) the government's implicit guarantee of preferred shares has always been in place;
- (B) that implicit guarantee did not change when the GSEs were placed into conservatorship; and
- (C) the guarantee is still in place today.

Mr. Angel explains that the government's implicit guarantee of the GSEs' financial obligations -- their debts and preferred securities -- arose over time by a combination of statutory provisions and conduct. If not for the government's implicit guarantee, Fannie Mae would never have been able to sell \$22 billion of preferred stock and additional common shares at \$20 apiece in the year prior to entering conservatorship.

Mr. Angel acknowledges that when the GSEs pre-conservatorship boards of directors agreed to conservatorship, they ceded control over the GSEs' assets and conveyed plenary management power to FHFA as conservator. But HERA -- the governing conservatorship statute -- does not give the

current directors a license to disregard their contractual obligations and fiduciary duties to preferred shareholders.

Interestingly, Howard N. Cayne, Esq., at Arnold & Porter LLP, argued last week before the D.C. Circuit that FHFA has no duty to anyone but itself and the GSEs. We suspect Fannie, Freddie and FHFA would also contend that the GSEs directors have no duty to anyone but FHFA. But the D.C. Circuit requested supplemental briefs concerning 12 U.S.C. Sec. 4623 -- see <http://goo.gl/8KzzLt> -- a statute never previously discussed in GSE shareholder litigation which describes a process for Fannie and Freddie to challenge actions taken by FHFA. That process seems to contravene the notion that the Congress intended for GSE directors to be handpicked FHFA puppets and suggests directors are not fully insulated from litigation.

"Even more ethically troublesome," Mr. Angel says, "is Treasury amnesia regarding its moral responsibility to effect junior preferred share dividend, and stated value repayment in light of its complicity in the marketing of the preferred shares as a virtually risk free investment by virtue of the implicit guarantee." Recall that U.S. banks were allowed to treat GSE preferred stock as Tier I capital. To quantify the risk, if any, the market perceived about Fannie Mae's Series T preferred securities issued less than four months prior to the conservatorship, we contacted Bloomberg, Creditex and Markit, and the International Swaps and Derivatives Association, Inc., for help locating credit default swap pricing data for CUSIP 313586737. To our surprise, there isn't any pricing data. That only makes sense if nobody perceived there was any risk to insure and no credit default swaps were traded.

Mr. Angel's draft complaints charge that the Net Worth Sweep provided the GSEs with no benefit, and the directors' failure to reject the Third Amendment constitute multiple breaches of their duties to preferred shareholders in addition to plain old-fashioned corporate waste.

Honoring Commitments

Mr. Angel points to a Treasury-issued news release -- see <https://goo.gl/ZO00N4> -- dated Sept. 11, 2008, that affirmed the implicit guarantee when it said, "[T]he U.S. Government stands behind the preferred stock purchase agreements and will honor its commitments. Contracts are respected in this country as a fundamental part of rule of law."

At last week's hearing before the D.C. Circuit, Treasury's lawyer from the Department of Justice branded GSE shareholders as speculators. Hamish Hume, Esq., at Boies, Schiller & Flexner LLP, representing the Class Plaintiffs in *Perry v. Lew*, reminded the three-judge panel that Fannie Mae sold roughly two-thirds of its outstanding preferred stock within the year prior to conservatorship at par -- and speculators don't pay par value.

In U.S. history, there was talk about evil speculators in 1789 when Alexander Hamilton proposed his monetary plan to the First Congress that called for reinstatement of all Revolutionary War debts at 100-cents-on-the-dollar plus interest. Representative William Maclay from

Pennsylvania railed against Mr. Hamilton, and Rep. Maclay's personal journal contains more unflattering commentary about Mr. Hamilton. Our Nation's decision to assume and pay all Revolutionary War debts with interest has given our country unlimited access to global capital markets -- to the tune of \$19 trillion dollars and counting.

Argentina completed the largest emerging market bond sale in history this week, selling \$16.5 billion in bonds after honoring its obligations to so-called speculators following its default 15 years ago.

Corporate debtors emerging from chapter 11 restructurings routinely arrange exit financing facilities and find investors eager to hold new post-reorganization debt and equity securities. That's because those broken companies fix their problems while under the supervision of a bankruptcy court, write a new contract called a plan of reorganization with their stakeholders, and honor their obligations as required under the Bankruptcy Code and other applicable law.

Some intriguing proposals to restructure Fannie and Freddie have been released in the past year by:

- * investment banker Jim Millstein at Millstein & Co. -- see <http://goo.gl/mTlMBX>
- * thought leaders Drs. Robert J. Shapiro and Elaine C. Karmarck -- see <http://goo.gl/7VRjgW> and
- * former Fannie Mae executive J. Timothy Howard -- see <https://goo.gl/Z3DaFG>

and they all require Fannie and Freddie (or their successors, regardless of what name they may be known by) to have access to capital. If the government refuses to honor Fannie and Freddie's pre-conservatorship preferred stock obligations, lenders and investors won't make the capital available.

Monday's edition of the TCR delivers a list of indicative prices for bond issues that reportedly trade well below par. Prices are obtained by TCR editors from a variety of outside sources during the prior week we think are reliable. Those sources may not, however, be complete or accurate. The Monday Bond Pricing table is compiled on the Friday prior to publication. Prices reported are not intended to reflect actual trades. Prices for actual trades are probably different. Our objective is to share information, not make markets in publicly traded securities. Nothing in the TCR constitutes an offer or solicitation to buy or sell any security of any kind. It is likely that some entity affiliated with a TCR editor holds some position in the issuers public debt and equity securities about which we report.

Each Tuesday edition of the TCR contains a list of companies with insolvent balance sheets whose shares trade higher than \$3 per share in public markets. At first glance, this list may look like the definitive compilation of stocks that are ideal to sell short.

Don't be fooled. Assets, for example, reported at historical cost net of depreciation may understate the true value of a firm's assets. A company may establish reserves on its balance sheet for liabilities that may never materialize. The prices at which equity securities trade in public market are determined by more than a balance sheet solvency test.

On Thursdays, the TCR delivers a list of recently filed Chapter 11 cases involving less than \$1,000,000 in assets and liabilities delivered to nation's bankruptcy courts. The list includes links to freely downloadable images of these small-dollar petitions in Acrobat PDF format.

Each Friday's edition of the TCR includes a review about a book of interest to troubled company professionals. All titles are available at your local bookstore or through Amazon.com. Go to <http://www.bankrupt.com/books/> to order any title today.

Monthly Operating Reports are summarized in every Saturday edition of the TCR.

The Sunday TCR delivers securitization rating news from the week then-ending.

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