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IN THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

FAIRHOLME FUNDS, INC., ACADIA INSURANCE COMPANY, ADMIRAL INDEMNITY COMPANY, ADMIRAL INSURANCE COMPANY, BERKLEY INSURANCE COMPANY, BERKLEY REGIONAL INSURANCE COMPANY, CAROLINA CASUALTY INSURANCE COMPANY, CONTINENTAL WESTERN INSURANCE COMPANY, MIDWEST EMPLOYERS CASUALTY INSURANCE COMPANY, NAUTILUS INSURANCE COMPANY, PREFERRED EMPLOYERS INSURANCE COMPANY, THE FAIRHOLME FUND, ANDREW T. BARRETT,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Cross-Appellant.

2020-1912, -1914

Appeals from the United States Court of Federal Claims in No. 1:13-cv-00465-MMS, Chief Judge Margaret M. Sweeney.

OWL CREEK ASIA I, L.P., OWL CREEK ASIA II, L.P., OWL CREEK I, L.P., OWL CREEK II, L.P., OWL CREEK ASIA MASTER FUND, LTD., OWL CREEK CREDIT OPPORTUNITIES MASTER FUND, L.P., OWL CREEK OVERSEAS MASTER FUND, LTD., OWL CREEK SRI MASTER FUND, LTD.,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Appellee.

2020-1934

Appeal from the United States Court of Federal Claims in No. 1:18-cv-00281-MMS, Chief Judge Margaret M. Sweeney.

MASON CAPITAL L.P., MASON CAPITAL MASTER FUND L.P.,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Appellee.

2020-1936

Appeal from the United States Court of Federal Claims in No. 1:18-cv-00529-MMS, Chief Judge Margaret M. Sweeney.

AKANTHOS OPPORTUNITY FUND, L.P.,
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellee.

2020-1938

Appeal from the United States Court of Federal Claims in No. 1:18-cv-00369-MMS, Chief Judge Margaret M. Sweeney.

APPALOOSA INVESTMENT LIMITED PARTNERSHIP I, PALOMINO MASTER LTD., AZTECA PARTNERS LLC, PALOMINO FUND LTD.,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Appellee.

2020-1954

Appeal from the United States Court of Federal Claims in No. 1:18-cv-00370-MMS, Chief Judge Margaret M. Sweeney.

CSS, LLC,
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellant.

2020-1955

Appeal from the United States Court of Federal Claims in No. 1:18-cv-00371-MMS, Chief Judge Margaret M. Sweeney.

ARROWOOD INDEMNITY COMPANY, ARROWOOD SURPLUS LINES INSURANCE COMPANY, FINANCIAL STRUCTURES LIMITED,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Appellee.

2020-2020

Appeal from the United States Court of Federal Claims in No. 1:13-cv-00698-MMS, Chief Judge Margaret M. Sweeney.

JOSEPH CACCIAPALLE,
Plaintiff-Appellant,

MELVIN BAREISS, on Behalf of Themselves and All Others Similarly Situated, BRYNDON FISHER, BRUCE REID, ERICK SHIPMON, AMERICAN EUROPEAN INSURANCE COMPANY, FRANCIS J. DENNIS,
Plaintiffs

v.

UNITED STATES,
Defendant- Appellee.

2020-2037

Appeal from the United States Court of Federal Claims in No. 1:13-cv-00466-MMS, Chief Judge Margaret M. Sweeney.

PLAINTIFF-APPELLANT PRIVATE SHAREHOLDERS' NON-CONFIDENTIAL JOINT APPENDIX

The Plaintiff-Appellant Private Shareholders are: Fairholme Funds, Inc., Acadia Insurance Company, Admiral Indemnity Company, Admiral Insurance Company, Berkley Insurance Company, Berkley Regional Insurance Company, Carolina Casualty Insurance Company, Continental Western Insurance Company, Midwest Employers Casualty Insurance Company, Nautilus Insurance Company, Preferred Employers Insurance Company, The Fairholme Fund, Andrew T. Barrett, Owl Creek Asia I, L.P., Owl Creek Asia II, L.P., Owl Creek I, L.P., Owl Creek II, L.P., Owl Creek Asia Master Fund, Ltd., Owl Creek Credit Opportunities Master Fund, L.P., Owl Creek Overseas Master Fund, Ltd., Owl Creek SRI Master Fund, Ltd., Mason Capital L.P., Mason Capital Master Fund L.P., Akanthos Opportunity Fund, L.P., Appaloosa Investment Limited Partnership I, Palomino Master Ltd., Azteca Partners LLC, Palomino Fund Ltd., CSS, LLC, Arrowood Indemnity Company, Arrowood Surplus Lines Insurance Company, Financial Structures Limited, and Joseph Cacciapalle

April 2, 2021

Lawrence D. Rosenberg
C. Kevin Marshall
JONES DAY
51 Louisiana Avenue, N.W.
Washington, D.C. 20001
Telephone: (202) 879-3939
Facsimile: (202) 626-1700
ldrosenberg@jonesday.com
ckmarshall@jonesday.com

Attorneys for Plaintiffs-Appellants Owl Creek Asia I, L.P., Owl Creek Asia II, L.P., Owl Creek I, L.P., Owl Creek II, L.P., Owl Creek Asia Master Fund, Ltd., Owl Creek Credit Opportunities Master Fund, L.P., Owl Creek Overseas Master Fund, Ltd., Owl Creek SRI Master Fund, Ltd.; Mason Capital L.P., Mason Capital Master Fund L.P.; Akanthos Opportunity Fund, L.P.; Appaloosa Investment Limited Partnership I, Palomino Master Ltd., Azteca Partners LLC, Palomino Fund Ltd.; and CSS, LLC

Richard M. Zuckerman
DENTONS US LLP
1221 Avenue of the Americas
New York, New York 10020
Tel.: (212) 768-6700
Fax: (212) 768-6800
richard.zuckerman@dentons.com

Attorney for Plaintiffs-Appellants Arrowood Indemnity Company, Arrowood Surplus Lines Insurance Company, Financial Structures Limited

Hamish P.M. Hume
Samuel C. Kaplan
BOIES SCHILLER FLEXNER LLP
1401 New York Ave. NW
Washington, DC 20005
Tel: (202) 237-2727
Fax: (202) 237-6131
hhume@bsfllp.com

Attorneys for Plaintiff-Appellant Joseph Cacciapalle

Charles J. Cooper
COOPER & KIRK, PLLC
1523 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 220-9600
(202) 220-9601 (fax)
ccooper@cooperkirk.com

Attorney for Plaintiff-Appellants Fairholme Funds, Inc., Acadia Insurance Company, Admiral Indemnity Company, Admiral Insurance Company, Berkley Insurance Company, Berkley Regional Insurance Company, Carolina Casualty Insurance Company, Continental Western Insurance Company, Midwest Employers Casualty Insurance Company, Nautilus Insurance Company, Preferred Employers Insurance Company, The Fairholme Fund, Andrew T. Barrett

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NOTE ON CONFIDENTIAL MATERIAL

Material subject to the Third Amended Protective Order entered in *Fairholme Funds, Inc. et al., v. United States*, Case No. 13-465 (Ct. Fed. Cl.) [ECF 417] (the "Protective Order"), has been highlighted.

The material on Appx429, Appx430, Appx435, Appx436, Appx446, and Appx447 (*Fairholme* Second Amended Complaint); Appx868 (email between Treasury officials); Appx872–873 (Treasury proposal regarding PSPAs); Appx875–876 (email between Treasury and White House officials); Appx880–882 (Freddie Mac Board Minutes); Appx883–887 (Fannie Mae Board Minutes); and Appx902–906 (deposition transcript of Jeffrey Foster), has been highlighted as it is Confidential Information pursuant to the government's request that the information remain subject to the Protective Order. The Private Shareholders take no position on whether the information should be confidential.

UNITED STATES COURT OF FEDERAL CLAIMS

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

Plaintiffs,

v.

THE UNITED STATES OF AMERICA,

Defendant.

Case No. 1:13-cv-00698 MMS

SECOND AMENDED COMPLAINT

Plaintiffs Arrowood Indemnity Company, Arrowood Surplus Lines Insurance Company, and Financial Structures Limited (collectively, "Plaintiffs" or the "Arrowood Parties"), by and through the undersigned attorneys, bring this action under the Fifth Amendment to the United States Constitution and 28 U.S.C. § 1491, seeking compensation for the taking or, alternatively, the illegal exaction of Plaintiffs' property, and damages for breach of fiduciary duty. In support of their Second Amended Complaint, Plaintiffs allege as follows:

NATURE AND SUMMARY OF THE ACTION

1. In August 2012, at a time when the housing market was recovering from the financial crisis and Federal National Mortgage Association ("Fannie") and Federal Home Loan Mortgage Corporation ("Freddie") (collectively, the "Companies") had returned to stable profitability in a growing economy, the federal government took for itself the entire value of the rights held by Plaintiffs and Fannie's and Freddie's other private shareholders by forcing these publicly-traded, shareholder-owned Companies to turn over their **entire** net worth, less a small capital reserve, to the federal government on a quarterly basis **forever**—an action the

government called the "Net Worth Sweep" and that effectively nationalizes the Companies. This action is brought by Plaintiffs, holders of non-cumulative preferred stock ("Preferred Stock") issued by Fannie and Freddie seeking just compensation for the taking of their property by the United States of America, acting by and through, *inter alia*, the Department of the Treasury ("Treasury"), the Federal Housing Finance Administration ("FHFA"), and agents acting at their direction. Plaintiffs alternatively seek damages for themselves for an illegal exaction in violation of the Fifth Amendment. And Plaintiffs finally seek damages for themselves for the Government's breach of fiduciary duty.

2. At Treasury's urging, in July 2008, Congress enacted the Housing and Economic Recovery Act of 2008 ("HERA"). HERA created the Federal Housing Finance Agency (Treasury and FHFA are sometimes collectively referred to herein as the "Agencies") to replace Fannie's and Freddie's prior regulator and authorized FHFA to appoint itself as conservator or receiver of the Companies in certain statutorily specified circumstances. HERA charges FHFA as conservator to rehabilitate Fannie and Freddie by taking action to put the Companies in a sound and solvent condition while preserving and conserving their assets.

3. HERA also granted Treasury temporary authority to invest in the Companies' stock until December 31, 2009. Congress made clear that in exercising this authority Treasury was required to consider the "need to maintain [Fannie's and Freddie's] status as . . . private, shareholder-owned compan[ies]."

4. On September 6, 2008—despite prior public statements assuring investors that the Companies were in sound financial shape—FHFA, at Treasury's urging, abruptly forced Fannie and Freddie into conservatorship. Immediately after the Companies were forced into conservatorship, Treasury exercised its temporary authority under HERA to enter into

agreements with FHFA to purchase securities of Fannie and Freddie ("Preferred Stock Purchase Agreements," "Purchase Agreements," or "PSPAs"). Under these PSPAs, Treasury designed an entirely new class of securities in the Companies, known as Senior Preferred Stock ("Government Stock"), which came with very favorable terms for Treasury. At the outset, Treasury received $1 billion of Government Stock (via one million shares) in each Company and warrants to acquire 79.9% of the Common Stock of the Companies at a nominal price in return for its commitment to acquire Government Stock in the future.

5. The Government Stock entitled Treasury to collect dividends at an annualized rate of 10% if paid in cash or 12% if paid in kind—an extraordinarily generous return in an economic environment in which interest rates on government debt were near zero. The Government Stock was entitled to receive cash dividends from each Company only to the extent declared by the Board of Directors "in its sole discretion, from funds legally available therefor." If the Companies did not wish to—or legally could not—pay a cash dividend, the unpaid dividends on the Government Stock could be capitalized (or paid "in kind") by increasing the liquidation preference of the outstanding Government Stock. Therefore, the Companies were *never* required to pay cash dividends on Government Stock. There was *never* any threat that the Companies would become insolvent by virtue of making cash dividend payments. The PSPAs specifically allowed the Companies to utilize this mechanism throughout the life of the agreements, thereby foreclosing any possibility that they would exhaust Treasury's funding commitment because of a need to make a dividend payment to Treasury.

6. The Government Stock diluted, but did not eliminate, the economic interests of the Companies' private shareholders. The warrants to purchase 79.9% of the Companies' Common Stock gave Treasury "upside" via economic participation in the Companies'

profitability, but this upside would be *shared* with preferred shareholders (who had to be paid before any payment could be made on common stock purchased with Treasury's warrants) and private common shareholders (who retained rights to 20.1% of the Companies' residual value). James Lockhart, the Director of FHFA, accordingly assured Congress shortly after imposition of the conservatorship that Fannie's and Freddie's "shareholders are still in place; both the preferred and common shareholders have an economic interest in the companies" and that "going forward there may be some value" in that interest.

7. Under FHFA's supervision, the Companies were forced to excessively write down the value of their assets, primarily due to decisions based on grossly improper accounting. By June 2012, the Agencies had forced Fannie and Freddie to issue $161 billion in Government Stock to make up for the balance-sheet deficits caused by the Agencies' unrealistic and overly pessimistic accounting decisions, even though there was no indication that the Companies' actual cash expenses could not be met by their cash receipts. The Companies were further forced to issue an additional $26 billion of Government Stock so that Fannie and Freddie would be able to pay *cash* dividends to Treasury even though, as explained above, the Companies were never required to pay cash dividends. Finally, because (i) the Companies were forced to issue Government Stock to Treasury in return for funds that they did not need to continue operations and (ii) the structure of Treasury's financial support did not permit the Companies to repay and redeem the Government Stock outstanding, the amount of the dividends owed on the Government Stock was artificially—and permanently—inflated.

8. As a result of these transactions, Treasury amassed a total of $189 billion in Government Stock—a substantial sum, albeit far less than the $5 trillion in assets held in the Companies' mortgage portfolios. But based on the Companies' performance in the second

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quarter of 2012, it was apparent that there was still value in the Companies' private shares. By that time, the Companies were thriving and could easily pay 10% annualized cash dividends on the Government Stock without drawing additional capital from Treasury. And based on the improving housing market and the high quality of the newer loans backed by the Companies, it was apparent that they had returned to stable profitability. Indeed, the Agencies had specific information from the Companies demonstrating that this return to profitability was inevitable because the Companies would soon be reversing many of the non-cash accounting losses they had incurred under FHFA's supervision. In light of that information and the broad-based recovery in the housing industry that had occurred by the middle of 2012, the Agencies fully understood that the Companies were about to generate huge profits, far in excess of the dividends owed on the Government Stock.

9. The Government was not content to benefit from its investment like an investor in any other company and did not want to share the value of the Companies with private shareholders. Instead, it was committed to ensuring that, unlike all other companies that received financial assistance from the federal government during the financial crisis, Fannie and Freddie would be operated for the exclusive benefit of the federal government. Indeed, unbeknownst to the public, Treasury had secretly resolved "to ensure existing common equity holders will not have access to any positive earnings from the [Companies] in the future." Treasury also was seeking to transform the housing finance market by eliminating Fannie and Freddie, and it and FHFA had no intention of allowing the Companies to rehabilitate and exit conservatorship. By the middle of 2012, however, it was apparent that even the large amount of Government Stock outstanding would not achieve these surreptitious policy goals.

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10. Therefore, on August 17, 2012, just days after the Companies announced record-breaking quarterly earnings, the Agencies unilaterally imposed the Net Worth Sweep to expropriate for the federal government the value of Fannie and Freddie shares held by private investors and to ensure that the Companies could not begin rebuilding their capital levels. Treasury itself said that the Net Worth Sweep was intended to ensure both that "every dollar of earnings that Fannie Mae and Freddie Mac generate will benefit taxpayers" and that the Companies "will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." With the stroke of a pen, the Agencies had nationalized the Companies and taken all the value of the Companies for Treasury, thereby depriving the private shareholders of all their economic rights. No equivalent wipeout of private shareholder investments was imposed on other financial institutions that received assistance during the 2008 financial crisis, much less four years *after* that crisis was over.

11. The Companies received no incremental investment by Treasury or other meaningful consideration in return for the Net Worth Sweep, which restricts them to a small maximum capital level above which any profits they generate must be paid over to Treasury. This was done notwithstanding "the path laid out under HERA," which, as even Treasury acknowledged internally, was for FHFA to *rehabilitate* Fannie and Freddie, thus allowing them to "becom[e] adequately capitalized" and "exit conservatorship as private companies."

12. Despite the transparent fact that the Net Worth Sweep was designed to expropriate private property rights, the Government has claimed both in public and in prior filings in this case that the Net Worth Sweep was necessary to prevent the Companies from falling into a "death spiral" in which the Companies' increasing dividend obligations to Treasury

would consume Treasury's remaining funding commitment to the Companies. This made-for-litigation defense narrative is wholly inaccurate.

13. As an initial matter, the Government did not impose the Net Worth Sweep at a time when the Companies were struggling to generate enough income to pay the dividend on Treasury's stock. Rather, the Net Worth Sweep was imposed just days after the Companies disclosed that they had returned to stable profitability and had earned several billion dollars more than was necessary to pay the Treasury dividend in cash. And it was by then virtually inevitable, thanks to a strengthening housing market and the improving quality of loans guaranteed by the Companies, that they would soon reverse the non-cash accounting adjustments that were responsible for the great majority of the losses that they had experienced in the preceding years, thereby generating massive profits. More importantly, quite apart from the Companies' improved financial outlook, the Companies were contractually protected from a scenario in which their dividend obligation to Treasury could cause a death spiral: the Companies were entitled under the PSPAs to pay dividends to Treasury "in kind," with additional senior preferred stock, rather than in cash.

14. Materials produced in discovery further undermine the Government's death spiral narrative. Indeed, those materials reveal that the Net Worth Sweep was adopted not out of a concern that the Companies would earn too little, but rather out of concern that the Companies would make *too much* and thus would complicate the Administration's plans to keep Fannie and Freddie in perpetual conservatorship and to prevent their private shareholders from seeing any return on their investments. As a senior White House official stated in an email to a senior Treasury official on the day the Net Worth Sweep was announced, "we've closed off [the] possibility that [Fannie and Freddie] ever[] go (pretend) private again." That same official stated

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in another email that Peter Wallison of the American Enterprise Institute was "exactly right on substance and intent" when he said that "[t]he most significant issue here is whether Fannie and Freddie will come back to life because their profits will enable them to re-capitalize themselves and then it will look as though it is feasible for them to return as private companies backed by the government. . . . What the Treasury Department seems to be doing here . . . is to deprive them of all their capital so that doesn't happen." An internal Treasury document dated August 16, 2012, expressed the same sentiment: "By taking all of their profits going forward, we are making clear that [Fannie and Freddie] will not ever be allowed to return to profitable entities . . . ."

15. The Net Worth Sweep has resulted in a massive and unprecedented financial windfall for the federal government at the expense of the Companies' private shareholders. From the fourth quarter of 2012, the first fiscal quarter subject to the Net Worth Sweep, through the fourth quarter of 2017, the most recently reported fiscal quarter, Fannie and Freddie generated $217 billion in comprehensive income. But rather than using those profits to prudently build capital reserves and prepare to exit conservatorship, Fannie and Freddie instead have been forced to pay substantially all of it as "dividends" to the federal government under the Net Worth Sweep—$124 billion more than the government would have received under the original PSPAs. Adding Net Worth Sweep dividends to the dividends Fannie and Freddie had already paid, Treasury has now recouped $87 billion *more* than it has invested in the Companies. Yet, according to the Government, these payments have not reduced Treasury's liquidation preference by one cent, and Treasury continues to insist that it has the right to Fannie's and Freddie's future earnings *in perpetuity*.

16. The Net Worth Sweep has resulted in a massive and unprecedented expropriation of private property. To the extent this ongoing expropriation is authorized by law, the Fifth Amendment compels the Government to pay just compensation to Plaintiffs for the taking. To the extent it is not authorized, the Fifth Amendment compels the Government to pay damages to Plaintiffs for the illegal exaction. Indeed, in addition to exceeding FHFA's powers under statute, FHFA itself is an unlawfully organized agency because the Constitution's separation of powers does not permit an independent agency with far-reaching powers such as FHFA to be headed by a single Director rather than a multi-member Board. HERA's concentration of power in one person who is only removable by the President for cause is unconstitutional. Finally, the extraordinary control exercised by FHFA as conservator over Fannie and Freddie created a fiduciary relationship between FHFA, on the one hand, and the Companies' shareholders, on the other. The Net Worth Sweep violated FHFA's fiduciary duties, and Plaintiffs are entitled to damages for the breach.

17. Accordingly, through this action, Plaintiffs seek the recompense to which they are entitled.

JURISDICTION AND VENUE

18. This Court has jurisdiction over this action and venue is proper in this Court, pursuant to 28 U.S.C. § 1491(a)(1).

THE PARTIES

19. Plaintiff Arrowood Indemnity Company ("Arrowood Indemnity") is a Delaware corporation with its principal place of business at 3600 Arco Corporate Drive, Charlotte, North Carolina 28273. At the time of commencement of this action, Arrowood Indemnity owned the following shares of Fannie Mae Preferred Stock and Freddie Mac Preferred Stock, all of which were acquired prior to September 6, 2008, and had been continuously owned by Arrowood

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Indemnity since the date of acquisition, other than 2000 shares of Fannie Mae Preferred Stock which were sold in 2013 and then repurchased later in 2013:

Entity	CUSIP	Coupon Rate	Series	Shares	Par Value Per Share	Aggregate Par Value
Fannie Mae	313586844	5.125%	L	38,800	$ 50.00	$ 1,940,000
Fannie Mae	313586877	5.375%	I	78,000	$ 50.00	$ 3,900,000
Fannie Mae	313586885	5.81%	H	147,400	$ 50.00	$ 7,370,000
Freddie Mac	313400855	5.10%	H	160,000	$ 50.00	$ 8,000,000
Freddie Mac	313400731	5.70%	R	100,000	$ 50.00	$ 5,000,000
Freddie Mac	313400772	5.81%	O	119,750	$ 50.00	$ 5,987,500
Freddie Mac	313400749	6.00%	P	60,000	$ 50.00	$ 3,000,000
			Total	703,950		$ 35,197,500

20. Arrowood Indemnity has continued to own and now owns:

Entity	CUSIP	Coupon Rate	Series	Shares	Par Value Per Share	Aggregate Par Value
Fannie Mae	313586877	5.375%	I	103,000	$ 50	$ 5,150,000
Freddie Mac	313400772	5.810%	O	19,750	$ 50	$ 987,500
			Total	**122,750**		**$ 6,137,500**

21. Plaintiff Arrowood Surplus Lines Insurance Company ("Arrowood Surplus Lines") is a Delaware corporation with its principal place of business at 3600 Arco Corporate Drive, Charlotte, North Carolina 28273. At the time of commencement of this action, Arrowood Surplus Lines owned the following shares of Fannie Mae Preferred Stock and Freddie Mac Preferred Stock, all of which were acquired prior to September 6, 2008, and had been continuously owned by Arrowood Surplus Lines since the date of acquisition:

Entity	CUSIP	Coupon Rate	Series	Shares	Par Value Per Share	Aggregate Par Value
Fannie Mae	313586877	5.375%	I	22,000	$ 50.00	$ 1,100,000
Freddie Mac	313400772	5.81%	O	40,000	$ 50.00	$ 2,000,000
Freddie Mac	313400749	6.00%	P	40,000	$ 50.00	$ 2,000,000
			Total	102,000		$ 5,100,000

22. Arrowood Surplus Lines has continued to own and now owns:

Entity	CUSIP	Coupon Rate	Series	Shares	Par Value Per Share	Aggregate Par Value
Fannie Mae	313586877	5.375%	I	22,000	$ 50	$ 1,100,000
Freddie Mac	313400772	5.810%	O	40,000	$ 50	$ 2,000,000
			Total	**62,000**		**$ 3,100,000**

23. Plaintiff Financial Structures Limited ("Financial Structures") is an insurance company organized under the laws of Bermuda, with an office at 7 Par-la-Ville Rd., Hamilton HM11, Bermuda. Financial Structures owns the following shares of Freddie Mac Preferred Stock, all of which were acquired prior to September 6, 2008, have been continuously owned by Financial Structures since the date of acquisition, and are still owned by Financial Structures:

Entity	CUSIP	Coupon Rate	Series	Shares	Par Value Per Share	Aggregate Par Value
Freddie Mac	313400772	5.81%	O	40,000	$ 50.00	$ 2,000,000
			Total	40,000		$ 2,000,000

24. Arrowood Surplus Lines and Financial Structures are wholly-owned subsidiaries of Arrowood Indemnity. Arrowood Indemnity is an indirect wholly-owned subsidiary of Arrowpoint Capital Corp., a Delaware corporation.

25. Arrowood Indemnity and Arrowood Surplus Lines are insurance companies that are now in "run-off" under the jurisdiction of the Commissioner of Insurance of the State of Delaware. Financial Structures is also an insurance company in run-off. As insurance companies

in run-off, the Arrowood Parties do not issue any new insurance policies, and have an obligation to manage their businesses, and conservatively invest their assets, so that funds will be available to fulfill their obligations to existing policyholders. Each of the Arrowood Parties regarded its investments in the Preferred Stock of Fannie Mae and Freddie Mac to be conservative investments.

26. Defendant United States of America includes Treasury, FHFA, and agents acting at their direction.

CONSTITUTIONAL AND STATUTORY PROVISIONS

27. Plaintiffs' claims are founded on the Fifth Amendment to the United States Constitution, which provides in pertinent part that no person shall "be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation," and on HERA, 12 U.S.C. §§ 1455(*l*), 1719(g), 4617.

FACTUAL ALLEGATIONS

Fannie and Freddie

28. Fannie is a for-profit, stockholder-owned corporation organized and existing under the Federal National Mortgage Act. Freddie is a for-profit, stockholder-owned corporation organized and existing under the Federal Home Loan Corporation Act. The Companies' business includes purchasing and guaranteeing mortgages originated by private banks and bundling the mortgages into mortgage-related securities that can be sold to investors. Prior to 2008, the Companies' mortgage portfolios had a combined value of $5 trillion.

29. Fannie and Freddie are owned by private shareholders and their securities are publicly traded. Fannie was chartered by Congress in 1938 and originally operated as an agency of the Federal Government. In 1968, Congress reorganized Fannie into a for-profit corporation owned by private shareholders. Freddie was established by Congress in 1970 as a wholly-owned

subsidiary of the Federal Home Loan Bank System. In 1989, Congress reorganized Freddie into a for-profit corporation owned by private shareholders.

30. Before being forced into conservatorship, both Fannie and Freddie had issued Common Stock and several series of Preferred Stock that were marketed and sold to community banks, insurance companies, and countless other institutional and individual investors. The several series of Preferred Stock of the Companies are in parity with each other with respect to their claims on income (i.e., dividend payments) and claims on assets (i.e., liquidation preference or redemption price), but they have priority over the Companies' Common Stock for these purposes. The holders of Common Stock are entitled to the residual economic value of the firms. The Companies have outstanding Preferred Stock with an aggregate liquidation preference of $33 billion.

31. Under the Certificates of Designation setting out the terms and conditions of the Preferred Stock issued by Fannie and Freddie prior to September 6, 2008, each series of Preferred Stock issued by the Companies enjoyed parity with all other issued and outstanding series of Preferred Stock as to the payment of dividends and the distribution of assets upon dissolution, liquidation, or winding up of the companies. Thus, the holders of each series of Preferred Stock had equal contractual rights to receive their respective liquidation preferences (or their respective pro rata portions thereof) upon dissolution, liquidation, or winding up of the Companies.

32. Prior to 2007, Fannie and Freddie were consistently profitable. In fact, Fannie had not reported a full-year loss since 1985 and Freddie had not reported a full-year loss since becoming owned by private shareholders. In addition, both Companies regularly declared and

paid dividends on each series of their respective Preferred Stock and their respective Common Stock.

Fannie and Freddie Are Forced into Conservatorship

33. The Companies were well-positioned to weather the decline in home prices and financial turmoil of 2007 and 2008. While banks and other financial institutions involved in the mortgage markets had heavily invested in increasingly risky mortgages in the years leading up to the financial crisis, Fannie and Freddie had taken a more conservative approach that meant that the mortgages that they insured (primarily 30-year fixed rate conforming mortgages) were far safer than those insured by the nation's largest banks. And although both Companies recorded losses in 2007 and the first two quarters of 2008—losses that largely reflected a temporary decline in the market value of their holdings caused by declining home prices—both Companies continued to generate enough cash to easily pay their debts and retained billions of dollars of capital that could be used to cover any future losses.

34. Neither Company was in danger of insolvency in 2008. Indeed, during the summer of 2008, both Treasury Secretary Henry Paulson and Office of Federal Housing and Enterprise Oversight ("OFHEO") Director James Lockhart publicly stated that Fannie and Freddie were financially healthy. For example, on July 8, 2008, Director Lockhart told CNBC that "both of these companies are adequately capitalized, which is our highest criteria." Two days later, on July 10, Secretary Paulson testified to the House Committee on Financial Services that Fannie's and Freddie's "regulator has made clear that they are adequately capitalized." On July 13, Director Lockhart issued a statement emphasizing that "the Enterprises' $95 billion in total capital, their substantial cash and liquidity portfolios, and their experienced management serve as strong supports for the Enterprises' continued operations." In August 2008, the

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Companies issued their financial statements which reflected that as of the end of June 2008, Fannie Mae's assets exceeded its debts by over $41 billion and that Freddie Mac's assets exceeded its debts by nearly $13 billion. An analysis of Freddie's financial condition in August 2008 for FHFA by BlackRock stated that Freddie's "long-term solvency does not appear endangered—we do not expect Freddie Mac to breach critical capital levels even in stress case." Furthermore, on August 22, 2008, FHFA confirmed that Fannie Mae and Freddie Mac were adequately capitalized, even under additional capital requirements imposed by FHFA under its risk-based capital stress test. See Letter from Christopher H. Dickerson, Acting Deputy Dir., FHFA, to Daniel H. Mudd, President and Chief Exec. Officer, Fannie Mae (Aug. 22, 2008); Letter from Christopher H. Dickerson, Acting Deputy Dir., FHFA, to Richard F. Syron, Chairman and Chief Exec. Officer, Freddie Mac (Aug. 22, 2008). In sum, despite arguments to the contrary by lawyers for the Agencies in litigation related to the Net Worth Sweep, the Companies were not on the precipice of failure in 2008.

35. Despite (or perhaps because of) the Companies' comparatively strong financial position amidst the crisis, Treasury initiated a long-term policy of seeking to seize control of Fannie and Freddie and operate them for the exclusive benefit of the federal government. To that end, as early as March 2008, Treasury was internally discussing "potential costs and benefits of nationalization" of the Companies. Around the same time, a Treasury official was the off-the-record source for a Barron's article that inaccurately claimed that the Companies' books overstated assets and understated liabilities.

36. The Companies' sound financial condition in the weeks leading up to imposition of the conservatorships is further illustrated by the decision by Fannie's Board of Directors to declare dividends on both its preferred and common stock in August 2008 and by FHFA's

subsequent decision as conservator to direct Fannie to pay those dividends out of cash available for distribution in late September 2008. It is a fundamental principle of corporate law that a company may not declare dividends when it is insolvent, and dividends that a company improperly declares when insolvent may not be lawfully paid. Fannie's Board thus could not have lawfully declared dividends in August 2008 unless the Company was solvent at that time, and the Board's decision to declare those dividends showed its confidence that Fannie was financially healthy. Furthermore, it is evident that both FHFA and Treasury agreed that Fannie was solvent when it declared dividends in August 2008 because, rather than halting or voiding the dividends that the outgoing Fannie Board had declared, both Agencies publicly took the position that Fannie was legally obligated to pay them even after conservatorship was imposed in early September 2008

37. Also during the summer of 2008, Treasury pressed Congress to pass what became HERA. HERA created FHFA (which succeeded to the regulatory authority over Fannie and Freddie previously held by OFHEO) and authorized FHFA, under certain statutorily prescribed and circumscribed conditions, to place the Companies into either conservatorship or receivership.

38. In authorizing FHFA to act as conservator under specified circumstances, Congress took FHFA's conservatorship mission verbatim from the Federal Deposit Insurance Act ("FDIA"), *see* 12 U.S.C. § 1821(d)(2)(D), which itself incorporated a long history of financial supervision and rehabilitation of troubled entities under common law. HERA and the FDIA, as well as the common law concept on which both statutes draw, treat conservatorship as a process designed to stabilize a troubled institution with the objective of returning it to normal

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business operations. Like any conservator, when FHFA acts as a conservator under HERA it has a fiduciary duty to safeguard the interests of the Companies and their shareholders.

39. According to HERA, FHFA "may, as conservator, take such action as may be—(i) necessary to put the regulated entity in a sound and solvent condition, and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." 12 U.S.C. § 4617(b)(2)(D). FHFA has acknowledged that "[t]he purpose of conservatorship is to preserve and conserve each company's assets and property and to put the companies in a sound and solvent condition," and "[t]o fulfill the statutory mandate of conservator, FHFA must follow governance and risk management practices associated with private-sector disciplines." FHFA, REPORT TO CONGRESS 2009 at i, 99 (May 25, 2010).

40. FHFA has repeatedly stated publicly that HERA *requires* and *mandates* FHFA as conservator to preserve and conserve Fannie's and Freddie's assets and to restore them to a sound and solvent condition. The following are just a few examples:

- The provisions of 12 U.S.C. § 4617(b)(2)(D) are "statutory mandates" and as conservator FHFA "must follow the mandates assigned to it by statute." FHFA, STRATEGIC PLAN: FISCAL YEARS 2018-2022 at 3-4 (Jan. 29, 2018). https://goo.gl/yDZmir.
- FHFA has "statutory obligations to operate the [Companies] in a safe and sound manner." Prepared Remarks of Melvin L. Watt, Dir., FHFA, at American Mortgage Conference (May 18, 2017). https://goo.gl/rT3f6C.
- FHFA's "statutory mandates obligate" it to "[c]onserve and preserve the assets of the Enterprises while they are in conservatorship." Statement of Melvin L. Watt,

Dir., FHFA, Before the U.S. Senate Comm. on Banking, Housing, and Urban Affairs (May 11, 2017). https://goo.gl/h44qRf.

- FHFA has a " 'preserve and conserve' mandate." FHFA STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIP: THE NEXT CHAPTER IN A STORY THAT NEEDS AN ENDING at 7 (Feb. 21, 2012), http://goo.gl/uXreKX ("A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIP").
- "By law, the conservatorships are intended to rehabilitate [Fannie and Freddie] as private firms." Letter from Edward DeMarco, Acting Director, FHFA to Senators at 1 (Nov. 10, 2011), http://goo.gl/hbBe25.
- "The statutory role of FHFA as conservator requires FHFA to take actions to preserve and conserve the assets of the Enterprises and restore them to safety and soundness. FHFA REPORT TO CONGRESS 2009 at 99 (May 25, 2010), http://goo.gl/YOOgzC.
- "As the conservator, FHFA's most important goal is to preserve the assets of Fannie Mae and Freddie Mac over the conservatorship period. That is our statutory responsibility." The Present Condition and Future Status of Fannie Mae and Freddie Mac: Hearing Before the Subcomm. of Capital Markets, Ins. & Gov't Sponsored Enters of the H. Comm. On Fin. Servs. 111th Cong. 136 (2009). (statement of James B. Lockhart III, Dir., FHFA).
- FHFA as conservator "preserves and conserves the assets and property of the Enterprises . . . and facilitates their financial stability and emergence from conservatorship." FHFA, STRATEGIC PLAN 2009–2014, at 33, http://goo.gl/UjCxf6. "The conservatorship of Fannie Mae and Freddie Mac

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allows the FHFA to preserve the assets of the [Companies], ensure they focus on their housing mission and are positioned to emerge from conservatorship as financially strong . . . ." Id. at 20.

41. The Agencies' similarly acknowledged FHFA's mandates as conservator in internal documents produced in discovery. Treasury, for example, acknowledged that "FHFA as conservator is required to preserve assets" and that one of the "[l]egal [c]onstraints" imposed upon FHFA is its "mandate[ ] to 'conserve assets.' " FHFA recognized that it "has a responsibility to take such actions as may be necessary to put the Enterprises in a sound and solvent condition and to preserve and conserve their assets and property."

42. Under HERA, conservatorship is a status distinct from receivership, with very different purposes, responsibilities, and restrictions. When acting as a receiver, but *not* when acting as a conservator, FHFA is authorized and obliged to "place the regulated entity in liquidation and proceed to realize upon the assets of the regulated entity." *Id.* § 4617(b)(2)(E). The only "post-conservatorship outcome[] . . . that FHFA may implement today under existing law," by contrast, "is to reconstitute [Fannie and Freddie] under their current charters." Letter from Edward J. DeMarco, Acting Director, FHFA, to Chairmen and Ranking Members of the Senate Committee on Banking, Housing, and Urban Affairs and to the House Committee on Financial Services 7 (Feb. 2, 2010). In other words, receivership is aimed at winding down a company's affairs and liquidating its assets, while conservatorship aims to rehabilitate it and return it to normal operation. This distinction between the purposes and authorities of a receiver and a conservator is a well-established tenet of financial regulation and common law. In our nation's history, there has *never* been an example of a regulator forcing a healthy, profitable company to remain captive in a perpetual conservatorship (in this instance, going on ten years)

while facilitating the looting and plundering of the company's assets by another federal agency *and* simultaneously avoiding the organized claims process of a receivership.

43. In promulgating regulations governing its operations as conservator versus receiver of the Companies, FHFA specifically acknowledged the distinctions in its statutory responsibilities as conservator and as receiver: "A conservator's goal is to continue the operations of a regulated entity, rehabilitate it and return it to a safe, sound and solvent condition." 76 Fed. Reg. 35,724, 35,730. In contrast, when FHFA acts as a receiver, the regulation specifically provides that "[t]he Agency, as receiver, *shall* place the regulated entity in liquidation . . . ." 12 C.F.R. § 1237.3(b) (emphasis added). Consistent with this interpretation of HERA, a FHFA Advisory Bulletin describes "the conservator's or receiver's powers and responsibilities" as including "in the case of a conservator, to put the regulated entity in a sound and solvent condition, and to carry on its business and preserve and conserve its assets, and in the case of a receiver, to liquidate the regulated entity."

44. During conservatorship FHFA has dual and potentially conflicting roles as the Companies' conservator and regulator. As conservator, FHFA's mission is to preserve and conserve the Companies' assets and restore them to soundness and solvency. In contrast, as regulator, FHFA is charged with the public mission of ensuring that the Companies "foster liquid, efficient, competitive, and resilient national housing finance markets (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities)" and conduct their operations in a manner "consistent with the public interest." 12 U.S.C. § 4513(a)(1)(B). The FDIC, which has similar dual roles, has in the past sought to manage this conflict by erecting a "firewall" between personnel tasked with working for the agency as conservator and other

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personnel tasked with working for the agency as regulator. *See Plaintiffs in All Winstar-Related Cases at Court v. United States*, 44 Fed. Cl. 3, 7 n.5 (1999). FHFA has not taken similar steps to protect the integrity of its conservatorship role and, as set forth in greater detail below, abandoned the traditional role of a conservator by disregarding the interests of the Companies when it took the actions that are the subject of this suit.

45. On September 6, 2008, FHFA and Treasury persuaded the Companies' boards to consent to conservatorship. As Former Secretary Paulson has explained, Treasury was the driving force behind the imposition of the conservatorships: "FHFA had been balky all along [about the imposition of a conservatorship] . . . We had to convince its people that [conservatorship] was the right thing to do, while making sure to let them feel they were still in charge." HENRY M. PAULSON, JR., ON THE BRINK 6 (2010). Given that the Companies were not in financial distress and were in no danger of defaulting on their debts, the Companies' directors were confronted with a Hobson's choice: agree to conservatorship, or they would face "nasty lawsuits" and Treasury would refuse to provide the Companies with any capital if they needed it. THE FINANCIAL CRISIS INQUIRY COMMISSION REPORT 320 (Jan. 2011). The Agencies ultimately obtained the Companies' consent by threatening to seize them if they did not acquiesce and by informing them that the Agencies had already selected new CEOs and had teams ready to move in and take control. In agreeing to the FHFA takeover, both Companies' boards understood that the "conservatorship" FHFA and Treasury proposed would be like all other federal conservatorships in American history and that the Companies would be operated by their regulator acting in a fiduciary capacity for the benefit of all stakeholders, including private shareholders.

46. In publicly announcing the conservatorship, FHFA acknowledged that the Companies' stock remains outstanding during conservatorship and "continue[s] to trade," *FHFA Fact Sheet, Questions and Answers on Conservatorship* 3, https://goo.gl/DV4nAt, and Fannie's and Freddie's stockholders "continue to retain all rights in the stock's financial worth," *id.* Director Lockhart testified before Congress that Fannie's and Freddie's "shareholders are still in place; both the preferred and common shareholders have an economic interest in the companies" and that "going forward there may be some value" in that interest. *Oversight Hearing to Examine Recent Treasury & FHFA Actions Regarding the Housing GSEs: Hearing Before the H. Comm. on Fin. Servs.,* 110th Cong. 29–30, 34 (2008).

47. FHFA also emphasized that the conservatorship was temporary: "Upon the Director's determination that the Conservator's plan to restore the [Companies] to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship." *FHFA Fact Sheet, Questions and Answers on Conservatorship* 2. Investors were entitled to rely on these official statements of the purposes of the conservatorship, and public trading in Fannie's and Freddie's stock was permitted to, and did, continue.

48. In short, the Companies were not in financial distress when they were forced into conservatorship. The Companies' boards acquiesced to conservatorship based on the understanding that FHFA, like any other conservator, would operate the Companies as a fiduciary with the goal of preserving and conserving their assets and managing them in a safe and solvent manner. And in publicly announcing the conservatorships, FHFA confirmed that the Companies' private shareholders continued to hold an economic interest that could have value, particularly as the Companies generated profits in the future.

<u>**FHFA and Treasury Enter into the Purchase Agreements**</u>

49. On September 7, 2008, Treasury and FHFA, acting in its capacity as conservator of Fannie and Freddie, entered into the Preferred Stock Purchase Agreements.

50. In entering into the Purchase Agreements, Treasury exercised its temporary authority under HERA to purchase securities issued by the Companies. *See* 12 U.S.C. §§ 1455(*l*), 1719(g). To exercise that authority, the Secretary of the Treasury was required to determine that purchasing the Companies' securities was "necessary to. . .provide stability to the financial markets; . . . prevent disruptions in the availability of mortgage finance; and . . . protect the taxpayer." 12 U.S.C. §§ 1455(*l*)(1)(B), 1719(g)(1)(B). In making those determinations, the Secretary was required to consider six factors:

> (i) The need for preferences or priorities regarding payments to the Government.
> (ii) Limits on maturity or disposition of obligations or securities to be purchased.
> (iii) *The [Companies'] plan[s] for the orderly resumption of private market funding or capital market access*.
> (iv) The probability of the [Companies] fulfilling the terms of any such obligation or other security, including repayment.
> (v) *The need to maintain the [Companies'] status as . . . private shareholder-owned compan[ies]*.
> (vi) Restrictions on the use of [the Companies'] resources, including limitations on the payment of dividends and executive compensation and any such other terms and conditions as appropriate for those purposes.

Id. §§ 1455(*l*)(1)(C), 1719(g)(1)(C) (emphasis added).

51. In approving the exercise of Treasury's temporary authority under HERA to purchase securities of the Companies, Treasury Secretary Paulson determined (1) [u]nder conservatorship, Fannie Mae and Freddie Mac will continue to operate as going concerns', (2) "Fannie Mae and Freddie Mac may emerge from conservatorship to resume independent operations", and (3) "[c]onservatorship preserves the status and claims of the preferred and common shareholders." Action Memorandum for Secretary Paulson (Sept. 7, 2008).

52. Treasury's authority under HERA to purchase the Companies' securities expired on December 31, 2009. *See* 12 U.S.C. §§ 1455(*l*)(4), 1719(g)(4). After that date, HERA authorized Treasury only "to hold, exercise any rights received in connection with, or sell" previously purchased securities. *Id.* §§ 1455(*l*)(2)(D), 1719(g)(2)(D).

53. Treasury's PSPAs with Fannie and Freddie are materially identical. Under the original agreements, Treasury committed to provide up to $100 billion to each Company to ensure that it maintained a positive net worth. In particular, for quarters in which either Company's liabilities exceed its assets under Generally Accepted Accounting Principles, the PSPAs authorize Fannie and Freddie to draw upon Treasury's commitment in an amount equal to the difference between its liabilities and assets.

54. In return for Treasury's funding commitment, Treasury received 1 million shares of Government Stock in each Company and warrants to purchase 79.9% of the common stock of each Company at a nominal price. Exercising these warrants would entitle Treasury to up to 79.9% of all future profits of the Companies, subject to the Companies' obligation to satisfy their dividend obligations with respect to the Government Stock and Preferred Stock and to share the remaining 20.1% of those profits with private common shareholders. As Treasury noted in entering the PSPAs, the warrants "provide potential future upside to the taxpayers." Action Memorandum for Secretary Paulson (Sept. 7, 2008).

55. Treasury's Government Stock in each Company had an initial liquidation preference of $1 billion. In other words, Treasury took an upfront fee of $1 billion from each of the Companies before either Company received *any* funding from Treasury in return. This liquidation preference increases by one dollar for each dollar the Companies receive from Treasury pursuant to the PSPAs. In the event the Companies liquidate, Treasury is entitled to

recover the full liquidation value of its shares before any other shareholder may recover anything.

56. While Treasury's commitment remains outstanding, Fannie and Freddie generally are prohibited from paying down amounts added to the liquidation preference due to draws from Treasury's commitment. *See* Fannie and Freddie Government Stock Certificates § 3(a). This extraordinary feature of the original PSPAs would play an important role in enabling the Government to permanently increase the size of the dividends on the Government Stock by artificially reducing the Companies' reported net worth through the accounting manipulations discussed below.

57. In addition to the liquidation preference, the original PSPAs provided for Treasury to receive either a cumulative cash dividend equal to 10% of the value of the outstanding liquidation preference or a stock dividend. If the Companies decided not to pay the dividend in cash, the value of the dividend would be added to the liquidation preference—effectively amounting to an in-kind dividend payment of additional Government Stock. After an in-kind dividend payment, the dividend rate would increase to 12% until such time as full cumulative dividends were paid in cash, at which point the rate would return to 10%. The plain terms of the PSPAs thus make clear that Fannie and Freddie never were required to pay a cash dividend to Treasury but rather had the discretion to pay dividends in kind. In other words, the Companies were never under any obligation to pay a fixed 10% cash dividend to Treasury. Moreover, there was never any risk that payment of dividends would render the Companies insolvent since it would have been illegal under state law for either Company to pay a dividend that would render it insolvent.

58. Numerous materials prove beyond any reasonable doubt that the Agencies recognized that the PSPAs were designed, as their express terms plainly provide, to allow the payment of dividends in kind—in additional senior preferred stock—rather than in cash. In an internal October 2008 email to Mario Ugoletti—who was then a Treasury official, but later moved to FHFA and was a key point of contact with Treasury in the development of the Net Worth Sweep—another Treasury official indicated that Treasury's consultant wanted to know "whether we expect [Fannie and Freddie] to pay the preferred stock dividends in cash or to just accrue the payments." Mr. Ugoletti did not forget about this feature of the PSPAs when he moved to FHFA. Indeed, he acknowledged the option to pay dividends "in kind" in an email that he sent the very day the Net Worth Sweep was announced. In a similar vein, a document attached to a September 16, 2008, email between FHFA officials expressly states that PSPA dividends may be "paid in-kind." In an October 2008 email to Treasury and FHFA officials, a Treasury consultant sought to clarify whether Fannie and Freddie "intend[ed] to pay cash at 10 percent or accrue at 12 percent as a matter of policy." An internal Treasury document says that the dividend rate "may increase to the rate of 12 percent if, in any quarter, the dividends are not paid in cash." And an internal FHFA document says that Treasury's senior stock pays "10 percent cash dividend (12 percent payment-in-kind)."

59. Documents that the Agencies placed in the public domain also support this understanding of the payment-in-kind option. Upon entering the PSPAs Treasury released a fact sheet stating that, "[t]he senior preferred stock shall accrue dividends at 10% per year. The rate shall increase to 12% if, in any quarter, the dividends are not paid in cash . . . ." U.S. TREASURY DEP'T OFFICE OF PUB. AFFAIRS, FACT SHEET: TREASURY SENIOR PREFERRED STOCK PURCHASE AGREEMENT (Sept. 7, 2008), https://goo.gl/ynb3TC. And a presentation Treasury included in the

administrative record in a case in the District of the District of Columbia acknowledges that the dividend rate of the PSPAs would be 12% "if elected to be paid in kind." Treasury Presentation to SEC, GSE Preferred Stock Purchase Agreements (PSPA), Overview and Key Considerations at 9, June 13, 2012.

60. The Companies shared this understanding of the terms of their agreements with Treasury. Fannie's and Freddie's Chief Financial Officers ("CFOs") have testified that they were aware of the payment-in-kind option. Various Freddie documents say that "[t]he dividend becomes 12% if Freddie Mac is unable to pay the dividend through organic income," that "[t]he senior preferred stock will pay quarterly cumulative dividends at a rate of 10% per year or 12% in any quarter in which dividends are not paid in cash," that Treasury's stock "[p]ays quarterly cumulative dividend rate at 10% per year, or 12% in any quarter in which dividends are not paid in cash," and that Treasury's stock "will pay quarterly cumulative dividends at a rate of 10% per year, or 12% in any quarter in which dividends are not paid in cash." Similarly, Fannie documents say that "Treasury's preferred stock "has an annual dividend rate of 10%, which could increase to 12% if not paid in cash," and that "[i]f at any time . . . the Company does not pay the cash dividends in a timely manner, . . . the annual dividend rate will be 12%."

61. An in-kind dividend payment would not decrease Treasury's funding commitment because only when the Companies receive "funding under the Commitment" does its size decrease. Fannie and Freddie Amended and Restated Senior Preferred Stock Purchase Agreements ("PSPA") § 1. Jeff Foster, one of the architects of the Net Worth Sweep at Treasury, accordingly has testified in a deposition that he could not identify any "problems of the circularity [in dividend payments that] would have remained had the [payment-in-kind] option been adopted." Thus, as the Congressional Research Service has acknowledged, under the

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PSPAs' original terms the Companies could "pay a 12% annual senior preferred stock dividend indefinitely." N. ERIC WEISS, CONG. RESEARCH SERV., RL34661, FANNIE MAE'S AND FREDDIE MAC'S FINANCIAL PROBLEMS (Aug. 10, 2012). In other words, because of the payment-in-kind option, there was no risk—none whatsoever—that the PSPAs would force Fannie and Freddie to exhaust Treasury's funding commitment to facilitate the payment of dividends.

62. The PSPAs also provided for the Companies to pay Treasury a quarterly periodic commitment fee "intended to fully compensate [Treasury] for the support provided by the ongoing Commitment." PSPA § 3.2(a). The periodic commitment fee was to be set for five-year periods by agreement of the Companies and Treasury, but Treasury had the option to waive it for up to a year at a time. Treasury has exercised this option and has never received a periodic commitment fee under the PSPAs. Even if the fee had been charged, the Companies were always free under the express terms of the PSPAs to pay the fee in-kind with additional senior preferred stock rather than in cash. *See* PSPA § 3.2(c) ("At the election of Seller, the Periodic Commitment Fee may be paid in cash or by adding the amount thereof ratably to the liquidation preference of each outstanding share of Senior Preferred Stock . . . ."). This is a fact that Freddie's auditor recognized in a document produced in this case.

63. Finally, the PSPAs also grant Treasury substantial control over FHFA's operation of Fannie and Freddie and the conservatorships. In particular, from their inception through the adoption of the Net Worth Sweep the PSPAs provided as follows:

> From the Effective Date until such time as the Senior Preferred Stock shall have been repaid or redeemed in full in accordance with its terms:
>
> 5.1. *Restricted Payments.* Seller shall not, and shall not permit any of its subsidiaries to, in each case without the prior written consent of Purchaser, declare or pay any dividend (preferred or otherwise) or make any other distribution (by reduction of capital or otherwise), whether in cash, property, securities or a combination thereof, with respect to any of Seller's Equity Interests

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(other than with respect to the Senior Preferred Stock or the Warrant) or directly or indirectly redeem, purchase, retire or otherwise acquire for value any of Seller's Equity Interests (other than the Senior Preferred Stock or the Warrant), or set aside any amount for any such purpose.

5.2. *Issuance of Capital Stock*. Seller shall not, and shall not permit any of its subsidiaries to, in each case without the prior written consent of Purchaser, sell or issue Equity Interests of Seller or any of its subsidiaries of any kind or nature, in any amount, other than the sale and issuance of the Senior Preferred Stock and Warrant on the Effective Date and the common stock subject to the Warrant upon exercise thereof, and other than as required by (and pursuant to) the terms of any binding agreement as in effect on the date hereof.

5.3. *Conservatorship*. Seller shall not (and Conservator, by its signature below, agrees that it shall not), without the prior written consent of Purchaser, terminate, seek termination of or permit to be terminated the conservatorship of Seller pursuant to Section 1367 of the FHE Act, other than in connection with a receivership pursuant to Section 1367 of the FHE Act.

5.4. *Transfer of Assets*. Seller shall not, and shall not permit any of its subsidiaries to, in each case without the prior written consent of Purchaser, sell, transfer, lease or otherwise dispose of (in one transaction or a series of related transactions) all or any portion of its assets (including Equity Interests in other persons, including subsidiaries), whether now owned or hereafter acquired (any such sale, transfer, lease or disposition, a "Disposition"), other than Dispositions for fair market value:

(a) to a limited life regulated entity ("LLRE") pursuant to Section 1367(i) of the FHE Act;

(b) of assets and properties in the ordinary course of business, consistent with past practice;

(c) in connection with a liquidation of Seller by a receiver appointed pursuant to Section 1367(a) of the FHE Act;

(d) of cash or cash equivalents for cash or cash equivalents; or

(e) to the extent necessary to comply with the covenant set forth in Section 5.7 below.[1]

[1] The Third Amendment, discussed below, added a provision to Section 5.4 permitting the Companies to sell up to $250,000,000 in assets in a single transaction without Treasury's consent.

> 5.5. *Indebtedness*. Seller shall not, and shall not permit any of its subsidiaries to, in each case without the prior written consent of Purchaser, incur, assume or otherwise become liable for (a) any indebtedness if, after giving effect to the incurrence thereof, the aggregate Indebtedness of Seller and its subsidiaries on a consolidated basis would exceed 110.0% of the aggregate Indebtedness of Seller and its subsidiaries on a consolidated basis as of June 30, 2008 or (b) any Indebtedness if such Indebtedness is subordinated by its terms to any other Indebtedness of Seller or the applicable subsidiary. For purposes of this covenant the acquisition of a subsidiary with Indebtedness will be deemed to be the incurrence of such Indebtedness at the time of such acquisition.
>
> 5.6. *Fundamental Changes*. Seller shall not, and shall not permit any of its subsidiaries to, in each case without the prior written consent of Purchaser, (i) merge into or consolidate or amalgamate with any other Person, or permit any other Person to merge into or consolidate or amalgamate with it, (ii) effect a reorganization or recapitalization involving the common stock of Seller, a reclassification of the common stock of Seller or similar corporate transaction or event or (iii) purchase, lease or otherwise acquire (in one transaction or a series of transactions) all or substantially all of the assets of any other Person or any division, unit or business of any Person.
>
> . . .
>
> 5.8. *Transactions with Affiliates*. Seller shall not, and shall not permit any of its subsidiaries to, without the prior written consent of Purchaser, engage in any transaction of any kind or nature with an Affiliate of Seller unless such transaction is (i) Pursuant to this Agreement, the Senior Preferred Stock or the Warrant, (ii) upon terms no less favorable to Seller than would be obtained in a comparable arm's-length transaction with a Person that is not an Affiliate of Seller or (iii) a transaction undertaken in the ordinary course or pursuant to a contractual obligation or customary employment arrangement in existence as of the date hereof.
>
> PSPAs at 8–10.

64. As Freddie has observed, these covenants "restrict [the Companies'] business activities" and prevent them from taking certain actions even at the direction of FHFA "without prior written consent of Treasury."

65. On May 6, 2009, FHFA and Treasury amended the PSPAs to increase Treasury's funding commitment to each Company from $100 billion to $200 billion. On December 24, 2009—one week before Treasury's temporary statutory authority to purchase the Companies'

securities expired—the agencies again amended the terms of Treasury's funding commitment. Instead of resetting the commitment at a specific dollar amount, the second amendment established a formula to allow Treasury's total commitment to each Company to exceed (but not fall below) $200 billion depending upon any net worth deficiencies experienced in 2010, 2011, and 2012, and any surplus existing as of December 31, 2012. In an action memorandum explaining the second of these two amendments, Treasury stated that the increased funding commitment was "a strong statement that the U.S. Government will make sure that the institutions continue to function" and that it was not expected that the Companies would require any additional increase because "[i]t is unlikely that either [Company] will reach the $200 billion existing cap unless the housing market worsens sharply from here." As Treasury acknowledged, in the same document, expiration of its authority to purchase the Companies' shares at the end of 2009 meant that its "ability to make further changes to the PSPAs . . . [was] constrained." Action Memorandum for Secretary Geithner at 3, 4 (Dec. 22, 2009).

The Agencies Force Accounting Changes To Increase
the Companies' Draws From Treasury

66. Beginning in the third quarter of 2008—when FHFA took control of the Companies as conservator—the Companies began to make wildly pessimistic and obviously unrealistic assumptions about their future financial prospects. Indeed, these assumptions would have only been accurate if the United States had suffered a catastrophic, multi-decade depression that no company, irrespective of its financial health, could have survived. These false assumptions triggered adjustments to the Companies' balance sheets, most notably write-downs of significant tax assets and the establishment of large loan loss reserves, which caused the Companies to report non-cash losses. Although reflecting nothing more than unjustifiable

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accounting assumptions about the Companies' future prospects and having no effect on the cash flow the Companies were generating, these non-cash losses temporarily and misleadingly decreased the Companies' reported net worth by in excess of a hundred billion dollars. For example, in the first year and a half after imposition of the conservatorship, Fannie reported $127 billion in losses, but only $16 billion of that amount reflected actual credit-related losses. These excessive non-cash losses resulted in excessive purchases of Government Stock by Treasury. Had the Companies' net worth been properly calculated under Generally Accepted Accounting Principles, their liabilities would never have exceeded their assets. In 2010, during the period when these improper accounting adjustments were being made, FHFA also decided to order the Companies to de-list their shares from the New York Stock Exchange, a decision that had no effect on the stock's underlying economic value but caused a precipitous decline in its market price.

67. By the end of 2011, the Companies' reported net worth had fallen by $100 billion as a result of the decision made shortly after imposition of the conservatorship to write down the value of their deferred tax assets. A deferred tax asset is an asset that may be used to offset future tax liability. Under Generally Accepted Accounting Principles, if a company determines that it is unlikely that some or all of a deferred tax asset will be used, the company must establish a "valuation allowance" in the amount that is unlikely to be used. In other words, a company must write down a deferred tax asset if it is unlikely to be used to offset future taxable profits. Shortly after FHFA took control of the Companies, FHFA made the implausible assumption that the Companies would *never again* generate taxable income and that their deferred tax assets were therefore worthless. That incomprehensibly flawed decision dramatically reduced the Companies' reported net worth.

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68. The decision to designate excessive loan loss reserves was another important factor in the artificial decline in the Companies' reported net worth during the early years of conservatorship. Loan loss reserves are an entry on the Companies' balance sheets that reduces their reported net worth to reflect anticipated losses on the mortgages they own. Beginning when FHFA took control of the Companies in the third quarter of 2008 and continuing through 2009, the Companies were forced to provision additional loan loss reserves far in excess of the credit losses they were actually experiencing. The extent to which excess loan loss reserve provisioning reduced the Companies' reported net worth is dramatically illustrated by the following chart, which compares the Companies' loan loss reserve provisioning to their actual credit losses. As the chart shows, FHFA caused the Companies to make grossly excessive loan loss reserve provisions in 2008 and 2009. The excessive nature of these loan loss provisions was readily apparent by 2012, and the inevitable reversals would appear as income on the Companies' balance sheet.

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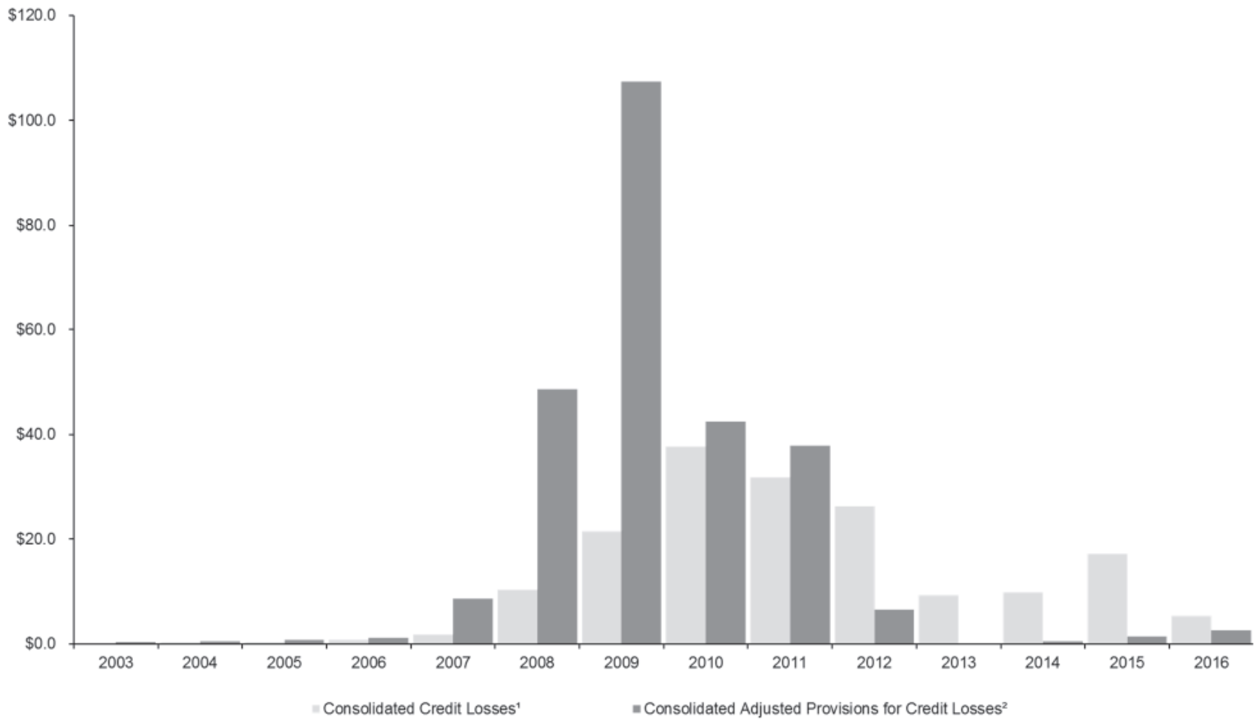
Loan Loss Reserve Provisions vs. Credit Expenses

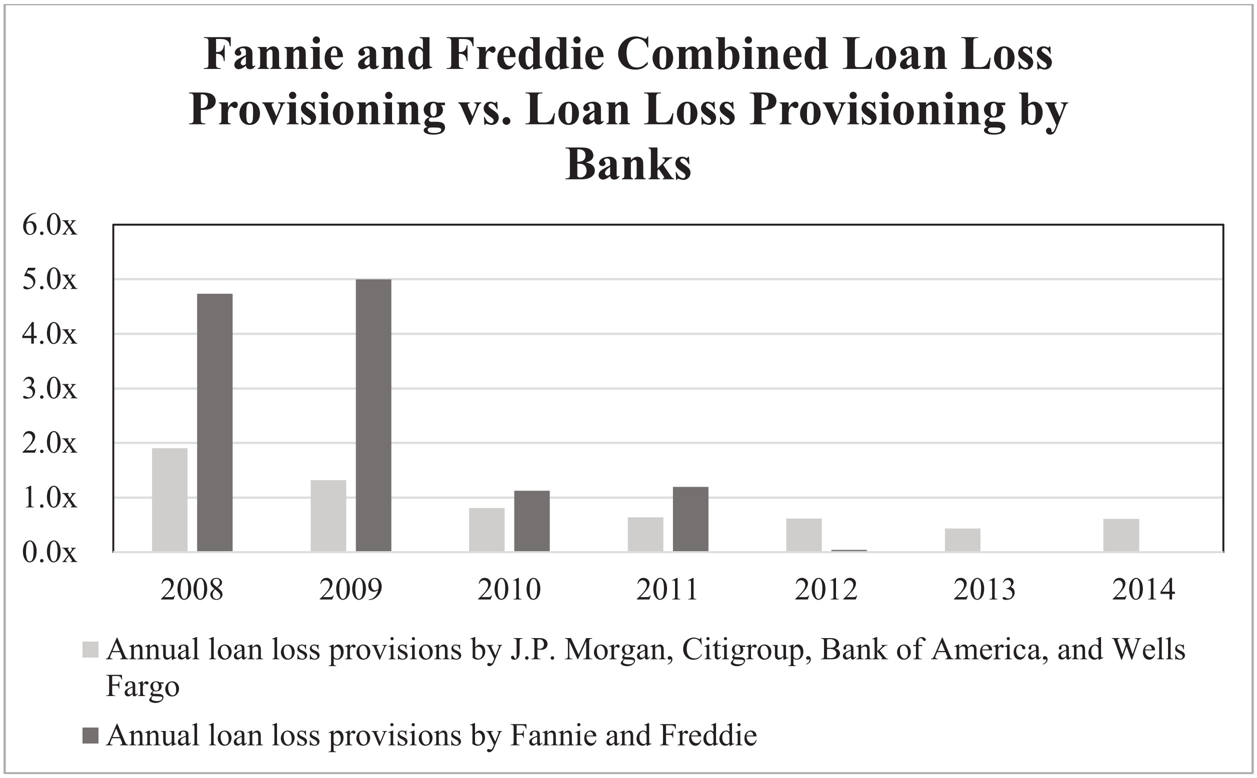


Source: Company Financials

(1) Credit losses based on net charge-offs (charge-offs less recoveries), plus foreclosed property expense. Charge-offs taken in relation to credit-impaired loans of Fannie Mae have been reversed, and replaced with ultimately realized

(2) Provisions shown include stated provisions, plus foreclosed property expense for Fannie Mae, and REO expense and Transfers for Freddie Mac. Note, stated provisions based on provisions only and excludes impact of provision reversals

69. Despite the fact that the Companies' mortgage portfolios were safer than the similar portfolios held by banks involved in the mortgage business, banks were much more accurate—and, with the consent of their regulators, far less aggressive—in reducing their net worth to reflect expected loan losses. The following chart illustrates this fact:



70. In June 2011, FHFA officials observed in an email exchange that Freddie was taking loan loss reserves in excess of what its own financial models supported but that Freddie would "face some hard questioning from FHFA" if it sought "to take down the reserves in the current clime." And in November 2011, a Treasury consultant that had reviewed Fannie financial projections previously used to justify loan loss reserve decisions observed that "actual net losses were typically lower than predicted in the optimistic and base cases . . . and far lower than forecasted in the stress cases."

71. By June of 2012, the Companies had drawn a total of $187 billion from Treasury, in large part to fill the holes in the Companies' balance sheets created by these artificial non-cash losses imposed under conservatorship. Approximately $26 billion of these combined amounts were drawn simply to pay the 10% dividend payments owed to Treasury. (In other words, FHFA

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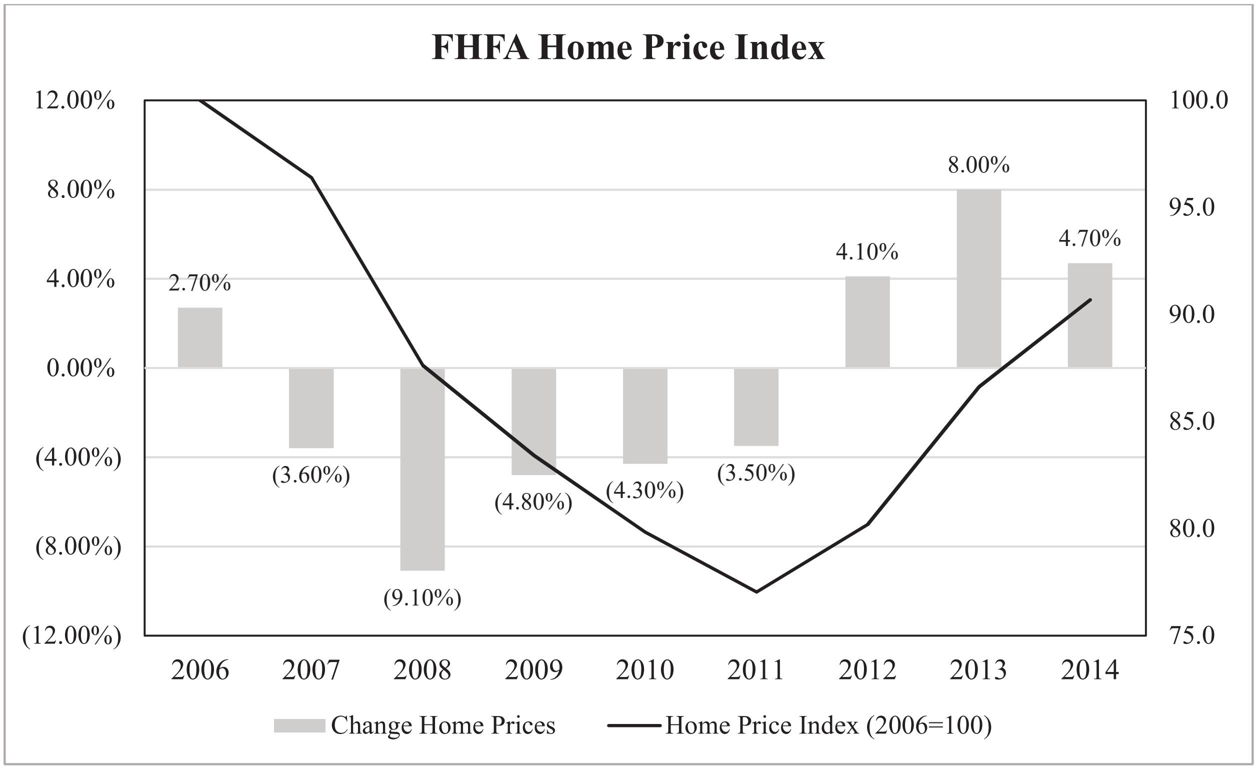
requested draws to pay Treasury this $26 billion in cash that was not otherwise available rather than electing to pay the dividends in kind. Had the dividends been paid in kind, FHFA would not have had to draw from—and, consequently, reduce the remaining size of—Treasury's commitment to pay them.) Thus, Treasury actually disbursed approximately $161 billion to the Companies, primarily reflecting temporary changes in the valuation estimates of assets and liabilities.

72. From the outset of the conservatorship through the imposition of the Net Worth Sweep, the Companies' net operating revenue exceeded their net operating expenses, and their actual losses were never so severe that they would have had a negative net worth but for the excessively pessimistic and unjustified treatment of deferred tax assets and loan loss reserves. In other words, despite manipulations made to the Companies' balance sheets while they were under the Government's control, they never had any difficulty paying their debts and other obligations. Over time, the Companies' cash receipts have consistently exceeded their expenses.

The Companies Return to Profitability and Stability

73. By 2012, Fannie and Freddie began generating consistent profits notwithstanding their overstated loss reserves and the write-down of their deferred tax assets. In fact, in the first two quarters of 2012, the Companies posted sizable profits totaling more than $11 billion. What is more, the Companies were well-positioned to continue generating robust profits for the foreseeable future.

74. Fannie's and Freddie's financial results are strongly influenced by home prices. And as FHFA's own Home Price Index shows, the market reached its bottom in 2011:



75. The improving housing market was coupled with stricter underwriting standards at Fannie and Freddie. As a result—and as the Agencies knew—Fannie- and Freddie-backed loans issued after 2008 had dramatically lower serious delinquency rates than loans issued between 2005 and 2008. To appreciate the significance of this point, it is useful to understand that the mortgages the Companies purchase and securitize in a given year are sometimes collectively referred to as that year's "vintage." Some vintages are more profitable than others; the Companies make more money from mortgages purchased in years when borrowers were on the whole more creditworthy and overall home prices were lower (factors that reduce the rate at which borrowers default). Although each vintage generates income for the Companies for many years (the Companies mostly purchase 30-year mortgages), it is possible to make an early assessment of how profitable a given vintage will be by examining the vintage's default rate in its first few years. In this manner, the Companies and the Agencies were able to examine the

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quality of the mortgage vintages from after 2008, and by 2012 they fully understood that those newer vintages would be highly profitable.

76. The strong quality of these newer vintages of mortgages boded well for Fannie's and Freddie's future financial prospects. Indeed, as early as June 2011, a Treasury official observed that "[a]s Fannie and Freddie continue to work through their legacy book of business, —i.e., vintages from before 2009—" the actual realized losses are expected to decline significantly." And an internal Treasury document similarly observed that the Companies' losses during the early years of conservatorship "are almost entirely attributable to loans that were originated and guaranteed before conservatorship" and that "[t]he 2006, 2007, and 2008 vintages account for over 70% of all credit losses."

77. Together, the Companies' return to robust profitability and the stable recovery of the housing market showed in early 2012 that the Companies could in time redeem Treasury's Government Stock and that value remained in their Preferred Stock and Common Stock. Indeed, a presentation sent to senior Treasury officials in February 2012 indicated that "Fannie and Freddie could have the earnings power to provide taxpayers with enough value to repay Treasury's net cash investments in the two entities." The Companies' financial performance and outlook only further improved in the ensuing months. In the weeks leading up to the Net Worth Sweep, one Treasury official observed that Freddie's second quarter 2012 results were "very positive," and a report circulated among senior FHFA officials said that the agency deserved a "high five" for the Companies' strong financial outlook.

78. As a result of Fannie's and Freddie's return to sustained profitability, it was clear that the overly pessimistic accounting decisions weighing down the Companies' balance sheets would have to be reversed. Indeed, by early August 2012, the Agencies knew that Fannie and

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Freddie were poised to generate massive profits well in excess of the Companies' dividend obligations to Treasury—profits that would make the $11 billion the Companies generated in the first half of 2012 look small by comparison.

79. By August 2012, the Agencies knew that the Companies' reserves for loan losses far exceeded their actual losses. These excess loss reserves artificially depressed the Companies' net worth, and reversing them would increase the Companies' net worth accordingly. Indeed, on July 19, 2012, a Treasury official observed that the release of loan loss reserves could "increase the [Companies'] net [worth] substantially." A Treasury document from early August 2012 likewise stated that the Companies were about to report "[r]ecord earnings" that would be "driven by [a] large credit loss reserve release." And the Agencies were focused on this issue. An internal briefing memorandum prepared for Under Secretary Miller in advance of August 9, 2012 meetings with Fannie and Freddie executives reveals that the number one question Treasury had for the Companies was "how quickly they forecast releasing credit reserves." And a handwritten note on a presentation from the August 9 meeting with Freddie says to "expect material release of loan loss reserves in the future." FHFA also knew that loan loss reserve releases would boost the Companies' profits going forward, as FHFA officials attended a meeting of Freddie's Loan Loss Reserve Governance Committee on August 8, 2012. FHFA's knowledge of the status of the Companies' loan loss reserves is also dramatically illustrated by a July 2012 FHFA presentation showing that starting in 2008 the Companies had set aside loan loss reserves far in excess of their actual losses.

80. Another principal driver of the outsized profits that the Companies would inevitably generate was the mandated release of the Companies' deferred tax assets valuation allowances. By mid-2012, Fannie and Freddie had combined deferred tax assets valuation

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allowances of nearly $100 billion. Under relevant accounting rules, those valuation allowances would have to be reversed if the Companies determined that it was more likely than not that they would generate taxable income and therefore be able to use their deferred tax assets. The Treasury Department was intimately familiar with these issues, having seen such a reversal in February 2012 in connection with its massive investment in AIG. In 2011, it was also known within Fannie that the valuation allowance would be reversed; the only question was the timing.

81. The Companies' improved prospects came into even sharper focus on August 9, 2012, when Under Secretary Miller and other senior Treasury officials had meetings with the senior executives of both Fannie and Freddie. During the meeting with Fannie's management, Treasury was presented with ten-year projections showing the Company earning an average of more than $11 billion per year from 2012 through 2022 and having over $116 billion left of Treasury's funding commitment at the end of that time period. Those projections are reproduced below:

Annual Detail of Cumulative Dividends and SPSPA Draws

Fannie Mae

($ in Billions)	2008-2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Comprehensive Income		11.6	7.5	11.0	12.5	13.9	13.2	12.2	11.4	10.9	10.5	10.5
Preferred Dividend Payment	19.8	11.6	11.8	12.1	12.2	12.2	12.2	12.2	12.2	12.2	12.3	12.5
Residual Equity	0.0	0.0	0.0	0.0	0.2	1.8	2.8	2.7	1.9	0.5	0.0	0.0
Cumulative Dividends	19.8	31.4	43.2	55.3	67.6	79.8	92.1	104.3	116.6	128.8	141.1	153.6
Cumulative SPSPA Draws	(116.1)	(116.1)	(119.0)	(121.2)	(121.5)	(121.5)	(121.5)	(121.5)	(121.5)	(121.5)	(122.9)	(124.8)
Cumulative Dividends Less Draws	*(96.3)*	*(84.7)*	*(75.8)*	*(65.9)*	*(53.9)*	*(41.7)*	*(29.4)*	*(17.2)*	*(4.9)*	*7.3*	*18.3*	*28.8*
SPSPA Funding Cap	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9
Remaining Funding under SPSPA	124.8	124.8	122.0	119.7	119.5	119.5	119.5	119.5	119.5	119.5	118.1	116.1

Note: 2012-2016 figures from Fannie Mae July BOD corporate forecast. 2017-2022 figures are based on simplifying assumptions derived from trends observed within the 2012-2016 horizon.

Freddie Mac

($ in Billions)	2008-2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Comprehensive Income		11.6	7.5	8.2	8.6	9.0	8.7	8.3	7.7	7.1	6.7	6.5
Preferred Dividend Payment	16.3	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Residual Equity	0.0	0.0	0.4	1.7	3.5	5.6	6.9	7.9	8.1	7.9	7.2	6.3
Cumulative Dividends	16.3	23.7	31.1	38.4	45.8	53.2	60.6	68.0	75.4	82.8	90.2	97.6
Cumulative SPSPA Draws	(72.2)	(116.1)	(73.0)	(73.0)	(73.0)	(73.0)	(73.0)	(73.0)	(73.0)	(73.0)	(73.0)	(73.0)
Cumulative Dividends Less Draws	*(55.9)*	*(92.4)*	*(41.9)*	*(34.5)*	*(27.1)*	*(19.7)*	*(12.3)*	*(4.9)*	*2.5*	*9.9*	*17.3*	*24.7*
SPSPA Funding Cap	220.5	221.3	221.3	221.3	221.3	221.3	221.3	221.3	221.3	221.3	221.3	221.3
Remaining Funding under SPSPA	148.3	105.2	148.3	148.3	148.3	148.3	148.3	148.3	148.3	148.3	148.3	148.3

Note: 2012-2022 figures are based on simplifying assumptions derived from Fannie Mae forecast trends and observed relationships between key Fannie Mae and Freddie Mac performance metrics. Reported 2011 results re-aligned as necessary to correspond to Fannie Mae management reporting.

Note: Numbers may not fool due to rounding

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82. Furthermore, Treasury learned that Fannie's near-term earnings likely would be even higher than those in the projections due to the release of the Companies' deferred tax assets valuation allowance. During the August 9 meeting, Fannie CFO Susan McFarland informed Treasury that the criteria for reversing the deferred tax assets valuation allowance could be met in the not-so-distant future. And when asked for more specifics by Under Secretary Miller, Ms. McFarland stated that the reversal would be probably in the $50-billion range and probably sometime mid-2013, an assessment that proved remarkably accurate.

83. Like Treasury, FHFA was in possession of information showing that the Companies would soon generate substantial profits, thus making it inevitable that they would release their deferred tax asset valuation allowances. On July 13, 2012, Bradford Martin, Principal Advisor in FHFA's Office of Conservatorship Operations, broadly circulated within FHFA minutes from a July 9, 2012 Fannie executive management meeting. The recipients of the email included Acting Director DeMarco and Mr. Ugoletti. The minutes stated that Fannie Treasurer David Benson "referred to the next 8 years as likely to be 'the golden years of GSE earnings.' " Projections substantially similar to those shared with Treasury on August 9 were attached to the email containing the following slide:

Verification and Review in Progress

DRAFT

Annual view of net "repayment" to the US Government

Fannie Mae

($ in billions)

	2008-2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Comprehensive Income		11.2	7.4	11.0	12.4	13.8	12.9	12.2	11.6	11.2	10.9	11.2
Preferred Dividend Payment	19.8	11.6	11.8	12.1	12.2	12.2	12.1	12.1	12.1	12.1	12.2	12.2
Residual Equity	0.0	0.0	0.0	0.0	0.2	1.8	2.5	2.5	2.0	1.0	0.0	0.0
Cumulative Dividends	19.8	31.4	43.2	55.3	67.6	79.8	92.0	104.1	116.3	128.4	140.6	152.8
Cumulative Infusion	(116.1)	(116.1)	(119.0)	(121.2)	(121.5)	(121.5)	(121.5)	(121.5)	(121.5)	(121.5)	(121.7)	(122.7)
Net "Repayment" to Gov't	*(96.3)*	*(84.7)*	*(75.8)*	*(65.9)*	*(53.9)*	*(41.7)*	*(29.5)*	*(17.4)*	*(5.2)*	*6.9*	*18.9*	*30.1*
SPSPA Funding Cap	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9	240.9
Remaining Funding under SPSPA	124.8	124.8	122.0	119.7	119.5	119.5	119.5	119.5	119.5	119.5	119.3	118.3

A228

Combined GSE "repayment" could occur in 2020

Freddie Mac

($ in billions)

	2008-2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Comprehensive Income		7.3	8.1	8.9	9.4	9.8	10.2	9.8	9.4	9.1	8.9	9.0
Preferred Dividend Payment	16.3	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2
Residual Equity	0.0	3.1	4.5	6.6	9.2	12.2	15.2	17.7	19.9	21.8	23.4	25.2
Cumulative Dividends	16.3	23.5	30.8	38.0	45.2	52.5	59.7	66.9	74.1	81.4	88.6	95.8
Cumulative Infusion	(72.2)	(72.3)	(72.3)	(72.3)	(72.3)	(72.3)	(72.3)	(72.3)	(72.3)	(72.3)	(72.3)	(72.3)
Net "Repayment" to Gov't	*(55.9)*	*(48.8)*	*(41.6)*	*(34.3)*	*(27.1)*	*(19.9)*	*(12.6)*	*(5.4)*	*1.8*	*9.1*	*16.3*	*23.5*
SPSPA Funding Cap	220.5	220.6	220.6	220.6	220.6	220.6	220.6	220.6	220.6	220.6	220.6	220.6
Remaining Funding under SPSPA	148.3	148.3	148.3	148.3	148.3	148.3	148.3	148.3	148.3	148.3	148.3	148.3

Our approach is analogous to analyses by Moody's, OMB, and Millstein.

Note: Numbers may not foot due to rounding

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84. Those projections expressly stated the assumption that Fannie would not be paying taxes because it would be using its deferred tax assets—and if Fannie was expecting to

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use its deferred tax assets, it would have to release the valuation allowance it had established for them. FHFA knew this; indeed, FHFA accountants were monitoring the Companies' deferred tax assets situation, and FHFA knew that the Companies' audit committees were assessing the status of the valuation allowances on a quarterly basis. Indeed, in an August 14, 2012 email, an FHFA official indicated that both Companies had discussed the issue of "re-recording certain deferred tax assets that had been written off" during their most recent Board meetings "based on the view that they were going to be profitable going forward." In addition, Ms. McFarland testified that in July 2012 she would have mentioned the potential release of the valuation allowance at a Fannie executive committee meeting attended by at least one FHFA official, and she also testified that FHFA was on notice of the statement she made to Under Secretary Miller on August 9, 2012 regarding the potential release of the valuation allowance.

85. Rather than acknowledging the projections just discussed, the Government has instead sought to support the Net Worth Sweep by pointing to other financial projections that its own documents show were outdated and unreliable by August 2012. In other litigation, the Government has relied on a set of "June 13, 2012" projections that discovery in this case revealed were taken verbatim from projections prepared by Treasury consultant Grant Thornton in November 2011 using data from September 2011. Although not as positive as the more updated projections discussed above, the Grant Thornton analysis projected combined profits at the Companies of over $20 billion in 2014, with annual profits then gradually declining to a long-term figure of about $13.5 billion. Profits of this magnitude necessarily would have led to the reversal of the valuation allowances. And Treasury took notice. Hand-written notes on a Grant Thornton document produced by Treasury displaying Freddie's results through the first quarter of 2012 anticipate that Freddie could release its valuation allowance "probably [in] 2013,

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2014." The agenda for a meeting indicates that by May 2012 Treasury and Grant Thornton were discussing "[r]eturning the deferred tax asset to the GSE balance sheets" and that Treasury planned to discuss this issue with FHFA and the Companies in early June. And a Grant Thornton document sent to Treasury on June 29, 2012 recognizes that two "key issues" for determining the value of Treasury's investment in 2012 were "whether and when the GSEs will return their deferred tax assets to their balance sheets" and "whether and when the GSEs will become taxpaying entities."

86. By August 2012, it was apparent that the Grant Thornton projections based on data from September 2011 drastically underestimated Fannie's and Freddie's earning capacity. The manager of Grant Thornton's valuation services to Treasury, Anne Eberhardt, admitted in a deposition that the projections based on September 2011 data were no longer valid 11 months later, and Fannie's Chief Financial Officer, the highest ranking and responsible financial expert at the Company, Susan McFarland, has testified that it was particularly important to have fresh financial forecasts at that time. Mr. Ugoletti and Ms. Eberhardt likewise have testified to the importance of using up-to-date financial information, and Mr. DeMarco testified that FHFA as conservator was "constantly responding to a changing economic environment." And as Mr. DeMarco also testified, one change that took place between September 2011 and mid-August 2012 "was strengthening in the housing market." Mr. Ugoletti also has admitted that FHFA's own projections consistently were overly pessimistic leading up to August 2012. Treasury and FHFA therefore knew that Fannie and Freddie were poised to be even more profitable than Grant Thornton had projected in 2011.

87. In other litigation, the Government has also relied on a set of financial projections sent to Secretary Geithner on June 6, 2012, that showed that starting in 2018 Fannie would report only $4.1 billion in comprehensive income per year.

88. In sum, by August 2012 the Agencies knew that Fannie and Freddie were poised to add tens of billions of dollars of deferred tax assets to their balance sheets and to reverse billions of dollars of loan loss reserves. Thanks to these inevitable accounting decisions, coupled with Fannie's and Freddie's strong earnings from their day-to-day operations, the Companies anticipated that they would be able to pay their 10% dividends to Treasury without drawing on Treasury's funding commitment in the future, and dividend payments on the Government Stock did not threaten to erode Treasury's unused funding commitment.

89. In addition to the release of loan loss reserves and deferred tax assets valuation allowances, Fannie and Freddie also had sizeable assets in the form of claims and suits brought by FHFA as conservator relating to securities law violations and fraud in the sale of private-label securities to Fannie and Freddie between 2005 and 2007. In 2013 and 2014, the Companies recovered over $18 billion from financial institutions via settlements of such claims and suits. The Companies, FHFA, and Treasury knew in August 2012 that the Companies would reap substantial profits from such settlements.

FHFA and Treasury Amend the PSPAs To Expropriate Private Shareholders' Investment <u>and Ensure Fannie and Freddie Cannot Exit Conservatorship</u>

90. With Fannie's and Freddie's return to consistent and indeed record profitability, the holders of the Companies' Preferred Stock and Common Stock had reason to believe and expect that they would in time receive a return on their investment. Moreover, the Companies' return to profitability led to a reasonable expectation that they would eventually be healthy enough to redeem Treasury's Government Stock, exit conservatorship, and be "return[ed] to

normal business operations," as FHFA's Director had vowed when the conservatorship was created.

91. These reasonable and realistic expectations were short-lived, however, not because of any change in the outlook for the housing market or broader economy, nor because of any change in the financial performance of Fannie or Freddie, but rather because of the Government's own self-dealing.

92. On August 17, 2012, within days after the Companies had announced their return to profitability and just as it was becoming clear that they had regained the earnings power to redeem Treasury's Government Stock and exit conservatorship, the Agencies unilaterally amended the PSPAs for a third time.

93. The centerpiece of this "Third Amendment" was the Net Worth Sweep. The Net Worth Sweep fundamentally changed the nature of Treasury's investment in the Companies. Instead of quarterly dividend payments at an annual rate of 10% (if paid in cash) or 12% (if paid in kind) of the total amount of Treasury's liquidation preference, the Net Worth Sweep entitles Treasury to *all—100%*—of the Companies' existing net worth and future profits. Beginning January 1, 2013, the Companies have been required to pay Treasury a quarterly dividend equal to their *entire net worth*, minus a capital reserve amount that starts at $3 billion and decreases to $0 by January 1, 2018. (In December 2017, FHFA and Treasury amended the PSPAs a fourth time to reset the capital reserve amount to $3 billion beginning in the first quarter of 2018. This change does not materially affect the claims in this litigation.)

94. The Companies did not receive any meaningful consideration for the imposition of the Net Worth Sweep. Because the Companies always had the option to pay dividends "in

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kind" at a 12% interest rate, the Net Worth Sweep did not provide the Companies with any additional flexibility or benefit.

95. To be sure, the Net Worth Sweep provides that the Companies will not have to pay a periodic commitment fee under the PSPAs while the Net Worth Sweep is in effect. But Treasury had consistently waived the periodic commitment fee before the Net Worth Sweep, and it could only set the amount of such a fee with the agreement of the Companies and at a market rate. And that rate likely would have been, at most, a small fraction of the outstanding amount of Treasury's commitment. Freddie forecasted its "sensitivity" to imposition of a periodic commitment fee as follows: "Our sensitivity to a commitment fee based on remaining commitment available beginning in 2013 of $149 billion shows that a 25 bps fee results in a $0.4 billion annual impact on Stockholders' Equity." Further, the purpose of the fee was to compensate Treasury for its ongoing support in the form of the commitment to invest in the Companies' Government Stock. By the time of the Net Worth Sweep, the 10% return on the Government Stock and the warrants for 79.9% of the common stock provided a more than adequate return on the government's stand-by commitment, and thus any additional fee would have been inappropriate. In August of 2012, the Companies had returned to stable profitability and were no longer drawing from Treasury's commitment. Given the Companies' return to profitability, the market rate for the periodic commitment fee in 2012 and after would have been zero. Finally, even if a market-rate fee had been agreed between Treasury and FHFA and imposed pursuant to the PSPA, the Companies had sufficient market power to pass the entire amount of this fee through to their customers—as the Companies do for other operating and financing costs—without affecting profitability or the value of the Companies' equity securities.

96. The Net Worth Sweep has had far-reaching effects. These effects were intended and anticipated by FHFA and Treasury, and the Agencies adopted the Net Worth Sweep in furtherance of their policy objectives as agencies of the federal government.

97. First, the Net Worth Sweep eliminated entirely the economic interests in Fannie and Freddie held by the Companies' private shareholders. The quarterly sweep of the Companies' net worth ensures that there never will be sufficient funds for the Companies to pay a dividend to private shareholders. It also ensures that private shareholders will receive nothing in the event of liquidation, as Treasury's Government Stock entitles it to an additional dividend payment *plus* its liquidation preference in the event of liquidation. Government Stock Certificate § 8. The dividend payment will leave Fannie and Freddie with negligible capital well shy of the Government's nearly $200 billion liquidation preference, guaranteeing that there will be nothing left for private shareholders. In light of this reality, it is not surprising that, as FHFA's Mr. Ugoletti observed, "the preferred stock got hammered the day the Net Worth Sweep was announced." Similarly, after the imposition of the Net Worth Sweep, Mr. Lockhart—FHFA's former Director—told a reporter that the Companies' privately-owned stock "is worthless and should be worthless."

98. Upon its announcement, Treasury emphasized that the Net Worth Sweep would ensure that "every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers." Press Release, U.S. Dep't of the Treasury, Treasury Department Announces Further Steps to Expedite Wind Down of Fannie Mae and Freddie Mac (Aug. 17, 2012). https://goo.gl/NDAKhQ. The necessary corollary to this, of course, is that nothing would be left for private shareholders. Unbeknownst to the public, this was a long-term Treasury goal. Indeed, as early as December 2010, an internal Treasury memorandum acknowledged the

"Administration's commitment to ensure existing common equity holders will not have access to any positive earnings from the [Companies] in the future." Action Memorandum for Secretary Geithner (Dec. 20, 2010).

99. FHFA shared Treasury's goal of advancing the Government's interests and ensuring that private shareholders would not benefit from their stock ownership. In its 2012 report to Congress, for example, FHFA explained that the Net Worth Sweep "ensures all the [Companies'] earnings are used to benefit taxpayers." FHFA, REPORT TO CONGRESS: 2012 at 1 (June 13, 2013), https://goo.gl/ocyB9J. And while FHFA had earlier resolved to operate Fannie and Freddie with a view toward "minimiz[ing] losses on behalf of taxpayers," A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS: at 7, the Net Worth Sweep indicates that the agency in fact is operating them to maximize taxpayer profits at the expense of private shareholders. Director Watt summed up the situation succinctly when stating that he does not "lay awake at night worrying about what's fair to the shareholders" but rather focuses on "what is responsible for the taxpayers." C-SPAN, Newsmakers with Mel Watt, at 9:00-9:27 (May 16, 2014), http://goo.gl/s3XWqi. Consistent with this understanding of FHFA's goals, it stated that the Net Worth Sweep was intended to "fully capture financial benefits for taxpayers.".

100. Second, the Net Worth Sweep not only destroyed the economic interests of Fannie's and Freddie's private shareholders but also transferred their interests to the federal government, resulting in Fannie and Freddie being wholly nationalized entities. As a Staff Report from the Federal Reserve Bank of New York acknowledged, the Net Worth Sweep "effectively narrows the difference between conservatorship and nationalization, by transferring essentially all profits and losses from the firms to the Treasury." W. Scott Frame, et al., *The Rescue of Fannie Mae and Freddie Mac* at 21, FED. RES. BANK OF N.Y. STAFF REP., no. 719

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(Mar. 2015) https://goo.gl/DKBlQ1. Fortune similarly has reported that the Net Worth Sweep "effectively nationalized" the Companies. Indeed, the Government itself has stated in a brief in another case that an "interest in residual profits is the defining feature of an equity interest in a corporation." Reply Brief of the United States at 24, *Starr Int'l.Co. v. United States*, No. 15-5103 (Fed. Cir. June 1, 2016). After the Net Worth Sweep, Treasury has the right to all residual profits, and it hence owns all the equity. All other equity interests have been eliminated.

101. Third, the nationalization effected by the Net Worth Sweep has enriched the federal government to the tune of ***$124 billion*** to date. As the Agencies anticipated, Fannie and Freddie have been extraordinarily profitable since the imposition of the Net Worth Sweep. From the third quarter of 2012 through the fourth quarter of 2017, Fannie and Freddie have reported total comprehensive income of $134 billion and $91 billion, respectively—numbers that include the release of the Companies' deferred tax assets valuation allowances, which in 2013 added over $50 billion and $20 billion to Fannie's and Freddie's earnings, respectively. The Companies' staggering net worth in 2013, 2014, and all subsequent years has been no higher than the Agencies anticipated when they imposed the Net Worth Sweep in August 2012.

102. Because of Fannie's and Freddie's tremendous profitability, the Net Worth Sweep dividend payments to Treasury have been enormous, as the following chart demonstrates:

Dividend Payments Under the Net Worth Sweep (in billions)

		Fannie	Freddie	Combined
2013	Q1	**$4.2**	**$5.8**	**$10.0**
	Q2	**$59.4**	**$7.0**	**$66.4**
	Q3	**$10.2**	**$4.4**	**$14.6**
	Q4	**$8.6**	**$30.4**	**$39.0**

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2014	Q1	**$7.2**	**$10.4**	**$17.6**
	Q2	**$5.7**	**$4.5**	**$10.2**
	Q3	**$3.7**	**$1.9**	**$5.6**
	Q4	**$4.0**	**$2.8**	**$6.8**
2015	Q1	**$1.9**	**$0.9**	**$2.8**
	Q2	**$1.8**	**$0.7**	**$2.5**
	Q3	**$4.4**	**$3.9**	**$8.3**
	Q4	**$2.2**	**$0.0**	**$2.2**
2016	Q1	**$2.9**	**$1.7**	**$4.6**
	Q2	**$0.9**	**$0.0**	**$0.9**
	Q3	**$2.9**	**$0.9**	**$3.8**
	Q4	**$3.0**	**$2.3**	**$5.3**
2017	Q1	**$5.5**	**$4.5**	**$10.0**
	Q2	**$2.8**	**$2.2**	**$5.0**
	Q3	**$3.1**	**$2.0**	**$5.1**
	Q4	**$0.7**	**$2.3**	**$3.0**
2018	Q1	**$0.0**	**$0.0**	**$0.0**
Total		**$135.1**	**$88.6**	**$223.7**

103. As the above chart shows, the Companies have paid Treasury $223.7 billion in "dividends" under the Net Worth Sweep. Had they instead been paying 10% cash dividends, they would have paid Treasury $99.5 billion by the end of the first quarter of 2018. The Government has thus profited from the Net Worth Sweep by $124 billion.

104. The chart above also shows that the Companies' dividend obligations in the fourth quarter of 2017 and first quarter of 2018 totaled $3.0 billion. But this is not in any way a sign that the Companies are in distress or that they are no longer positioned to generate large profits. In the third quarter of 2017, the Companies generated $7.7 billion of comprehensive income, and under the Net Worth Sweep that total was the dividend due in the fourth quarter. Before that

dividend was paid, however, Treasury and FHFA agreed that the Companies could each retain $2.4 billion, and, as noted above, that moving forward the capital buffer under the sweep would be $3 billion, rather than decreasing to $0 in 2018. This "Fourth Amendment" does not affect the substance of Plaintiffs' claims in this litigation. Indeed, FHFA and Treasury specified that the liquidation preference of Treasury's stock in each company would be increased by $3.0 billion, making clear that the capital buffer ultimately would benefit Treasury, not private shareholders.

105. In the fourth quarter of 2017, Fannie and Freddie were required to write down the value of their deferred tax assets to account for the recent decrease in the corporate income tax rate. This write-down decreased their comprehensive income for the quarter by $15.3 billion. Thus, instead of reporting comprehensive income of $5.3 billion, the Companies reported a comprehensive loss of $10 billion, and they announced that they will be requesting a $4 billion draw from Treasury's commitment. This one-time event does not change the Companies' underlying profitability and, in fact, moving forward the decrease in the tax rate enhances the Companies' outlook.

106. Another way to gauge the financial impact of the Net Worth Sweep is to compare it to what would have happened had the Companies instead been allowed to use their quarterly profits above Treasury's 10% dividend to partially retire Treasury's senior preferred stock. In that alternative scenario, Treasury's remaining investment in Freddie would have been fully redeemed in 2017. Indeed, Freddie has paid Treasury $6.3 billion *more* than the amount needed to redeem the Government Stock completely. Similarly, had Fannie been allowed to use its profits in excess of Treasury's original 10% dividend to partially redeem the Government Stock, the remaining liquidation preference on that stock would today stand at only $2.1 billion. Furthermore, given the Companies' strong financial condition when the Net Worth Sweep was

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announced and the very low interest rates that prevailed at the time, the Companies could have used debt and equity markets to obtain additional capital at a rate far lower than the 10% cash or 12% in kind rate mandated by the original terms of the Government Stock.

107. The Net Worth Sweep has become a major revenue source for the United States Government. Indeed, the federal government's record-breaking $53.2 billion surplus for the month of December 2013 was driven in large part by the $39 billion swept from Fannie and Freddie.

108. These massive influxes of cash began to arrive just when the government was confronting the statutory debt ceiling and accompanying political deadlock. *See* Jody Shenn & Ian Katz, *Fannie Mae Profit May Swell Treasury Coffers as Debt Limit Looms*, Bloomberg (Apr. 8, 2013), http://www.bloomberg.com/news/articles/2013-04-08/fannie-mae-profit-may-swell-treasury-coffers-as-debt-limit-looms. And because they were characterized as "dividends," and not a redemption of Treasury's Stock, the Pay It Back Act allowed the cash to be used for the government's general operating expenses rather than only for debt reduction. *See* 12 U.S.C. § 1719(g)(2); 12 U.S.C. § 1455(*l*)(2); 12 U.S.C. § 1455 note.

109. All told, Fannie has requested $119.8 billion in draws from Treasury under the PSPAs, and Treasury has recouped a total of $166.4 billion from Fannie in the form of purported "dividends." Freddie has requested $71.6 in draws from Treasury under the PSPAs and Treasury has recouped a total of $112.4 billion from Freddie in the form of purported "dividends." Combined, Fannie and Freddie have paid Treasury approximately $87 billion more than they have received.

110. As explained above, when entering the Net Worth Sweep FHFA and Treasury knew that the Companies were poised to generate earnings well in excess of 10% dividend

payments, and they therefore knew that the Net Worth Sweep would be profitable for the federal government. It is thus not surprising that a document prepared for internal Treasury consumption and dated August 16, 2012 listed the Companies' "improving operating performance" and the "potential for near-term earnings to exceed the 10% dividend" as reasons for "putting in place a better deal for taxpayers" by promptly adopting the Net Worth Sweep. Another Treasury document emphasized that the Net Worth Sweep would put the taxpayer "in a better position" because rather than having "Treasury's upside . . . capped at the 10% dividend, now the taxpayer will be the beneficiary of any future earnings produced by the GSEs." Additional Treasury communications indicate that the Agency anticipated that Treasury's receipts under the Net Worth Sweep "will likely exceed the amount that would have been paid if the 10% was still in effect" and that the Net Worth Sweep would lead to "a better outcome" for Treasury.

111. Fourth, the Net Worth Sweep guarantees that Fannie and Freddie can never be rehabilitated to a sound and solvent condition, and it positions them to be wound down and eliminated. The Net Worth Sweep makes the Companies unique in financial regulation. All other financial institutions are required to retain minimum levels of capital that ensure that they can withstand the vicissitudes of the economic cycle and are prohibited from paying dividends when they are not adequately capitalized. The FDIC's Risk Management Manual of Examination Policies explains why capital is critical to any financial institution: "It absorbs losses, promotes public confidence, helps restrict excessive asset growth, and provides protection to [market participants]." For this reason, in all other contexts financial regulators work to ensure that financial institutions maintain minimum capital levels.

112. The Companies, in contrast, are not allowed to retain capital but instead must pay nearly their entire net worth over to Treasury as a quarterly dividend. In other words, whereas

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other financial institutions are subject to *minimum* capital standards, the Net Worth Sweep makes the Companies subject to a capital *maximum*—any amount of retained capital that they hold in excess of a small capital buffer is swept to Treasury on a quarterly basis. The effect of the Net Worth Sweep is thus to force the Companies to operate in perpetuity on the brink of insolvency and to prohibit them from operating in a safe and sound manner. Indeed, HERA itself recognizes that a fundamental aspect of the Companies' soundness is the "maintenance of adequate capital." 12 U.S.C. § 4513(a)(1)(B)(i). Director Watt has expressed the same view, describing the Companies' inability to build capital reserves under the Net Worth Sweep as a "serious risk" that erodes investor confidence in the Companies because they have "no ability to weather quarterly losses." Indeed, the fact that the Companies were required to take a draw because of a tax cut demonstrates the perversity of the Government's decision to strip the Companies of their capital.

113. The timing of the Net Worth Sweep was driven by the Companies' return to profitability. Notwithstanding the Agencies' statutory duties, the Administration had decided that Fannie and Freddie would be wound down and would *not* be allowed to exit conservatorship in their current form. Allowing Fannie and Freddie to rebuild their capital levels, however, would make that political decision more difficult to explain and sustain. The Economist stated the obvious in reporting that the Net Worth Sweep "squashe[d] hopes that [Fannie and Freddie] may ever be private again." *Back to Black*, THE ECONOMIST, (Aug. 25, 2012 http:goo.gl/1PHMs.

114. Treasury openly proclaimed that the Net Worth Sweep would "expedite the wind down of Fannie Mae and Freddie Mac. Press Release, U.S. Dep't of the Treasury, Treasury Department Announces Further Steps to Expedite Wind Down of Fannie Mae and Freddie Mac (Aug. 17, 2012). https://goo.gl/NDAKhQ. Indeed, Treasury emphasized that the Net Worth

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Sweep would ensure that the Companies "will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form." *Id*.

115. FHFA Acting Director Edward DeMarco similarly informed a Senate Committee that the "recent changes to the PSPAs, replacing the 10 percent dividend with a net worth sweep, reinforce the notion that the [Companies] will not be building capital as a potential step to regaining their former corporate status." Edward J. DeMarco, Acting Director, FHFA, Statement Before the U.S. Sen. Comm. on Banking, Housing & Urban Affairs (Apr. 18, 2013), https://goo.gl/oxdMc6.. And in its 2012 report to Congress, FHFA explained that it had begun "prioritizing [its] actions to move the housing industry to a new state, one without Fannie Mae and Freddie Mac." FHFA, FHFA, REPORT TO CONGRESS: 2012 at 13 (June 13, 2013), https://goo.gl/ocyB9J. The Net Worth Sweep thus "reinforces the fact that the [Companies] will not be building capital." *Id.* at 1, 13.

116. As a result of the Net Worth Sweep, it is clear that FHFA will not allow Fannie and Freddie to exit conservatorship but rather will continue to operate them essentially as wards of the state, unless and until Congress takes action. Indeed, FHFA's website states that "FHFA will continue to carry out its responsibilities as Conservator" until "Congress determines the future of Fannie Mae and Freddie Mac and the housing finance market." *FHFA as Conservator of Fannie Mae and Freddie Mac,* FHFA, http://goo.gl/PjyPZb. This is consistent with the testimony of former Acting Director DeMarco, who stated that he had no intention of returning Fannie and Freddie to private control under charters he perceived to be "flawed." Mr. Ugoletti also testified that FHFA's objective "was not for Fannie and Freddie Mac to emerge from conservatorship."

117. This understanding of the purpose of the Net Worth Sweep is further supported by the testimony of Ms. McFarland, Fannie's CFO at the time. She believed that the Agencies imposed the Net Worth Sweep in response to what she told Treasury on August 9, and she thought its purpose "was probably a desire not to allow capital to build up within the enterprises and not to allow the enterprises to recapitalize themselves." According to Ms. McFarland, Fannie "didn't believe that Treasury would be too fond of a significant amount of capital buildup inside the enterprises."

118. Communications involving White House official Jim Parrott provide further proof that the Net Worth Sweep was intended to advance the policy objectives discussed above. At the time of the Net Worth Sweep, Mr. Parrott was a senior advisor at the National Economic Council, where he led a team of advisors charged with counseling President Obama and the cabinet on housing issues. He worked closely with Treasury in the development and rollout of the Net Worth Sweep. Indeed, the day after the Net Worth Sweep was announced, he emailed Treasury officials congratulating them on achieving an important policy goal: "Team Tsy, You guys did a remarkable job on the PSPAs this week. You delivered on a policy change of enormous importance that's actually being recognized as such by the outside world . . . , and as a credit to the Secretary and the President. It was a very high risk exercise, which could have gone sideways on us any number of ways, but it didn't." What Treasury had accomplished, Mr. Parrott's emails make clear, was maximizing Treasury's profits and guaranteeing that Fannie and Freddie would be unable to rebuild capital and escape conservatorship:

- In an August 13, 2012 email, Parrott wrote that "[w]e are making sure that each of these entities pays the taxpayer back every dollar of profit that they make, not just a 10%

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dividend," and that "[t]he taxpayer will thus ultimately collect more money with the changes."

- In an email to a Treasury official on the day the Net Worth Sweep was announced, Mr. Parrott stated that "we've closed off [the] possibility that [Fannie and Freddie] ever[] go (pretend) private again."
- That same day, Mr. Parrott received an email from a market analyst stating that the Net Worth Sweep "should lay to rest permanently the idea that the outstanding privately held pref[ferred stock] will ever get turned back on." He forwarded the email to Treasury officials and commented that "all the investors will get this very quickly."
- At 8:30 a.m. on August 17, Mr. Parrott wrote an email to Alex Pollock, Peter Wallison, and Edward Pinto offering "to walk you through the changes we're announcing on the pspas today. Feel like fellow travelers at this point so I owe it to you." Pollock, Wallison, and Pinto had written a policy paper for the American Enterprise Institute in 2011 recommending that "Fannie Mae and Freddie Mac should be eliminated as government-sponsored enterprises (GSEs) over time."
- Also on August 17, Mr. Wallison was quoted in Bloomberg saying the following: "The most significant issue here is whether Fannie and Freddie will come back to life because their profits will enable them to re-capitalize themselves and then it will look as though it is feasible for them to return as private companies backed by the government. . . . What the Treasury Department seems to be doing here, and I think it's a really good idea, is to deprive them of all their capital so that doesn't happen." In an email to Wallison that evening, Mr. Parrott stated, "Good comment in Bloomberg—**you are exactly right on substance and intent.**"

- In another email to Wallison that evening, Mr. Parrott wrote that, "[d]ividend is variable, set at whatever profit for quarter is, eliminating ability to pay down principal (so they can't repay their debt and escape as it were)."
- Mr. Parrott also wrote on August 17 that, "we're not reducing their dividend but including in it every dime these guys make going forward and ensuring they can't recapitalize."

119. Mr. Parrott, who has left the White House and is now with the Urban Institute, told The Economist that "[i]n the aftermath of the crisis there was widespread agreement that [Fannie and Freddie] needed to be replaced or overhauled." *A Funny Form of Conservation*, THE ECONOMIST, (Nov. 21, 2015), http:goo.gl/gJVJrN. The Net Worth Sweep ensured that the Companies' return to profitability did not threaten this goal.

120. In short, the Government's Net Worth Sweep is designed to raise general revenue and further the policy goals of the Agencies at the expense of the Companies and their shareholders, and it thereby imposes on the Companies and their shareholders a disproportionate burden that, in all fairness, should be borne by the public as a whole.

121. The Government has advanced an alternative explanation for the Net Worth Sweep—that it was intended to stave off the risk of a "death spiral" caused by drawing from Treasury's commitment to pay Treasury's dividends. But this "death spiral" explanation is belied by the following facts, in addition to those discussed above regarding the Net Worth Sweep's true purposes.

122. First, given Fannie and Freddie's return to profitability, there was no imminent risk that the Companies would be depleting Treasury's funding commitment—that risk was at its lowest point since the start of the conservatorships. Indeed, a memo prepared by Treasury staff

indicates that on June 25, 2012, FHFA Acting Director DeMarco informed Treasury Secretary Geithner and Under Secretary Miller that he saw no "urgency of amending the PSPAs this year" because Fannie and Freddie "will be generating large revenues over the coming years, thereby enabling them to pay the 10% annual dividend well into the future." Communications within both FHFA and Treasury in the months leading up to the Net Worth Sweep indicate that the Companies' bond investors regarded Treasury's funding commitment as sufficient. And on August 13, 2012, a Treasury official observed that an explanation that the Net Worth Sweep was needed because "the 10 percent dividend was likely to be unstable" was one that "[d]oesn't hold water."

123. Second, as explained above, the original terms of the PSPAs entitled the Companies to pay Treasury's dividends in kind with additional stock, thus avoiding the need to make draws on Treasury's funding commitment to finance cash dividends they could not otherwise afford. Furthermore, an internal Treasury memorandum from 2011 acknowledged that any threat to Treasury's funding commitment from dividend payments potentially could be addressed by "converting [Treasury's] preferred stock into common or cutting or deferring payment of the dividend (under legal review)." Memorandum from Jeffery A. Goldstein, Undersecretary, Domestic Finance, to Timothy Geithner, Secretary, United States Treasury, 3 (Jan. 4, 2011). In other words, the problem the Government was purportedly trying to solve with the Net Worth Sweep, a cash dividend too high to be serviced by earnings, could be addressed by other means already known to Treasury, such as cutting or deferring payment of the dividend. Of course, given the payment-in-kind option, the purported problem was wholly illusory. An internal Treasury document explicitly recognized this point: "To the extent that required dividend payments exceed net income, FHFA, as conservator, could consider not declaring

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dividends pursuant to the certificates of designation for the preferred shares, so that draws on the PSPAs are not used to pay dividends, preserving as much funding as possible to cover any unanticipated losses at Fannie Mae and Freddie Mac."

124. Third, the Agencies actually considered an alternative to the arrangement they ultimately adopted that would have had the Net Worth Sweep only kick in if Treasury's remaining funding commitment fell below $100 billion. The only plausible explanation for the Agencies' decision not to embrace that alternative is that they knew it would allow the Companies to rebuild capital in contravention of the Administration's commitment to wipe out private shareholders and prevent the Companies from exiting conservatorship.

125. Fourth, the structure and timing of the Net Worth Sweep—coming when the Companies were about to add tens of billions of dollars to their balance sheets—had the effect of *reducing* the amount of money available to guarantee that the Companies would maintain a positive net worth. If the Agencies were genuinely concerned about reassuring the Companies' bond investors that they would be repaid, the Agencies would have delayed imposing the Net Worth Sweep so long as the Companies maintained a substantial positive net worth. Instead, they adopted the Net Worth Sweep at a time when they knew that its near-term effect would be to transfer to Treasury massive profits that the Companies could have otherwise retained as a capital buffer and used to avoid making draws on Treasury's funding commitment in any subsequent unprofitable quarters. Indeed, FHFA has acknowledged how the Net Worth Sweep increases the chances of further draws on Treasury's funding commitment, observing that the Companies "are constrained by the PSPAs from building capital" and that the lack of retained capital combined with "mark-to-market volatility from the [Companies'] derivatives portfolio" has the effect of increasing "the likelihood of negative net worth in future quarters." Thus, even

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if the Agencies believed that the Companies could not generate enough profits in the long term to finance a 10% dividend on Treasury's investment, they would not have imposed the Net Worth Sweep when they did if their goal was to preserve Treasury's funding commitment. Doing so only increased the likelihood of future draws. Accordingly, the Net Worth Sweep has not ensured continued access to capital for the Companies or preserved their financial stability and solvency.

126. Fifth, the Net Worth Sweep, announced on the heels of Fannie and Freddie announcing earnings allowing them to begin rebuilding capital, was adopted when it was not because the Companies would be earning too little, but rather because they would be earning too much in light of the Agencies' policy goals of keeping Fannie and Freddie under government control and prohibiting their private shareholders from realizing any value from their investments. An internal Treasury document prepared on July 30, 2012, stated that the Net Worth Sweep should be announced shortly after August 7, when Treasury anticipated the Companies would "report very strong earnings . . . that will be in excess of the 10% dividend." On August 1, a Treasury official similarly emphasized that the Net Worth Sweep should be announced in mid-August because the Companies' "[e]arnings will be in excess of current 10% dividend." FHFA's Mr. Ugoletti reported a "renewed push" from Treasury to implement the Net Worth Sweep on August 9, 2012—the same day that Fannie's CFO told Treasury that it was likely that her company would soon be in a position to make an accounting decision that would add tens of billions of dollars to its earnings. And on August 17, 2012, Mr. Ugoletti wrote to Mr. DeMarco and other FHFA officials that "other than a transitory buffer," the Net Worth Sweep "does not allow the Enterprises to build up a retained surplus, which may give the impression that they are healthy institutions."

127. That the Net Worth Sweep was not intended to advance any legitimate interest of FHFA as conservator is further demonstrated by the fact Treasury was the driving force behind the initiative. Indeed, FHFA agreed to the Net Worth Sweep only at the insistence and under the direction and supervision of Treasury. The Net Worth Sweep was a Treasury initiative and reflected the culmination of Treasury's long-term plan to seize the Companies and see that they were operated for the exclusive benefit of the federal government. Indeed, Mr. Parrott has testified that the Net Worth Sweep was imposed through a "Treasury-driven process." It was Treasury that informed the Companies just days before the Net Worth Sweep that it was forthcoming, and a meeting addressing the Net Worth Sweep was held at Treasury during which a senior Treasury official announced the changes. Secretary Geithner apparently believed that even before the Net Worth Sweep was imposed, "we had already effectively nationalized the GSEs . . ., and could decide how to carve up, dismember, sell or restructure those institutions." Plaintiff's Corrected Post-Trial Proposed Findings of Fact 26.2.1(a), *Starr Int'l Co. v. United States*, No. 1:11-cv-779-TCW (Fed. Cl. Mar. 2, 2015), ECF No. 430. And Treasury officials intimately involved in the development of the Net Worth Sweep testified that they could not recall Treasury making any backup or contingency plans to prepare for any possibility that FHFA would reject the Net Worth Sweep proposal.

128. The Net Worth Sweep is just one example of the significant influence Treasury has exerted over FHFA from the beginning of the conservatorship. Secretary Paulson has written that "seizing control" of Fannie and Freddie, an action that is statutorily reserved to FHFA, was an action "I took." HENRY M. PAULSON, JR., ON THE BRINK xiv (2010). Secretary Geithner, who was president of the Federal Reserve Bank of New York at the time, understood the federal takeover of Fannie and Freddie to be a "Treasury operation," and then-Chairman of the Federal

Reserve Ben Bernanke has said that "Treasury took over Fannie and Freddie." Similarly, Congressional Budget Office Assistant Director for Financial Analysis Deborah Lucas told Congress that the Companies are subject to "ownership and control by the Treasury." *Fannie Mae, Freddie Mac & FHA: Taxpayer Exposure in the Housing Markets: Hearing Before the H. Comm. on the Budget*, 112th Cong. 15 (2011). When asked whether Fannie had ever considered paying Treasury's dividends in-kind, rather than a cash dividend, Ms. McFarland testified that "in my mind, what form of payment we would make and what we were able to do was what Treasury would allow us to do." In its SEC filings, Freddie has said that it and Treasury are "related parties," as defined by Statement of Financial Accounting Standards 57.

129. The Net Worth Sweep was merely one element of a broader Treasury plan to transform the housing finance market and to eliminate Fannie and Freddie. Indeed, a housing finance reform plan drafted by Treasury in early 2012 listed "restructur[ing] the PSPAs to allow for variable dividend payment based on positive net worth"—i.e., implementing a net worth sweep—as among the first steps to take in transitioning to Treasury's desired outcome. Other elements of that plan included the development of a single securitization utility to be used by both Fannie and Freddie—and by other entities once Fannie and Freddie are eliminated. FHFA has made the development of such a utility a key initiative of the conservatorships, providing further evidence that FHFA is operating according to Treasury's playbook.

COUNT I

Just Compensation Under the Fifth Amendment for the Taking of Private Property for Public Use

130. Plaintiffs incorporate by reference and reallege each allegation set forth above, as though fully set forth herein.

131. The Fifth Amendment provides that no person shall "be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

132. In the August 2012 Net Worth Sweep amendment to the Purchase Agreements, the Federal Government entered into an agreement with itself to take "every dollar of earnings each firm generates . . . to benefit taxpayers." One federal agency—FHFA, supposedly acting as conservator for the Companies—struck a deal with a second federal agency—Treasury—to effectively confiscate the Common and Preferred Stock held by the Plaintiffs and other private investors in Fannie and Freddie.

133. At the outset of conservatorship, FHFA's Director confirmed that both the preferred and common shareholders of Fannie and Freddie retained an economic interest in the Companies. As equity shareholders, that economic interest took the form of a claim on the Companies' equity that could be paid out in the form of dividends or a liquidation payment. Plaintiffs had both a property interest and a reasonable, investment-backed expectation in the economic interest in the Companies they held due to their ownership of Common and Preferred Stock. The Net Worth Sweep expropriated this economic interest by assigning the right to all of Fannie's and Freddie's equity to Treasury.

134. Treasury was the driving force behind the Net Worth Sweep, and both FHFA and Treasury entered the Net Worth Sweep to advance the interests of the United States Government. The policy interests the Agencies sought to advance through the Net Worth Sweep included: prohibiting Fannie and Freddie from recapitalizing and positioning themselves to exit conservatorship; ensuring that Fannie and Freddie would be wound down and, eventually,

eliminated; enriching the Federal Government; and expropriating the economic interests of Fannie's and Freddie's common and preferred shareholders.

135. Plaintiffs who are holders of Preferred Stock had both a property interest and a reasonable, investment-backed expectation in their Preferred Stock and in the share of the Companies' future earnings to which they and other holders of Preferred Stock were contractually entitled. Such Plaintiffs also had both a property interest and a reasonable, investment-backed expectation in the liquidation preference to which such Preferred Stock was contractually entitled in the event that Fannie and Freddie were dissolved or liquidated.

136. The Government, by operation of the Net Worth Sweep, has expropriated Plaintiffs' property interests in theirPreferred Stock and has destroyed Plaintiffs' reasonable, investment-backed expectations without paying just compensation.

137. As a result of the Net Worth Sweep, Plaintiffs have been deprived of all economically beneficial uses of their Preferred Stock in Fannie and Freddie.

138. Plaintiffs are entitled to just compensation for the Government's taking of their property.

COUNT II

Illegal Exaction Under the Fifth Amendment

(Alternative Claim)

139. Plaintiffs incorporate by reference and reallege each allegation set forth above, as though fully set forth herein.

140. In the August 2012 Net Worth Sweep amendment to the Purchase Agreements, the Federal Government entered into an agreement with itself to take "every dollar of earnings each firm generates . . . to benefit taxpayers." One federal agency—FHFA, supposedly acting as conservator for the Companies—struck a deal with a second federal agency—Treasury—to

effectively confiscate the Preferred Stock held by the Plaintiffs and other private investors in Fannie and Freddie.

141. At the outset of conservatorship, FHFA's Director confirmed that both the preferred and common shareholders of Fannie and Freddie retained an economic interest in the Companies. As equity shareholders, that economic interest took the form of a claim on the Companies' equity that could be paid out in the form of dividends or a liquidation payment. Plaintiffs had both a property interest and a reasonable, investment-backed expectation in the economic interest in the Companies they held due to their ownership of Preferred Stock. The Net Worth Sweep expropriated this economic interest by assigning the right to all of Fannie's and Freddie's equity to Treasury.

142. Treasury was the driving force behind the Net Worth Sweep, and both FHFA and Treasury entered the Net Worth Sweep to advance the interests of the United States Government. The policy interests the Agencies sought to advance through the Net Worth Sweep included: prohibiting Fannie and Freddie from recapitalizing and positioning themselves to exit conservatorship; ensuring that Fannie and Freddie would be wound down and, eventually, eliminated; enriching the Federal Government; and expropriating the economic interests of Fannie's and Freddie's common and preferred shareholders.

143. In agreeing to the Net Worth Sweep, FHFA purportedly acted pursuant to its authority as conservator of Fannie and Freddie under 12 U.S.C. § 4617, and Treasury purportedly acted pursuant to authority granted to it under 12 U.S.C. §§ 1455 and 1719. These statutes, however, did not authorize either FHFA or Treasury to expropriate Plaintiffs' economic interest in Fannie and Freddie for the benefit of the Federal Government.

144. In addition, FHFA acted unlawfully because it is an unconstitutional "independent" agency whose Director was removable only for cause in violation of the Appointments Clause.

145. The Constitution provides that the "executive Power shall be vested in a President," U.S. Const. art. II, § 1, and that "he shall take Care that the Laws be faithfully executed," U.S. Const. art. II, § 3. Those provisions vest all executive power in the President of the United States.

146. By making FHFA's head a single Director rather than a multi-member Board and eliminating the President's power to remove the Director at will, HERA violates the Constitution's separation of powers. An independent agency headed by a single Director is virtually unprecedented in our Nation's history, and this structure impermissibly concentrates power in a single person who is not the President.

147. Neither Congress nor the President can negate the constitution's structural requirements by signing or enacting (and thereby acceding to) HERA. "Perhaps an individual President"—or Congress—"might find advantages in tying his own hands," the Supreme Court has noted, "[b]ut the separation of powers does not depend on the views of individual Presidents"—or particular Congresses. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.,* 130 S. Ct. 3138, 3155 (2010). The Constitution's separation of powers does not depend "on whether 'the encroached-upon branch approves the encroachment.'" *Id*. (quoting *New York v. United States*, 505 U.S. 144, 182 (1992)).

148. "The diffusion of power" away from Congress and the President, to the independent FHFA, "carries with it a diffusion of accountability. . . . Without a clear and effective chain of command, the public cannot 'determine on whom the blame or the punishment

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of a pernicious measure, or series of pernicious measures ought really to fall." *Id.* (quoting The Federalist No. 70, p. 476 (J. Cooke ed. 1961) (A. Hamilton)).

149. FHFA and Treasury therefore have illegally exacted Plaintiffs' economic interest in Fannie and Freddie without due process.

COUNT III

Breach of Fiduciary Duty

150. Plaintiffs incorporate by reference and reallege each allegation set forth above, as though fully set forth herein.

151. The conservatorship provisions of HERA create a fiduciary relationship between the United States Government, on the one hand, and the Companies' shareholders, on the other hand. *See United States v. Mitchell*, 463 U.S. 206 (1983). FHFA therefore has a fiduciary responsibility to manage the conservatorships of Fannie and Freddie for the benefit of the Companies' shareholders.

152. As conservator, FHFA is given elaborate control over Fannie and Freddie. As conservator, the Agency is vested with "all rights, titles, powers, and privileges of [Fannie and Freddie], and of any stockholder, officer, or director of [Fannie and Freddie] with respect to [Fannie and Freddie] and [their] assets." 12 U.S.C. § 4617(b)(2)(A). As conservator, FHFA accordingly has the authority to "take over the assets of and operate [Fannie and Freddie] with all the powers of the shareholders, the directors, and the officers of [Fannie and Freddie] and conduct all business of [Fannie and Freddie]." *Id.* § 4617(b)(2)(B).

153. The term "conservator" has long been understood to denote a position of fiduciary responsibility. HERA accordingly makes clear that FHFA is to exercise its conservatorship authorities for the benefit of the Companies' shareholders, and that the overriding purpose of the conservatorship is "rehabilitating" Fannie and Freddie. 12 U.S.C. § 4617(a)(2). For example,

FHFA is authorized to "take such action as may be—(i) necessary to put [Fannie and Freddie] in a sound and solvent condition; and (ii) appropriate to carry on the business of [Fannie and Freddie] and preserve and conserve [their] assets and property." *Id*. § 4617(b)(2)(D). And when taking any action involving the disposition of Fannie's and Freddie's assets, FHFA is required to "conduct its operations in a manner which . . . maximizes the net present value return from the sale or disposition of such assets." *Id*. § 4617(b)(2)(E)(i).

154. In promulgating regulations implementing its conservator authorities, FHFA has recognized that "[a] conservator's goal is to continue the operations of a regulated entity, rehabilitate it and return it to a safe, sound and solvent condition." 76 Fed. Reg. 35724, 35730.

155. Given the existence of a fiduciary relationship between FHFA and the Companies' shareholders, it naturally follows that the Government should be liable in damages for the breach of its fiduciary duties.

156. The Net Worth Sweep is a self-dealing transaction with a sister agency of the Federal Government, and it improperly expropriates the economic interest in Fannie and Freddie held by holders of the Companies' Common and Preferred Stock for the benefit of the Federal Government.

157. The Net Worth Sweep was neither entirely nor intrinsically fair.

158. The Net Worth Sweep constituted waste, gross and palpable overreaching, and a gross abuse of discretion.

159. The Net Worth Sweep did not further any valid business purpose or reasonable business objective of Fannie and Freddie, did not reflect FHFA's good faith business judgment of what was in the best interest of Fannie and Freddie, and was unfair to the Companies' common and preferred shareholders.

160. Thus, by entering the Net Worth Sweep, FHFA violated its fiduciary duty to Plaintiffs and the other holders of Preferred Stock.

COUNT IV

Breach of Implied-in-Fact Contract Between the United States and the Companies

161. Plaintiffs incorporate by reference and reallege each allegation set forth above, as though fully set forth herein.

162. Prior to appointing itself conservator on September 6, 2008, FHFA, along with Treasury, unambiguously offered to place Fannie Mae and Freddie Mac into conservatorship by consent, under § 4617(a)(3)(I), with certain conditions described below, and the boards of directors of the Companies accepted this offer. The Government made no finding of insolvency, undercapitalization, or any other ground to impose conservatorship under § 4617(a)(3)(A)-(H) or (J)-(L).

163. FHFA, with the urging of Treasury, offered, and the boards of Fannie Mae and Freddie Mac accepted, a conservatorship that would aim to "preserve and conserve the [Companies'] assets and property" and restore the Companies to a "sound and solvent condition." See § 4617(b)(2)(D). The offer was also of a conservatorship that would end when that goal was achieved. Neither of these conditions was ambiguous.

164. Underlying the offer was its promise that FHFA would not, as conservator, wind down or liquidate the Companies. When it publicly announced the conservatorship, FHFA stated that it could not, as conservator, place the Companies into liquidation. FHFA stated at the time, and for several years into the conservatorship, that its goal was instead to "restore the [Companies'] assets and property to a sound and solvent condition," which continued course of

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performance constitutes evidence of the offer's original terms. The Companies' boards shared this understanding of conservatorship when they consented.

165. When consenting to the conservatorship, the boards of the Companies furnished good and valuable consideration to the Government by agreeing to forbear from a judicial or legislative challenge that the United States feared. See § 4617(a)(5). This forbearance was unambiguously furnished in exchange for the Agencies' promises to act to restore the Companies to a safe and solvent condition.

166. The United States and the Companies, through the acts described above, entered into an implied-in-fact contract. The terms of that contract, as relevant here, were that FHFA if made conservator would "preserve and conserve the [Companies'] assets and property," that its conservatorship would continue only until the Companies were placed in a safe and solvent condition, and that, in exchange, the boards of the Companies would consent to, and not challenge or litigate, such a course of action. Both the Government and the Companies intended that an implied contract would exist. That contract required FHFA to preserve the Companies' assets and property, and forbade it from diminishing or expropriating the Companies' assets and property. This intent was demonstrated through the offer and acceptance detailed above. The Government's offer was not ambiguous in its terms, and the boards' acceptance was manifested in its subsequent imposition of conservatorship based on the boards' consent.

167. Each Agency had actual authority, as an agency of the United States Government, to bind the United States.

168. The imposition of the Net Worth Sweep breached the contract by rendering it impossible for the Companies to build and retain the capital necessary to exit conservatorship and return to normal business operations.

169. Each subsequent Net Worth Sweep payment independently breaches that contract by depleting the Companies of capital (rather than "preserv[ing] and conserv[ing]" it), in a manner that FHFA has expressly recognized undermines the goals of conservatorship.

170. The Net Worth Sweep, thus, directly harmed Plaintiffs, by preventing the termination of the conservatorship; stripping the Companies of their ability to generate and retain funds to ever distribute as dividends to holders of the Preferred and Common Stock; and nullifying Plaintiffs' contractual right as shareholders to ever receive a liquidation preference upon the dissolution, liquidation, or winding up of the Companies. Plaintiffs are accordingly entitled to damages.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs seek a judgment as follows:

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

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

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

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

E. Awarding Plaintiffs pre-judgment interest, the costs and disbursements of this action, including reasonable attorneys' and experts' fees, costs and expenses; and

F. Granting such other and further relief as the Court deems just and proper.

Respectfully submitted,

DENTONS US LLP

By: */s/ Michael H. Barr*
Michael H. Barr
Richard M. Zuckerman
Sandra Hauser
1221 Avenue of the Americas
New York, New York 10020
Tel.: (212) 768-6700
Fax: (212) 768-6800
michael.barr@dentons.com
richard.zuckerman@dentons.com
sandra.hauser@dentons.com

Drew W. Marrocco
1900 K Street, NW
Washington, DC 20006
Tel.: (202) 408-6400
Fax: (202) 408-6399
Drew.Marrocco@dentons.com

Attorneys for Plaintiffs

September 17, 2018

UNITED STATES COURT OF FEDERAL CLAIMS

JOSEPH CACCIAPALLE *et al.*, On Behalf of Themselves and All Others Similarly Situated, Plaintiffs, v. THE UNITED STATES OF AMERICA, Defendant.	Case No. 1:13-cv-466-MMS

FIRST AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

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FIRST AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

Plaintiffs Joseph Cacciapalle and American European Insurance Company submit this First Amended Consolidated Class Action Complaint against the United States of America.

NATURE AND SUMMARY OF THE ACTION

1. This is a class action brought by Plaintiffs on behalf of themselves and classes (the "Classes," as defined herein) of holders of Preferred Stock issued by the Federal National Mortgage Association ("Fannie Mae" or "Fannie") and the Federal Home Loan Mortgage Corporation ("Freddie Mac" or "Freddie"; Fannie Mae and Freddie Mac together, the "Companies"). Plaintiffs and the Classes (together, the "Plaintiffs") seek just compensation for the taking of their private property, and, alternatively, damages for illegal exaction, breach of contract, breach of the implied covenant of good faith and fair dealing, and breach of fiduciary duty, in connection with the implementation of the Third Amendment to the Senior Preferred Stock Purchase Agreement, dated August 17, 2012 (the "Third Amendment") by the United States of America, including the Department of the Treasury ("Treasury"), the Federal Housing Finance Agency ("FHFA") and agents acting at their direction (collectively, the "Government").

2. Fannie Mae and Freddie Mac (the "Companies") are enterprises chartered by the U.S. Congress to facilitate liquidity and stability in the secondary market for home mortgages. While they have been commonly referred to as "Government Sponsored Enterprises" or "GSEs," Fannie Mae and Freddie Mac are not government agencies. Instead, Congress created the Companies to operate as private, for-profit corporations. As such, the Companies have stockholders, directors, and officers like other non-governmental corporations, and their debt and equity securities have for years been privately owned and publicly traded by individual

investors, including employees of the Companies, as well as by public pension funds, mutual funds, community banks, and insurance companies, among other institutional investors.

3. To raise capital, the Companies issued several publicly traded securities, including numerous classes of non-cumulative preferred stock ("Preferred Stock"). By 2008, Fannie Mae and Freddie Mac were two of the largest privately owned financial institutions in the world, and had been consistently profitable for decades. The Companies marketed their securities aggressively to investors, both large and small, and continued to do so through 2008. Indeed, when the Companies came into financial distress in 2007 and 2008, they successfully asked private shareholders to provide much needed capital by issuing new shares of preferred stock.

4. In July 2008, in response to the crisis in the residential housing and mortgage markets, Congress passed the Housing and Economic Recovery Act of 2008 ("HERA"), creating a new federal agency, FHFA, and empowering it to appoint itself as conservator of the Companies under certain circumstances.

5. On September 6, 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorship. When FHFA became Conservator, Fannie Mae and Freddie Mac each entered into a Senior Preferred Stock Purchase Agreement ("PSPA") with Treasury. Under these contracts, Treasury agreed to invest in the Companies in exchange for the issuance of a newly created class of securities in the Companies, known as Senior Preferred Stock. In return for its commitment to purchase Senior Preferred Stock, Treasury received $1 billion of Senior Preferred Stock in each Company as a commitment fee (*i.e.,* that $1 billion did not reflect any investment), as well warrants to acquire 79.9% of the Common Stock of the Companies at a very low, nominal price. The PSPA also provided that the Treasury would hold a liquidation preference in

each Company equal to the $1 billion commitment fee plus the total amount Treasury invested in that respective Company. In addition, the Senior Preferred Stock ranked senior in priority to all other series of Fannie Mae and Freddie Mac Preferred Stock, and would earn an annual dividend, paid quarterly, equal to 10% of the outstanding liquidation preference, *i.e.*, 10% of the sum of the $1 billion commitment fee plus the total amount Treasury invested in that Company. If a Company elected not to pay the dividend in cash, Treasury would receive a dividend in the form of additional Senior Preferred Stock with a face value equal to 12% of the liquidation preference. The warrants to acquire a 79.9% ownership stake in the Companies gave Treasury a significant "long" position—over and above the substantial 10% coupon on its Senior Preferred Stock. If exercised, these warrants would allow Treasury to receive enormous profits in the event the Companies returned to profitability and started paying dividends on their common stock. However, any dividends paid on that common stock would be paid only after the Companies paid dividends to the privately held Preferred Stock which ranked junior to the Senior Preferred Stock, but senior to any and all common stock (whether privately held or held by the Treasury based on the exercise of the warrants).

6. These terms would have been nonsensical if the imposition of the conservatorship had somehow nullified the rights of all private shareholders. Indeed, the structure of the PSPAs between Treasury and FHFA reflected the shared understanding that (a) the Companies continued to be owned by shareholders with certain contractual rights, and had not been simply "taken over by the Government," and (b) in addition to Treasury's rights as a shareholder, there were other, private shareholders who continued to have an ownership interest in the Companies, but whose rights were now subordinated to Treasury's rights as a senior preferred shareholder and (in the case of common shareholders) subject to dilution because

Treasury held warrants to buy 79.9% of the common stock. That was the enormous price of Treasury's commitment to providing funding to the Companies. But while it was an enormous price, it did not eliminate the rights of private shareholders. Indeed, at the time these PSPAs were executed, FHFA's director told investors that "**the common and all preferred stocks will continue to remain outstanding**." Statement of FHFA Director James B. Lockhart (Sept. 7, 2008) (*available at* goo.gl/xMjTse). Likewise, Treasury Secretary Paulson made clear that "**conservatorship does not eliminate the outstanding preferred stock**, but does place preferred shareholders second, after the common shareholders, in absorbing losses." Statement by Secretary Henry M. Paulson, Jr. (Sept. 7, 2008) (*available at* goo.gl/weFLds).

7. In any event, this lawsuit does not challenge the foregoing arrangement made in September 2008. While Plaintiffs do not concede that all the measures taken in September 2008 were justified or necessary, they are not here to challenge the placement of Fannie and Freddie into conservatorship at the height of the financial crisis, or the original deal struck by Treasury and FHFA at that time.

8. But four years later, something very different happened. Just as the housing market was recovering and the Companies were returning to robust profitability, the Treasury and FHFA agreed to an "amendment" to the PSPAs under which the 10% Senior Preferred Stock dividend was converted into a "Net Worth Sweep" that required the Companies to pay the full amount of their net worth to Treasury every quarter, minus a small reserve that was set to shrink to zero by 2018. Under this "Net Worth Sweep" (formally called the "Third Amendment" to the PSPAs), it became impossible for any private shareholders ever to receive any dividend or liquidation distribution from the Companies. Even if the Companies generate trillions of dollars in profits and positive net worth, it all goes to the Treasury, and nothing can

ever be distributed to private shareholders—not as a dividend, and not even if the Companies are liquidated.

9. As of August 16, 2012, the day before the Net Worth Sweep, private shareholders had vested rights to dividends and liquidation proceeds, and those rights had economic value. Once the Net Worth Sweep was put in place, however, those legal rights were obliterated. Their economic value was therefore also wiped out. The only value the preferred stock has had since the Net Worth Sweep is a value that depends on the Net Worth Sweep being invalidated by the courts or Congress—or from a court awarding damages or just compensation for the Net Worth Sweep.

10. The rights that were expropriated by the Government through the Net Worth Sweep belonged to real people who made real investments into Fannie and Freddie. For years, Fannie and Freddie were able to fulfill their public mission because of investments made by private citizens—often very ordinary citizens who invested their life savings, or small institutions who were told by their regulators to invest in these entities. These private investments were made not only in good times but also when the Companies faced financial distress in 2007.

11. The Government has reaped immense profits from the Third Amendment. In total, the Companies have paid $278.9 billion in dividends to Treasury. Of that amount, approximately $55 billion was paid before the Net Worth Sweep, and approximately $223.9 billion was paid after the Net Worth Sweep. This total amount of $278.9 billion is approximately $87.5 billion more than Treasury's total investment in the Companies. Moreover, as of the date of this filing, the total amount of dividends paid under the Net Worth Sweep is roughly $125.5 billion more than Treasury would have received under the 10% dividend

provided for in the original PSPAs. Meanwhile, the principal amount of Treasury's Senior Preferred Stock has not been reduced at all, and still stands at $193.4 billion. Of course, under the Third Amendment, the true amount of Treasury's liquidation preference is infinite: no matter how much positive value is generated by the Companies, all of it must go to Treasury. Thus, it would not be truly accurate to say that Treasury's "liquidation preference" is $193.4 billion; if the Companies are liquidated and a positive surplus results that is greater than $193.4 billion, the Third Amendment guarantees that all of that positive value must be paid to Treasury.

12. While the Net Worth Sweep has thus far allowed Treasury to receive $125 billion more than it would have received under the original Senior Preferred Stock deal, Treasury could have captured most of that windfall amount under the original deal if it had simply exercised its common stock warrants and authorized dividends on common stock. If Treasury had taken that approach—which was obviously the approach contemplated by the original Senior Preferred Stock Agreement—then Treasury would have received most of the $125 billion in excess value, but not quite all of it. First, for Treasury to have received distributions on its common stock, as contemplated in the original deal, Treasury would have to have permitted the Companies to pay dividends to private preferred shareholders (*i.e.*, Plaintiffs and the class they represent), who have to be paid dividends before a common shareholder can be paid. In addition, Treasury would also have had to have authorized pro rata distributions to private common shareholders, who would have owned 20.1% of the common stock. Treasury still would have gotten most of the $125 billion in excess value. But Treasury wanted absolutely all of it, and did not want private shareholders to receive anything, no matter how profitable the Companies might become. That is what motivated the Net Worth Sweep.

13. Under the Third Amendment, the Government has expropriated Plaintiffs' vested property rights and transferred their value to the Treasury. That constitutes a taking of private property and the Fifth Amendment requires that the Government pay just compensation to the Plaintiffs. In addition, to the extent this action violated statutory law, it constitutes an illegal exaction and the Fifth Amendment requires the Government to pay damages to plaintiffs. Further, by imposing the Third Amendment, the Government has nullified, and thereby breached, Plaintiffs' express and implied contractual rights to dividends, liquidation payments, and voting rights, contained in the stock certificates. Plaintiffs are seeking remedies for those contractual breaches in a companion case in the U.S. District Court for the District of Columbia, but to the extent the Government is held to be the proper defendant against such claims, we advance them here as well.[1] Finally, the extraordinary control exercised by FHFA as conservator over Fannie and Freddie created a fiduciary relationship between FHFA, on the one hand, and the Plaintiffs on the other; the Net Worth Sweep violated FHFA's fiduciary duties. Plaintiffs and the classes they represent are entitled to recover damages caused by those breaches.

JURISDICTION AND VENUE

14. This Court has jurisdiction over this action, and venue is proper in this Court, pursuant to 28 U.S.C. § 1491(a). The named Plaintiffs have claims under the Tucker Act

[1] The Plaintiffs in this action are also pursuing contract-based claims for damages against the FHFA (and the Companies) in the U.S. District Court for the District of Columbia. *See* Second Amended Consolidated Class Action and Derivative Complaint, *In re Fannie Mae/Freddie Mac Senior Preferred Stock Purchase Agreement Class Action Litigations,* No. 13-mc-1288 (D.D.C. filed Feb. 16, 2018). In that action, Plaintiffs proceed under the theory that their contract rights were breached by FHFA in its role as conservator for the Companies, assuming that role is not subject to governmental immunities. In this action, by contrast, Plaintiffs proceed under the alternative theory that their contract rights were breached by the United States. Plaintiffs do not seek a double recovery; they merely seek to ensure that the Plaintiffs receive damages and compensation to remedy the loss of their shareholder rights. We are required to proceed in two separate cases because of the jurisdictional rules governing claims against the Government. (The named Plaintiffs in this case were not the Plaintiffs who sought relief under the Little Tucker Act in the District Court case, as the Plaintiffs in this case have claims in excess of $10,000 each).

that are worth more than $10,000 each, and therefore can only adjudicate those claims in this Court.

THE PARTIES

15. Plaintiff Joseph Cacciapalle is a citizen of the state of New Jersey, and is a holder of Fannie Mae 8.25% Series S Preferred Stock, Fannie Mae 8.25% Series T Preferred Stock, and Freddie Mac 8.375% Series Z Preferred Stock. Mr. Cacciapalle purchased Fannie Mae Preferred Stock in January 2008, purchased Freddie Mac Preferred Stock in February 2008, and has been a holder of Fannie Mae Stock and Freddie Mac Preferred Stock continuously since then. He is recently retired, and purchased these securities to be a source of stable income in his retirement.

16. Plaintiff American European Insurance Company is a New Jersey corporation with offices in New York, New York, and is a holder of Fannie Mae 8.25% Series T Preferred Stock and Freddie Mac Variable Rate Series M Preferred Stock. American European Insurance Company held Fannie Mae Preferred Stock in May 2008 and Freddie Mac Preferred Stock in January 2001, and has been a holder of Fannie Mae Preferred Stock and Freddie Mac Preferred Stock continuously since then.

17. Defendant United States of America includes Treasury, FHFA, and agents acting at their direction.

CONSTITUTIONAL PROVISION

18. The Fifth Amendment to the United States Constitution provides in pertinent part that no person shall "be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

FACTUAL ALLEGATIONS

I. THROUGH 2008, FANNIE MAE AND FREDDIE MAC WERE FINANCED BY PRIVATE INVESTMENT.

19. Fannie Mae and Freddie Mac are stockholder-owned corporations. Fannie Mae was established in 1938 to provide the mortgage market with supplemental liquidity, and was converted to a private corporation in 1968. Freddie Mac was created in 1970 as an alternative to Fannie Mae to make the secondary mortgage market more competitive and efficient and was converted to a private corporation in 1989. Both Companies are sometimes referred to as "Government Sponsored Enterprises" (or "GSEs"), which reflects the fact that they are private corporations created by Congress to increase mortgage market liquidity. They purchase mortgages originated by private banks and bundle them into mortgage-related securities to be sold to investors. By creating this secondary mortgage market, the Companies increase liquidity for private banks, which enables them to make additional loans to individuals for home purchases.

20. Notwithstanding that they were created by federal statute, until September 2008, Fannie Mae and Freddie Mac were financed by private investment. The Companies actively marketed their securities to a wide variety of investors – including through 2008. For instance, they had a variety of programs to encourage their midlevel employees to buy Company stock. *See Worker Assets Shrink at Fannie and Freddie,* N.Y. TIMES (Aug. 28, 2008).

21. The Companies marketed their securities well into 2008. For instance, in 2008, Fannie Mae issued at least two series of preferred stock. The first issuance – Series 2008-1 Preferred Stock – was announced on May 8, 2008 and raised over $2.5 billion. The second issuance – Series T Preferred Stock – was announced on May 13, 2008, and raised nearly $2 billion. In May 2008, Fannie Mae produced a "Capital Raise Roadshow" presentation in which

the company touted its "[l]ong-term growth and profitability prospects" and the "[c]ompelling investment opportunities in current environment." The "rationale" was to "[e]nhance long-term shareholder value" and the presentation noted that the "[m]ix of the offering maintains an appropriate ratio of preferred to common equity in our capital structure . . . ."

22. Prior to 2007, Fannie and Freddie were consistently profitable. In fact, Fannie had not reported a full-year loss since 1985 and Freddie had not reported a full-year loss since becoming owned by private shareholders in 1989. In addition, both companies regularly declared and paid dividends on each series of their respective Preferred Stock.

23. All three major credit rating agencies assigned high investment-grade ratings on the Companies' Preferred Stock from the dates of issuance until 2008. Banking regulators permitted banks to carry the Companies' Preferred Stock on their balance sheets at a lower risk weighting than other companies' preferred stock.

24. The Companies' federal regulators also actively promoted investment in the companies – including through 2008. The Office of Federal Housing Enterprise Oversight (the "OFHEO") continued to assure the marketplace of the Companies' soundness through 2008. On June 9, 2008, OFHEO published a news release stating that it classified Fannie Mae and Freddie Mac as "adequately capitalized as of March 31, 2008." And, in a March 19, 2008 statement, OFHEO director James Lockhart said "both companies have prudent cushions above the OFHEO-directed capital requirements and have increased their reserves" and "We believe they can play an even more positive role in providing the stability and liquidity the markets need right now." Lockhart also said that the idea of a bailout is "nonsense in my mind" because "The companies are safe and sound, and they will continue to be safe and sound." *As Crisis Grew, A Few Options Shrank To One*, N.Y. TIMES (Sept. 7, 2008).

II. IN JULY 2008, CONGRESS CREATED FHFA, WHICH IN SEPTEMBER 2008 PLACED THE COMPANIES INTO CONSERVATORSHIP.

25. In July 2008, in response to the crisis in the housing and mortgage markets, Congress enacted HERA. That Act established FHFA to replace the OFHEO as the Companies' regulator, and granted Treasury temporary authority to assist the Companies through the purchase of securities. HERA provided a specific list of enumerated circumstances under which FHFA would have the power to place the Companies into conservatorship or receivership.

26. Key leaders repeatedly reassured the public, including the Companies' private investors, that neither Company was approaching insolvency or operating unsafely. Rather, they explained, the goal of the legislation was to provide confidence to the housing market. For instance, while HERA was under consideration, both Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke testified before the House Financial Services committee that Fannie Mae and Freddie Mac were adequately capitalized. Similarly, while HERA was under consideration, the Companies' then-regulator, OFHEO, issued a statement that, as of 2008, Fannie Mae and Freddie Mac were "holding capital well in excess of the OFHEO-directed requirement[.]" Similarly, in support of HERA, Senator Isakson (R-GA) commented that:

> The bill we are doing tomorrow is not a bailout to Freddie Mac and Fannie Mae or the institutions that made bad loans. It is an infusion of confidence the financial markets need. Fannie and Freddie suffer by perception from the difficulties of our mortgage market. If anybody would take the time to go look at the default rates, for example, they would look at the loans Fannie Mae holds, and they are at 1.2 percent, well under what is considered a normal, good, healthy balance. The subprime market's defaults are in the 4 to 6 to 8-point range. That is causing the problem. That wasn't Fannie Mae paper, and it wasn't securitized by Fannie Mae. They have $50 billion in capital, when the requirement is to have $15 billion, so they are sound. But the financial markets, because of the collapse of the mortgage market, have gotten worse.

27. Nevertheless, despite these prior assurances as to the ample capitalization of the Companies, on September 6, 2008, FHFA placed the Companies into conservatorship.

28. As the Conservator, FHFA became responsible for "preserv[ing] and conserv[ing] [the Companies'] assets and property" and managing them in a manner that would restore them to a "sound and solvent condition." 12 U.S.C. § 4617(b)(2)(D). At the time, FHFA stated that the goal of this action was "to help restore confidence in Fannie Mae and Freddie Mac, enhance their capacity to fulfill their mission, and mitigate the systemic risk that has contributed directly to the instability in the current market." According to FHFA's press release, the conservatorship was "designed to stabilize a troubled institution with the objective of returning the entities to normal business operations. FHFA will act as the conservator to operate the Enterprises until they are stabilized." FHFA also issued a Fact Sheet indicating that, "[u]pon the [FHFA] Director's determination that the Conservator's plan to restore the Company to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship."

29. As FHFA noted in an October 2008 presentation, "[c]onservatorship statutes provide broad authority for a conservator to operate the institution until it is stabilized **and then returned to shareholders**." (FHFA00047705) (emphasis added).

30. Reporting indicates that FHFA's decision to place the Companies into conservatorship was based primarily on a political judgment, rather than an analysis of the HERA statutory factors. As the *New York Times* reported, the administration sought "to shrink drastically [Fannie Mae and Freddie Mac's] outsize influence on Wall Street and on Capitol Hill while at the same time counting on them to pull the nation out of its worst housing crisis in decades." *In Rescue To Stabilize Lending, U.S. Takes Over Mortgage Finance Titans*, N.Y.

TIMES (Sept. 7, 2008). And "In the end, [Treasury Secretary] Paulson's decision seems to have been a philosophical one, rather than one forced by imminent crisis. Of course, for stagecraft purposes, it was played as impending disaster." *Paulson's Itchy Finger, on the Trigger of a Bazooka*, N.Y. TIMES (Sept. 9, 2008).

31. The conservatorship did not purport to involve the appropriation of any privately held stock, to amend any of the shareholder Certificates of Designation, or otherwise to modify any contractual rights held by private shareholders such as Plaintiffs.

32. At the outset of conservatorship, FHFA's director told investors that "**the common and all preferred stocks will continue to remain outstanding**." Statement of FHFA Director James B. Lockhart (Sept. 7, 2008) (*available at* goo.gl/xMjTse).

33. Treasury Secretary Paulson likewise made clear that, "**conservatorship does not eliminate the outstanding preferred stock**, but does place preferred shareholders second, after the common shareholders, in absorbing losses." Statement by Secretary Henry M. Paulson, Jr. (Sept. 7, 2008) (*available at* goo.gl/weFLds).

34. In a Form 8-K filing issued by Freddie Mac on September 11, 2008, Freddie Mac stated that, "The holders of Freddie Mac's existing common stock and preferred stock . . . **will retain all their rights** in the financial worth of those instruments, as such worth is determined by the market." (emphasis added).

35. In Fannie Mae's September 11, 2008 Form 8-K, it stated that "FHFA, as Conservator, has the power to repudiate contracts entered into by Fannie Mae prior to the appointment of FHFA as Conservator if FHFA determines, in its sole discretion, that performance of the contract is burdensome and that repudiation of the contract promotes the orderly administration of Fannie Mae's affairs. FHFA's right to repudiate any contract must be

exercised within a reasonable period of time after its appointment as Conservator." This statement reflected what is expressly set forth in HERA regarding FHFA's power to repudiate contracts. 12 U.S.C. § 4617(d). Thus, if FHFA was to repudiate the contracts between the Companies and their shareholders, FHFA was required to do so "within a reasonable period of time after its appointment as conservator" on September 6, 2008.

36. FHFA did not, either within a reasonable period of time after its appointment as Conservator or at any other time before August 17, 2012, purport to repudiate any of the contracts governing the Companies' Preferred Stock or any of its other shareholder relationships.

37. At the time the conservatorship was imposed, FHFA's director stated that it was critical to complete key regulations implementing HERA governing minimum capital standards, prudential safety and soundness standards and portfolio limits "so that any new investor will understand the investment proposition," clearly showing that FHFA intended that private investors would continue to purchase Fannie Mae and Freddie Mac securities. Statement of FHFA Director James B. Lockhart (Sept. 7, 2008) (*available at* goo.gl/xMjTse).

III. IN EXCHANGE FOR FUNDING, FHFA EXECUTED AN AGREEMENT GIVING TREASURY A 10% SENIOR PREFERRED STOCK DIVIDEND AND WARRANTS TO BUY 79.9% OF EACH COMPANY'S COMMON STOCK FOR A NOMINAL PRICE.

38. When the Companies were placed into conservatorship, Treasury entered into PSPAs with FHFA, which acted on behalf of both Companies. The PSPAs for Fannie Mae and Freddie Mac are identical in all material respects. Through these agreements, Treasury agreed to make investments in the Companies in exchange for Senior Preferred Stock plus warrants to acquire common stock equal to 79.9% of the common stock in the Companies. Under the instruments laying out the terms of the Senior Preferred Stock for each Company:

(a) Treasury was given the right to receive a senior preferred dividend each quarter in an amount equal (on an annual basis) to 10% of the outstanding principal value of the Senior Preferred Stock if the dividend was paid in cash;

(b) If a Company elected not to pay the dividend in cash, Treasury would receive a dividend in the form of additional Senior Preferred Stock with a face value equal to 12% of the outstanding principal value of the Senior Preferred Stock;

(c) The principal value of the Senior Preferred Stock in each Company would equal the amount invested by Treasury in each Company, plus $1 billion to reflect a commitment fee with respect to each Company (plus any stock dividends distributed based upon the 12% dividend right referenced above);

(d) The Senior Preferred Stock ranked senior in priority to all other Fannie Mae and Freddie Mac Stock, so that no dividends or liquidation distributions could be paid to any other owner of stock in the Companies until after Treasury had received its dividend or liquidation distributions under its Senior Preferred Stock (the liquidation preference was equal to the principal value of the Senior Preferred Stock plus any unpaid dividends);

(e) Treasury also received warrants to acquire 79.9% of the common stock of each Company for a nominal price; and

(f) Treasury was also given the right to receive a quarterly periodic commitment fee, to be set for five-year periods by agreement of the Companies and Treasury, but Treasury had the option to waive the fee for up to a year at a time.

39. The foregoing terms, particularly those referring to priority over the rights of other (private) shareholders, would have been nonsensical if the rights of other shareholders had been nullified by the conservatorship. The PSPAs clearly contemplate that private shareholders retained their rights to dividends and liquidation distributions, albeit subject to the preferences given to the Treasury under the PSPAs.

40. This can also be seen by looking at Treasury's statutory authority to purchase stock in the Companies, and statements made by the Treasury Secretary in connection with those purchases. In general, Treasury does not have the statutory authority to purchase corporate stock. However, HERA gave Treasury temporary authority to purchase securities issued by the Companies. *See* 12 U.S.C. §§ 1455(*l*), 1719(g). To exercise that authority, the Secretary of the Treasury was required to determine that purchasing the Companies' securities was "necessary to . . . provide stability to the financial markets; . . . prevent disruptions in the availability of mortgage finance; and . . . protect the taxpayer." 12 U.S.C. §§ 1455(*l*)(1)(B), 1719(g)(1)(B). In making those determinations, the Secretary was required to consider six factors:

> (i) The need for preferences or priorities regarding payments to the Government.
>
> (ii) Limits on maturity or disposition of obligations or securities to be purchased.
>
> (iii) *The [Companies'] plan[s] for the orderly resumption of private market funding or capital market access.*

(iv) The probability of the [Companies] fulfilling the terms of any such obligation or other security, including repayment.

(v) *The need to maintain the [Companies'] status as . . . private shareholder-owned compan[ies]*.

(vi) Restrictions on the use of [the Companies'] resources, including limitations on the payment of dividends and executive compensation and any such other terms and conditions as appropriate for those purposes.

Id. §§ 1455(*l*)(1)(C), 1719(g)(1)(C) (emphasis added).

41. In approving the exercise of Treasury's temporary authority under HERA to purchase securities of the Companies, Treasury Secretary Paulson determined (1) "[u]nder conservatorship, Fannie Mae and Freddie Mac will continue to operate as going concerns"; (2) "Fannie Mae and Freddie Mac may emerge from conservatorship to resume independent operations"; and (3) "[c]onservatorship **preserves the status and claims of the preferred and common shareholders**." Action Memorandum for Secretary Paulson (Sept. 7, 2008) (emphasis added). None of this would have made any sense if the conservatorship and original PSPAs were intended to nullify the rights of the Companies' private shareholders.

42. After FHFA took control of the Companies, it claimed that it did not expect them to be profitable, and that they would likely incur large losses in the coming years. These projections were based on extremely pessimistic and unrealistic assumptions regarding the Companies' future financial prospects. FHFA relied on these overly pessimistic projections to direct the Companies to book substantial loss reserves—recording anticipated mortgage loan losses before they were actually incurred—and require the Companies to eliminate from their balance sheets the value of deferred tax assets that would only be of use if the Companies became profitable (*i.e.*, generated positive taxable income).

43. As the Government was well aware in 2008, these write-downs and accounting decisions led to the payment of some circular dividend payments. To pay a quarterly dividend payment to Treasury, the FHFA caused the Companies to draw on Treasury's funding commitment. This, in turn, increased the amount of stock held by Treasury, which further increased the amount of dividends the Companies were required to pay.

44. Treasury's authority under HERA to purchase the Companies' securities expired on December 31, 2009. *See* 12 U.S.C. §§ 1455(*l*)(4), 1719(g)(4). After that date, HERA authorized Treasury only "to hold, exercise any rights received in connection with, or sell" previously purchased securities. *Id.* §§ 1455(*l*)(2)(D), 1719(g)(2)(D).

45. During 2009, Treasury and FHFA amended the PSPAs twice. First, in May 2009, Treasury agreed to expand its funding commitment to $200 billion per Company from $100 billion per Company. Then, on December 24, 2009, it agreed to a funding commitment that would be sufficient to allow the Companies to satisfy their 2010, 2011, and 2012 capitalization requirements and a funding commitment up to a limit determined by an agreed-upon formula for subsequent years.

46. Throughout this time, the Companies continued to be managed in conservatorship by FHFA. HERA empowered FHFA to force the Companies into receivership and to liquidate their assets under certain circumstances, 12 U.S.C. § 4617(b)(2)(E), but FHFA always has maintained that its relationship with the Companies is that of Conservator rather than liquidator. *See* News Release FHFA, *A Strategic Plan For Enterprise Conservatorships: The Next Chapter In A Story That Needs An Ending*, at 9 (Feb. 21, 2012) (asserting that "[w]ithout action by Congress, FHFA must continue to look to the existing statutory provisions that guide

the conservatorships.”). FHFA has never stated that it was placing the Companies into receivership.

IV. AT THE BEGINNING OF 2012, THE HOUSING MARKET REBOUNDED AND THE COMPANIES RETURNED TO PROFITABILITY.

47. By the beginning of 2012, it became clear that the Government had (perhaps deliberately) overestimated the Companies’ likely losses and underestimated the possibility of a return to profitability. Contrary to FHFA’s 2008 projections, the Companies posted profits of more than $10 billion for the first two quarters of 2012. Even more importantly, the Companies disclosed that they expected to be consistently profitable for the foreseeable future, such that they would soon be able to reverse the valuation allowance against their deferred tax assets, worth approximately $100 billion. In addition, the Companies’ actual loan losses were far less than anticipated. Between the beginning of 2007 and the second quarter of 2012, more than $234 billion had been set aside by the Companies to absorb anticipated loan losses, whereas loan losses of just over $125 billion were actually recognized during that period, such that the projected losses had been overestimated by $109 billion. The reversal of these excess reserves would lead to a substantial increase in profitability.

48. By the beginning of 2012, the Companies, FHFA, and Treasury were very well aware that Fannie Mae and Freddie Mac were expected to be sufficiently profitable for years to come to pay the 10% dividend on the Senior Preferred Stock without the necessity of drawing from the Treasury.

49. In fact, as early as November 8, 2011, the accounting and consulting firm Grant Thornton LLP prepared a report for Treasury acknowledging that “[f]rom December 31, 2012 through September 30, 2018, Freddie Mac is not projected to draw on the liquidity commitment to make its dividend payments because of increased earnings driven by significantly

reduced credit losses in 2012 and 2014." (GT007342.) A December 2011 internal Treasury memorandum acknowledged that "both Fannie Mae and Freddie Mac are expected to be net income positive (before dividends) on a stable, ongoing basis after 2012 . . . ." (UST00473633.)

50. In June 2012, Treasury was aware that "the GSEs will be generating large revenues over the coming years, thereby enabling them to pay the 10% annual dividend well into the future even with the caps." (UST00533645.) Similarly, an August 1, 2012 Treasury presentation acknowledged that earnings for the Companies would be "in excess of current 10% dividend paid to Treasury." (UST00385572).

51. By the end of 2011 and the beginning of 2012, the Companies, FHFA, and Treasury were aware that, beginning in 2012, the Companies were forecast to be so consistently profitable that the Companies could afford to repay Treasury its initial investment within eight years. In her 2015 deposition, Susan McFarland, Fannie Mae's then-Chief Financial Officer, testified that at a meeting with Treasury that was also "probably" attended by FHFA, shortly before learning of the Third Amendment, she had expressed her view that Fannie Mae was "**able to deliver sustainable profits over time**." (McFarland Tr., 45:2-4, 46) (emphasis added).

52. According to July 13, 2012 documents circulated among FHFA officials regarding a Fannie Mae Executive Management Meeting held on July 9, 2012, the following eight years were likely to be the "**golden years of GSE earnings**." (FHFA00047889) (emphasis added). In the same documents, Fannie Mae official Ann Gehrig noted that "[c]umulative 2012 – 2016 income is now forecast at $56.6 billion, $12.3 billion higher than the last projection." (FHFA00047890.) The Fannie Mae Executive Management Meeting documents also included a report from Fannie Mae Treasurer Dave Benson acknowledging that "[c]urrent projections show that cumulative GSE dividends paid will surpass cumulative GSE Treasury draws by 2020."

(FHFA00047889.) The report by David Benson, dated July 19, 2012 and distributed to the Fannie Mae board of directors, included projections demonstrating that "[th]e cumulative dividends from both GSEs exceed government investment by 2020 in baseline scenario" as well as forecasts of positive annual Total Comprehensive Income from 2012 through 2022. (FM_Fairholme_CFC-00000220-221, 231-232.)

53. In addition, as FHFA and Treasury were aware, the Companies had certain deferred tax credits that would further enhance their profitability in the very near term. In a May 29, 2012 meeting between Treasury and various financial advisors, there was a discussion of "[r]eturning the deferred tax asset to the GSE balance sheets." (UST00405880.) A series of August 14, 2012 emails between FHFA officials acknowledged that "re-recording certain deferred tax assets" had been discussed "on the view that" the Companies "were going to be profitable going forward." (FHFA00038592.) In her 2015 deposition, McFarland testified that shortly before learning of the Third Amendment, she had expressed her view at a meeting with Treasury that approximately $50 billion of deferred tax assets might soon be released. (McFarland Tr., 45:8; 59:18.)

54. Thus, as of the first half of 2012, FHFA, Treasury, and the Companies all knew that the Companies were positioned to pay back the Government for the support they had received, with money left over to provide a financial return to their other stockholders.

V. ON AUGUST 17, 2012 THE GOVERNMENT IMPOSED THE THIRD AMENDMENT, GIVING TREASURY A RIGHT TO A QUARTERLY DIVIDEND EQUAL TO 100% OF THE COMPANIES' NET WORTH (MINUS A SMALL RESERVE THAT SHRINKS TO ZERO IN 2018).

55. With the Companies' return to consistent, and indeed record profitability, the private stockholders had reason to believe and expect that the Companies would soon become healthy enough to redeem the Senior Preferred Stock, exit conservatorship, and be

"return[ed] to normal business operations," as FHFA's director had vowed when the conservatorship was established. Certainly, the holders of the Preferred Stock had reason to believe and expect that the economic value of their shares, and the rights they had as stockholders, would likely be increasing. They had no reason to believe those rights would be taken by the Government without just compensation.

56. But, rather than taking steps to enable the Companies to redeem the Senior Preferred Stock or at least to accumulate capital for the benefit of the Companies and their private shareholders, the Government took the unprecedented step of radically changing the deal FHFA and Treasury had originally made so as to seize 100% of all value the Companies could ever generate, and to eliminate any possibility that private shareholders would ever receive anything. On August 17, 2012, FHFA, purportedly acting as Conservator for the Companies, and the Treasury "agreed to" a so-called "Third Amendment" to the PSPAs. This Third Amendment was not really an "agreement" between two different entities negotiating at arm's length, but was instead a unilateral action by two government entities acting in concert. It provides that in place of the 10% coupon due on Treasury's Senior Preferred Stock under the original PSPAs, the Treasury would now receive a dividend equal to ***100% of the Companies' net worth*** (minus a small reserve that shrinks to zero in 2018). And, since the PSPAs provided that in the event of a liquidation of Fannie Mae or Freddie Mac, the Government would receive a liquidation distribution that included the amount of any prior unpaid dividend, the Third Amendment guaranteed that even if the Companies were liquidated, Treasury would receive ***100% of their net worth*** in that liquidation. No matter how much value the Companies generate, the Third Amendment provides that 100% of it has to go to the Treasury.

57. The Third Amendment, which Fannie Mae, Freddie Mac, and the Government implemented without seeking or obtaining the vote or consent of the holders of Preferred Stock as contractually required, sidestepped the rules of priority, eliminated the contractual rights of the Preferred Stockholders, and expropriated for the Government the economic value of these privately-held securities. As Treasury stated on the day of the announcement, the Third Amendment was intended to ensure that "every dollar of earnings that Fannie Mae and Freddie Mac generate will benefit taxpayers" – *i.e.,* not the private preferred stockholders.

58. Neither the Companies nor the stockholders received any meaningful consideration in exchange for the Third Amendment. Under the Third Amendment, the amount of cash the Companies transfer to Treasury as a dividend does not reduce the amount of the Senior Preferred Stock outstanding. Furthermore, the Companies have not been permitted to redeem Treasury's Senior Preferred Stock. Thus, regardless of how much money the Companies send to Treasury, all of the Senior Preferred Stock will remain outstanding, and Treasury will continue to take all of the Companies' net worth. The Third Amendment thus takes tens (if not hundreds) of billions of dollars of value from the Companies' private shareholders and transfers that value to the federal government.

59. The Government implemented the Third Amendment to promote the economic and political interests of one stockholder—the U.S. Treasury—at the expense of all others. The Net Worth Sweep furthered the Government's goal of ensuring that all future profits be transferred to Treasury (sometimes referred to as "taxpayers"), and not to the private stockholders. It also appears that the Third Amendment was designed to support the Treasury's political goal, at least as of 2012, of winding down the Companies (and winding them down in a

way that captured 100% of the surplus value for the Treasury). For instance, in a draft Question and Answer presentation circulated among Treasury officials on August 13, 2012, Treasury stated that the Third Amendment was "consistent with Treasury's policy to wind-down the GSEs," and specifically intended to "ensure that the GSEs will not be able to rebuild capital as they are wound down." (UST00406551; UST00406544.)

60. On August 15, 2012, Treasury officials circulated emails regarding an update to the "PSPA Q&As" in which the sought-after demise of the Companies was discussed. "By taking all of their profits going forward, we are making clear that the GSEs will *not* ever be allowed to return to profitable entities at the center of our housing finance system." (UST00554584; UST00505919) (emphasis in originals).

61. The Government's determination to eradicate private stockholder rights dates back to before 2012, although this was not publicly known. For example, jurisdictional discovery in this case has revealed that as early as December 20, 2010, then Under Secretary for Domestic Finance Jeffrey A. Goldstein authored an "ACTION MEMORANDUM" for Secretary Geithner noting that referred to "the Administration's commitment to ensure existing common equity holders will not have access to any positive earnings from the GSEs in the future." *See* 13-cv-1053 (D.D.C.) ECF No. 23-5 at TREASURY-0202.

62. Similarly, jurisdictional discovery in this case has shown that at least as early as January 2012, FHFA had also determined to "wind down" the Companies, a "goal" FHFA explicitly shared in "common" with Treasury. For example, a document produced in discovery shows that on January 4, 2012 Mary Miller (of Treasury) sent then-FHFA Director DeMarco an Agenda noting the "common goals" shared by FHFA and Treasury to "promote a strong housing market recovery, reduce government involvement in the housing market over

time and to provide the public and financial markets *with a clear plan to wind down the GSEs*" (FHFA00025816) (emphasis added). Subsection 2 of the Agenda was titled "Establish meaningful policies that demonstrate a commitment to winding down the GSEs." *Id.*

63. Discovery has also revealed August 14, 2012 emails between FHFA officials under the subject line "SPSPA Meeting," which acknowledged that the Third Amendment was "designed to demonstrate wind down," notwithstanding that the Companies "were going to be profitable going forward." (FHFA00038592.) On August 17, 2012, FHFA official Mario Ugoletti emailed colleagues, noting that the Third Amendment "does not allow the [Companies] to build up retained surplus, which may give the impression that they are healthy institutions." (FHFA00031721.)

64. At a dividend rate of 10%, Treasury's approximately $189 billion in outstanding Senior Preferred Stock (as of August 16, 2012) would have yielded annual dividends of some $18.9 billion, payable in quarterly installments of approximately $4.7 billion. Thus, ***but for the Third Amendment,*** in any quarter in which the Companies' combined profits exceeded $4.7 billion (or more precisely, any quarter in which Fannie Mae or Freddie Mac's profits exceed the dividend owed on their Senior Preferred Stock), that value would inure to the benefit of the private stockholders. As *Fortune* magazine reported:

> Why did the Treasury enact the so-called Third Amendment that so radically altered the preferred-stock agreement? By mid-2012, Fannie and Freddie were beginning to generate what would become gigantic earnings as the housing market rebounded. If the original agreement remained in place, the GSEs would build far more than $100 billion in retained earnings, and hence fresh capital, in 2013 alone. That would exert pressure for Congress to allow Fannie and Freddie to pay back the government in full, and reemerge as private players. Timothy Geithner was strongly opposed to the rebirth of the old Fannie and Freddie. The "sweep clause" that grabbed the entire windfall in profits was specifically designed to ensure that Fannie and Freddie remained wards of the state that would eventually be liquidated.

What's Behind Perry Capital's Fannie and Freddie Gambit, FORTUNE (July 8, 2013).

65. In an August 17, 2012 press release announcing the Third Amendment, Treasury said that the changes would "help expedite the wind down of Fannie Mae and Freddie Mac, make sure that every dollar of earnings each firm generates is used to benefit taxpayers, and support the continued flow of mortgage credit during a responsible transition to a reformed housing finance market." It called the Third Amendment a full sweep of "**every dollar of profit that [the] firm earns going forward**," and that the amendment will fulfill the "commitment made in the Administration's 2011 White Paper that [Fannie Mae and Freddie Mac] will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form."

66. This language was in stark contrast to the earlier public representations by Treasury and FHFA that they sought only to "stabilize" the Companies and return them "to normal business operations" (as well as Demarco's February 2, 2010 statement that "[t]here are a variety of options available for post-conservatorship outcomes, but the only one that FHFA may implement today under existing laws is to reconstitute the two companies under their current charters.")

67. Winding down the Companies via the Net Worth Sweep offered much higher returns to Treasury than the pre-amendment 10% dividend, an opportunity not lost on Treasury. A "KEY POINTS TO MAKE" document made clear that the Net Worth Sweep "means the taxpayer will benefit from <u>all</u> future earnings of the GSEs. Under the current framework we are limited to the 10% dividend." (UST00061421) (emphasis in original). The document describes taxpayers as being in a "better position" because they are not "capped at the 10% dividend." (UST00061422.) Similarly, an August 13, 2012 email to Bowler (of Treasury)

confirmed that "**[t]he taxpayer will thus ultimately collect more money with the changes**" and "**not just the 10% dividend**." (UST00061143.)

68. Thus, there can be no doubt about the intention behind the Third Amendment and its Net Worth Sweep: it was intended to give Treasury "more money" by ensuring that ***all*** the profits of the Companies would be swept to Treasury, "not just the 10% dividend." Regardless of whether the Companies are actually wound down or not, that is both the clear effect of the Net Worth Sweep and its stated intent. It takes the residual value held by private shareholders and transfers 100% of it to the Treasury.

69. After the Net Worth Sweep was finalized, a senior White House advisor involved in the process wrote that Treasury was "ensuring that [the Companies] can't recapitalize" and "clos[ing] off [the] possibility that [Fannie and Freddie] ever[] go (pretend) private again." The same official wrote in another email that the Net Worth Sweep would ensure that the Companies "can't repay their debt and escape."

70. The Government has received and will continue to receive a massive windfall pursuant to the terms of the Third Amendment. As of the date of this filing, the Treasury has received approximately $125.54 billion ***more*** under the Net Worth Sweep than it would have received under the 10% cash dividend payable under the original terms of the PSPAs. In total, Treasury has received $278.9 billion in dividends from the Companies; that is over $87.5 billion more than Treasury's total investment into both Companies. Yet the principal value of Treasury's Senior Preferred Stock has not been reduced at all, and it continues to receive quarterly dividends equal to the net worth of the two Companies.

71. The Third Amendment has even captured the Companies' recoveries on legal claims that preceded the conservatorships. For example, on October 1, 2013, Freddie Mac

announced that it had entered into a $1.3 billion settlement with three financial institutions concerning Freddie Mac's claims relating to representations and warranties on loans that it had purchased. FHFA, as Freddie Mac's Conservator, had approved the settlement. The claims at issue involved loans that Freddie Mac purchased between 2000 and 2012, most of which preceded the conservatorship by several years, yet none of the funds recouped will go to benefit Freddie Mac stockholders. Rather, Freddie Mac's CEO stated that, "[w]ith these settlements, Freddie Mac is recouping funds effectively due to the nation's taxpayers." On May 28, 2013, FHFA announced a $3.5 billion settlement of claims of alleged violations of federal and state securities laws in connection with private-label residential mortgage-backed securities purchased by Fannie Mae and Freddie Mac in the years prior to the conservatorships. Similarly, on October 25, 2013, FHFA announced a $1.1 billion settlement with JP Morgan relating to claims based on loans sold to Fannie and Freddie in the years leading up to the financial crisis and a separate $4 billion settlement with JP Morgan relating to claims for violations of federal securities laws in connection with the sales and securitizations of loans to the Companies from 2005 to 2007. In 2013 alone FHFA announced similar settlements with General Electric ($549 million), UBS ($885 million), Wells Fargo ($335 million), and Bank of America ($404 million), every penny of which went to Treasury. In 2014, FHFA announced settlements, in its role as Conservator to the Companies, totaling approximately $9.7 billion with Bank of America ($9.33 billion aggregate payment), Barclays Bank PLC ($280 million) and RBS Securities ($99.5 million) which cover private-label MBS purchased by the Companies from 2005 to 2007. More recently, in 2017, FHFA reached a $5.5 billion settlement with the Royal Bank of Scotland. The entirety of the Companies' recoveries in these settlements has been paid to Treasury, even though the claims belonged to the Companies for wrongdoing and harm suffered before the conservatorship.

72. In public statements and filings in this and other related cases, the Government has claimed that the Third Amendment was implemented for the purpose of ending the "circularity" or "downward spiral" caused by the Companies' drawing on Treasury funding to pay dividends to Treasury, which in turn increased Treasury's stake. This is false. When it implemented the Third Amendment, the Government knew the Companies had returned to profitability and were projected to be able to pay the dividends owed to the Treasury without drawing on additional funds long into the future. Indeed, the Government imposed the Net Worth Sweep after the Companies disclosed that they had returned to stable profitability and had earned several billion dollars more than was necessary to pay the Treasury dividend in cash. The real motive behind the Third Amendment was the U.S. Government's desire to cut off the Companies' private shareholders from receiving any money, maximize the amount of money flowing into the U.S. Treasury, and ensure that the Companies be wound down and ultimately eliminated (or at least not permitted to return to private ownership). Again, whether the Government chooses to wind down the Companies or not is a separate question from whether the Government is permitted to appropriate all of the shareholder rights held by private shareholders, and to transfer those rights to the Treasury. There is nothing that permits the Government to do that – at least not without paying just compensation or appropriate damages to the private shareholders.

73. In sum, since the implementation of the Third Amendment, the Government has expropriated "every dollar of earnings that each firm earns" on a quarterly basis, and will continue to do so forever (whether the Companies are wound down or not). This guarantees that there can never be a distribution to the holders of Preferred Stock no matter how much income the Companies earn and no matter how much their assets are worth – whether in

normal operations or in any liquidation. The intent and the effect are clear: private shareholders cannot ever receive a dime; everything goes to Treasury, no matter how many hundreds of billions in profit that means Treasury receives over and above what it has invested and what it would have received under the original PSPAs.

VI. IN DECEMBER 2017, TREASURY AND FHFA AGAIN CONFIRMED THAT THE NET WORTH SWEEP ENSURES THAT 100% OF ALL VALUE IN THE COMPANIES MUST GO TO TREASURY, NO MATTER HOW LARGE THAT VALUE MAY BE.

74. Under the original PSPA, the Net Worth Sweep required the entire net worth of the Companies to be paid to Treasury, minus a small reserve that would shrink gradually to zero by January 1, 2018. The intent was obvious: the Companies were to be wound down, and Treasury was to capture 100% of all the value.

75. By December 2017, however, Treasury and FHFA apparently concluded they were not ready to liquidate the Companies just yet, or to operate them with literally zero capital. Accordingly, in December 2017, Treasury and FHFA agreed to prolong the existence of a $3 billion capital reserve while the Companies were in operation, so that the quarterly dividend is equal to the "Net Worth Amount" minus that $3 billion reserve. Letter to M. Watt (Dec. 21, 2017) (*available at* goo.gl/hnPmKL).

76. However, Treasury and FHFA also made sure that this capital reserve did not create any possible risk of any amount ever being available for distribution to private shareholders. They expressly agreed that "the Liquidation Preference [*i.e.*, the Liquidation Preference held by Treasury] shall be increased by $3,000,000,000.00." *Id.* Thus, even the capital reserve has to be paid out to Treasury. No matter what happens—no matter how much money or positive net value Fannie and Freddie make—there is ***zero chance*** that private shareholders can ever receive anything in a liquidation.

VII. THE GOVERNMENT HAS TAKEN PLAINTIFFS' PROPERTY WITHOUT PROVIDING JUST COMPENSATION.

77. Prior to the imposition of the Net Worth Sweep, Plaintiffs had valuable vested property rights in their shares of Fannie Mae and Freddie Mac Preferred Stock, including the right to participate in the profits and increased net worth of Fannie and Freddie (whether through dividends, redemptions, liquidation or otherwise) to the extent those profits and increased net worth exceeded the amounts needed to fully satisfy all obligations on the Senior Preferred Stock issued to Treasury in 2008. The economic rights owned by the holders of Preferred Stock vested in their respective holders upon the holders' acquisition of shares of Preferred Stock.

78. The rights associated with the Preferred Stock were an essential part of those stocks, and Plaintiffs invested in these stocks based upon the economic value of those rights.

79. The economic rights owned by Plaintiffs constitute private property protected by the Fifth Amendment of the United States Constitution.

80. At all times prior to the imposition of the Net Worth Sweep – including after the enactment of HERA, imposition of the conservatorship, and execution of the PSPAs – Plaintiffs had a reasonable, investment-backed expectation that their property would not be appropriated by the Government without payment of just compensation.

81. Like investors in many publicly traded corporations and financial institutions, Plaintiffs' property rights were not unlimited. Like many Preferred Shareholders, Plaintiffs' right to receive dividends was, in part, subject to the discretion of the Companies' boards, and Plaintiffs' right to receive liquidation payments was conditional on the companies being in liquidation and there being enough assets to pay out to more senior creditors (if any).

And, like investors in every U.S. financial institution, the Plaintiffs' investments in the Companies was subject to the possibility that the Companies could be placed into conservatorship or receivership or bankruptcy in appropriate circumstances. Plaintiffs' economic rights were nevertheless vested and valuable property protected by the Fifth Amendment.

82. Simply because a dividend right may be subject to the discretion of a board of directors or majority shareholder does not render it valueless. A contrary view would mean the Government could appropriate all the dividend rights of every share of stock in the country without paying just compensation. Likewise, simply because the right to a distribution in liquidation depends on certain contingencies does not render it valueless. A contrary view would mean the Government could appropriate all liquidation rights of every shareholder in the country without paying just compensation. Further, when both dividend rights and liquidation rights are appropriated, and when a company is forced to pay 100% of its net worth to the majority shareholder (thereby eliminating the possibility of redemption rights as well), then the economic rights of otherwise valuable stock has been fully eliminated. That is what the Third Amendment does without providing any just compensation in return. There is no precedent for the Government being able to do this to the shareholders of any kind of institution under any circumstances.

83. No holder of Preferred Stock could have reasonably foreseen that the Government would effectively confiscate their shares by implementing the Net Worth Sweep. The Net Worth Sweep was unprecedented and contrary to the Governments' public statements that the Companies would be returned to shareholders. Never before in the history of the nation has the Government caused the *de facto* nationalization of a private corporation under the guise

of a "conservatorship" by a federal agency and an "investment" by the Treasury. Prior to the Net Worth Sweep, such an action would have been unthinkable.

84. Further, prior to the imposition of the Net Worth Sweep, Plaintiffs had a reasonable expectation that the Companies would be operated at a profit for the benefit of *all* stockholders and that the Companies would exercise their discretion to pay dividends in good faith. As described herein, such expectations were based upon numerous things including, at a minimum, the historical treatment of shareholders in all companies, including distressed companies and distressed financial institutions placed in federal conservatorship or receivership; the historical payment of dividends by the Companies; the Certificates of Designation; the provisions of HERA providing for the purposes of conservatorships in restoring the Companies to sound operating condition, and even providing for shareholders to retain their residual ownership rights even in a receivership and liquidation (which was never announced here); and the repeated public statements from the Government that the Companies, once stabilized, would be returned to normal operation and to the control and benefit of private shareholders.

85. The Government's imposition of the Net Worth Sweep categorically deprived Plaintiffs of all economic value in their economic rights as shareholders, including rights to dividends, redemptions, or liquidation distributions, and thereby appropriated their property without payment of just compensation.

86. Under the Net Worth Sweep, the Companies are no longer operated at a profit for the benefit of all stockholders, but are instead operated for the sole and exclusive benefit of Treasury. The Net Worth Sweep has made it impossible for Plaintiffs ever to receive dividends or their respective liquidation preferences, or any portion thereof, because the Net Worth Sweep has the purpose and effect of ensuring that Fannie Mae and Freddie Mac will never

have any funds available to pay a dividend on the Preferred Stock, to redeem the Government's Senior Preferred Stock (or any privately held stock), or to pay any liquidation proceeds to the holders of Preferred Stock. Thus, Fannie and Freddie will never have any funds available to distribute to the private holders of the Preferred Stock, whether as dividends, redemptions, or liquidation proceeds. The Net Worth Sweep permanently deprives Plaintiffs of their right to receive either dividends or their respective liquidation distributions upon liquidation of Fannie Mae and Freddie Mac *no matter how much net worth* Fannie Mae and Freddie Mac accumulate, or would have accumulated but for the Net Worth Sweep.

87. The Government's imposition of the Net Worth Sweep has categorically rendered Plaintiff's and the Class' economic rights a nullity and completely eradicated the value of those rights. As described above, Treasury has to date received $87.5 billion more than its total investment in the Companies and $125.54 billion more than it would have received under the 10% dividend provided for in the original Agreements. But for the Net Worth Sweep, the Companies would have been in a position to pay billions of dollars in profits to the private holders of Preferred Stock.

88. Although the Government plainly has many other means of raising revenue and supporting the economic recovery that would not appropriate the economic value of the Preferred Stock, the Net Worth Sweep has become a major source of revenue for the Government at the expense of Plaintiffs.

89. While the Government has collected, and will continue to collect billions of dollars from Fannie Mae and Freddie Mac, Plaintiffs have not been provided just compensation, nor any compensation, for the Government's taking of all of the economic rights that they previously owned by virtue of their ownership of Preferred Stock.

VIII. THE GOVERNMENT ALSO HAS TAKEN PLAINTIFFS' RIGHT TO BRING CERTAIN CAUSES OF ACTION CHALLENGING THE THIRD AMENDMENT WITHOUT PROVIDING JUST COMPENSATION.

90. The Supreme Court has recognized that a cause of action is a species of property protected by the Due Process Clause. *E.g.*, *Richards v. Jefferson Cty., Ala.*, 517 U.S. 793, 804 (1996). The Court has also suggested that a cause of action is property for purposes of the Takings Clause. *E.g.*, *Dames & Moore v. Regan*, 453 U.S. 654, 691 (1981) (Powell, J., concurring). The Federal Circuit has held unequivocally that a cause of action constitutes a property right protected by the Takings Clause. *Adams v. United States*, 391 F.3d 1212, 1225-1226 (Fed. Cir. 2004); *Abrahim-Youri v. United States*, 139 F.3d 1462 (Fed. Cir. 1997); *All. of Descendants of Tex. Land Grants v. United States*, 37 F.3d 1478, 1481 (Fed. Cir. 1994).

91. In the District Court for the District of Columbia, the Plaintiffs in this action filed various direct claims seeking to enjoin the Third Amendment, as well as derivative claims on behalf of Fannie and Freddie challenging the Third Amendment. In its July 2017 opinion, the D.C. Circuit ruled that Plaintiffs' claims seeking injunctive relief were barred by HERA, and the right to pursue derivative claims had been taken from the Companies' private shareholders by FHFA. *Perry Capital LLC v. Mnuchin,* 864 F.3d 591, 617-34 (D.C. Cir. 2017). Plaintiffs petitioned the Supreme Court for review of the latter holding, which conflicts with (*inter alia*) the Federal Circuit's interpretation of a nearly identical provision. *See First Hartford Corp. Pension Plan & Tr. v. United States*, 194 F.3d 1279 (Fed. Cir. 1999). The Supreme Court denied the petition on February 20, 2018.

92. Plaintiffs continue to take the position that the Federal Circuit's decision in *First Hartford* was correct, and therefore HERA cannot be read as taking from the Companies' shareholders the right to bring derivative claims on behalf of the Companies where those claims are against the FHFA or Treasury, given the "manifest conflict of interest"

preventing FHFA from ever bringing such claims. There are companion cases in this Court advancing such derivative claims. However, to the extent that any courts continue to hold that such derivative claims are not possible and thereby block the shareholders in Fannie and Freddie from obtaining a full and just recovery for the loss of their shareholder rights, we assert that such an interpretation of HERA, as applied to the facts of these cases and the Third Amendment, is itself a Taking without just compensation. We do not challenge the succession provision in HERA as a Taking on its face, and we do not claim that the conservatorship was a Taking. But the Third Amendment was a Taking and a nullification of Plaintiffs' shareholder rights, and the application of any HERA provision that prevents Plaintiffs from obtaining full relief from the Third Amendment is a Taking without payment of just compensation. This claim is advanced if and to the extent that Takings claim (or other claims) fail to provide the full just compensation to which Plaintiffs are entitled due to the application of any HERA provision to the cases that challenge the Third Amendment.

IX. THE GOVERNMENT ILLEGALLY EXACTED PLAINTIFFS' PROPERTY.

93. In the alternative to Plaintiffs' Takings Claims, the Third Amendment constitutes an Illegal Exaction of Plaintiffs' property in violation of the Fifth Amendment.

94. Under the Third Amendment, the Government took money from Plaintiffs by extracting the entire net worth of the Companies as a dividend on an ongoing and permanent basis, thereby assuring that Plaintiffs would not receive any future value from their investments in the company in the form of dividends or liquidation payments or in any other manner.

95. The Third Amendment was not authorized by statute. HERA directs that the FHFA, when acting as conservator, "may take such action as may be – (i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."

12 U.S.C. § 4617(b)(2)(D). As FHFA has recognized in numerous statements, this is a binding and mandatory obligation that limits the scope of FHFA's authority when it acts as a conservator:

- Section 4617(b)(2)(D) is one of FHFA's "statutory ***mandates***," and "FHFA, acting as conservator . . . , must follow the mandates assigned to it by statute." FHFA STRATEGIC PLAN: FISCAL YEARS 2018-2022 4 (Sept. 27, 2017) (emphasis added), https://goo.gl/P7w6mP;

- FHFA has "statutory ***obligations*** to operate the [Companies] in a safe and sound manner." Prepared Remarks of Melvin L. Watt, Dir., FHFA, at American Mortgage Conference (May 18, 2017) (emphasis added), https://goo.gl/ZPGBYA;

- FHFA's "statutory ***mandates*** obligate" it to "[c]onserve and preserve the assets of the Enterprises while they are in conservatorship." Statement of Melvin L. Watt, Dir., FHFA, Before the U.S. Senate Comm. on Banking, Housing, and Urban Affairs (May 11, 2017) (emphasis added), https://goo.gl/h44qRf;

- "FHFA, acting as conservator and regulator, ***must follow the mandates*** assigned to it by statute. . . . FHFA's authority as both conservator and regulator of the Enterprises is based upon ***statutory mandates*** enacted by Congress to ensure a liquid, efficient, competitive, and resilient national housing finance market, ensure safe and sound Enterprise operations, as well as to preserve and conserve their assets." FHFA STRATEGIC PLAN: FISCAL YEARS 2015-2019 5, 14 (Aug. 15, 2014) (emphasis added), https://goo.gl/5BCKem;

- FHFA has a "conservatorship ***mandate*** to preserve and conserve the [Companies'] assets." Statement of Edward J. DeMarco, Acting Dir., FHFA, Before the U.S. Senate Comm. on Banking, Housing and Urban Affairs at 3 (Apr. 18, 2013) (emphasis added), https://goo.gl/ZrHAUF;

- As conservator, FHFA has a " 'preserve and conserve' ***mandate***." FHFA, A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS: THE NEXT CHAPTER IN A STORY THAT NEEDS AN ENDING 7 (Feb. 21, 2012) (emphasis added), https://goo.gl/XwZxT7;

- "[T]he Conservator's ***mandate*** [is] to put the regulated entity in a sound and solvent condition and to preserve and conserve the assets and property of the regulated entity." Conservatorship and Receivership, 75 Fed. Reg. 39,462, 39,469 (July 9, 2010) (emphasis added);

- "The statutory role of FHFA as conservator ***requires*** FHFA to take actions to preserve and conserve the assets of the Enterprises and restore them to safety and soundness." FHFA, REPORT TO CONGRESS 2009 at 99 (May 25, 2010) (emphasis added), https://goo.gl/5BK9kH.

96. HERA also limits the scope of FHFA's powers as conservator by distinguishing between the powers granted to FHFA when it acts in that role and when it acts as a receiver. Specifically, HERA directs that when FHFA acts as a receiver, it must "place the regulated entity in liquidation and proceed to realize upon the assets of the regulated entity," and then distribute the proceeds to various stakeholders (including shareholders) according to a carefully-defined distribution schedule and pursuant to delineated statutory procedures. 12 U.S.C. §§ 4617(b)(2)(E), (b)(3)-(9), (c). Under HERA – as under common law – receivership is aimed at winding down a company's affairs and liquidating its assets, while conservatorship aims to rehabilitate the company and return it to normal operation.

97. By giving away all of the Companies' net assets to the Treasury, the Third Amendment does not "preserve" or "conserve" those assets or move the companies toward a "sound and solvent condition." The Government has admitted that the Third Amendment rendered the Companies "effectively balance-sheet insolvent, a textbook illustration of financial instability." Further, as alleged above, the Government implemented the Third Amendment for the purpose of "winding down" the companies, to prevent them from ever accruing capital, and to ensure that they could not "escape" Government control or return to functioning as private entities. Each of these goals are fundamentally incompatible with HERA's statutory mandate that FHFA act as conservator to preserve and conserve the Companies' assets and demonstrates that the Third Amendment was an unlawful end run around HERA's careful delineation between the roles of conservatorship and receivership.

98. The Third Amendment also violates HERA for several additional reasons. HERA grants FHFA the authority to "disaffirm or repudiate any contract" the Companies entered into prior to conservatorship when "the conservator determines" the "performance" of

such contracts "to be burdensome" to the Companies. But such repudiation must occur "within a reasonable period following" FHFA's appointment as conservator. 12 U.S.C. § 4617(d)(1) & (2).

99. The FHFA failed to repudiate the shareholder contracts (Certificates of Designation) held by Plaintiffs and other Preferred Shareholders "within a reasonable period" following the September 6, 2008 appointment of FHFA as conservator. Instead, the FHFA effected this repudiation only in August 2012 – four years after its appointment as conservator – by entering into the Third Amendment. That amendment fully repudiates and nullifies Plaintiffs' contract rights to dividends, liquidation distributions, and voting rights, but did so ***long after*** the expiration of the "reasonable" period in which the FHFA had statutory authority to do so. It was unlawful for this additional reason.

100. Finally, HERA granted Treasury the authority to purchase securities issued by the Companies, but dictated that this authority expired on December 31, 2009. 12 U.S.C. §§ 1455(l), 1719(g). In a recent filing in a related action, FHFA has characterized the Third Amendment as accomplishing "exactly the same thing" as a new issuance. Because the Third Amendment was implemented long after the expiration of Treasury's authority to purchase new shares, FHFA's characterization of the Third Amendment as "exactly the same" as the issuance of new securities would establish, if accepted, an additional basis for holding the Third Amendment to be unlawful.

101. The government appropriated Plaintiffs' valuable property and contract rights and has the Plaintiffs' money in its pocket. Because the Third Amendment was unlawful under HERA for the numerous reasons set forth above, it constitutes an Illegal Exaction.

X. THE THIRD AMENDMENT VIOLATED THE CONTRACTUAL RIGHTS OF HOLDERS OF THE COMPANIES' PREFERRED STOCK.

102. Prior to September 6, 2008, Fannie Mae had issued several series of Preferred Stock, including:

FANNIE MAE PREFERRED STOCK

Security	CUSIP	Ticker Symbol
5.25% Non-Cumulative Preferred Stock, Series D	313 586 505	FDDXD
5.10% Non-Cumulative Preferred Stock, Series E	313 586 604	FNMFM
Variable Rate Non-Cumulative Preferred Stock, Series F	313 586 703	FNMAP
Variable Rate Non-Cumulative Preferred Stock, Series G	313 586 802	FNMAO
5.81% Non-Cumulative Preferred Stock, Series H	313 586 885	FNMAM
5.375% Non-Cumulative Preferred Stock, Series I	313 586 877	FNMAG
5.125% Non-Cumulative Preferred Stock, Series L	313 586 844	FNMAN
4.75% Non-Cumulative Preferred Stock, Series M	313 586 836	FNMAL
5.50% Non-Cumulative Preferred Stock, Series N	313 586 828	FNMAK
Variable Rate Non-Cumulative Preferred Stock, Series O	313 586 794	FNMFN
5.375% Non-Cumulative Convertible Series 2004-1 Pref. Stock	313 586 810	FNMFO
Variable Rate Non-Cumulative Preferred Stock, Series P	313 586 786	FNMAH
6.75% Non-Cumulative Preferred Stock, Series Q	313 586 778	FNMAI
7.625% Non-Cumulative Preferred Stock, Series R	313 586 760	FNMAJ
Fixed-to-Floating Rate Non-Cumulative Preferred Stock, Series S	313 586 752	FNMAS
8.25% Non-Cumulative Preferred Stock, Series T	313 586 737	FNMAT

103. Likewise, prior to September 6, 2008, Freddie Mac had issued several series of Preferred Stock, including:

FREDDIE MAC PREFERRED STOCK

Security	CUSIP	Ticker Symbol
5.1% Preferred Stock, due 12/31/2049	313 400 814	FREJO
5.3% Non-Cumulative Perpetual Preferred Stock	313 400 822	FREJP
5.81% Perpetual Preferred Stock	313 400 889	FREGP
Variable-Rate Preferred Stock, Series B	313 400 608	FMCCI
5% Preferred Stock, Series F	313 400 863	FMCKK
Variable-Rate Preferred Stock, Series G	313 400 848	FMCCG
5.1% Preferred Stock, Series H	313 400 855	FMCCH
5.79% Preferred Stock, Series K	313 400 830	FMCCK
Variable-Rate Preferred Stock, Series L	313 400 798	FMCCL
Variable-Rate Preferred Stock, Series M	313 400 780	FMCCM
Variable-Rate Preferred Stock, Series N	313 400 764	FMCCN
5.81% Preferred Stock, Series O	313 400 772	FMCCO
6% Preferred Stock, Series P	313 400 749	FMCCP
Variable-Rate, Series Q	313 400 756	FMCCJ
5.7% Preferred Stock, Series R	313 400 731	FMCKP
Variable-Rate, Series S	313 400 715	FMCCS

104. The Preferred Stock listed above, which was issued prior to the issuance of the Senior Preferred Stock, is held by private investors such as pension funds, community banks, insurance companies, and individual investors. As of March 31, 2013, the Companies' outstanding Preferred Stock had an aggregate face amount and liquidation preference of over $33 billion. Each series of Preferred Stock has its own contractual dividend rate and liquidation value.

105. Prior to September 8, 2008, each series of Fannie Mae Preferred Stock ranked on a parity with all other issued and outstanding series of Fannie Mae Preferred Stock as to the payment of dividends and the distribution of assets upon dissolution, liquidation, or winding up of Fannie Mae. Likewise, each series of Freddie Mac Preferred Stock ranked on a parity with all other issued and outstanding series of Freddie Mac Preferred Stock as to the payment of dividends and the distribution of assets upon dissolution, liquidation, or winding up of Freddie Mac. In other words, each series of Fannie Mae and Freddie Mac Preferred Stock carried equal contractual rights with regards to the priority of payment of dividends, and each series of Fannie Mae and Freddie Mac Preferred Stock carried equal liquidation preferences (or their respective pro rata portions thereof) upon dissolution, liquidation, or winding up of Fannie Mae and Freddie Mac. Prior to September 6, 2008, Fannie Mae and Freddie Mac each regularly declared and paid dividends on each series of their respective Preferred Stock.

106. Delaware law applies to Fannie Mae pursuant to Section 1.05 of its bylaws, which provides that "the corporation has elected to follow the applicable corporate governance practices and procedures of the Delaware General Corporation Law." Virginia law applies to Freddie Mac pursuant to Section 11.3 of its bylaws, which provides that, "[T]he Corporation shall follow the corporate governance practices and procedures of the law of the

Commonwealth of Virginia[.]" Under both Delaware and Virginia law, certificates of designation are deemed to be contractual agreements between the stockholders and the company.

107. Thus, the Certificate of Designation for each series of Preferred Stock constitutes a contract with provisions governing the holders' dividend, liquidation, and voting rights. These provisions are materially similar to, for example, the Certificate of Designation for Fannie Mae's Series T Preferred Stock, as described below:

> **1. Dividends.**
>
> (a) Holders of record of Series T Preferred Stock (each individually a "Holder," or collectively the "Holders") will be entitled to receive, ratably, when, as and if declared by the Board of Directors, in its sole discretion out of funds legally available therefore, non-cumulative cash dividends at [specified rate] per annum of the [specified] stated value . . . of Series T Preferred Stock.
>
> * * *
>
> 4. Liquidation Rights.
>
> (a) Upon any voluntary or involuntary dissolution, liquidation or winding up of Fannie Mae, after payment or provision for the liabilities of Fannie Mae and the expenses of such dissolution, liquidation or winding up, the Holders of outstanding shares of the Series T Preferred Stock will be entitled to receive out of the assets of Fannie Mae or proceeds thereof available for distribution to stockholders, before any payment or distribution of assets is made to holders of Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, junior to the Series T Preferred Stock), the amount of [the stated value] per share plus an amount . . . equal to the dividend (whether or not declared) for the then-current quarterly Dividend Period accrued to but excluding the date of such liquidation payment, but without accumulation of unpaid dividends on the Series T Preferred Stock for prior Dividend Periods.
>
> (b) If the assets of Fannie Mae available for distribution in such event are insufficient to pay in full the aggregate amount payable to Holders of Series T Preferred Stock and holders of all other classes or series of stock of Fannie Mae, if any, ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, on a parity with the Series T Preferred Stock, the assets will be distributed to the Holders of Series T Preferred Stock and holders of all such other stock pro rata, based

on the full respective preferential amounts to which they are entitled (but without, in the case of any non-cumulative preferred stock, accumulation of unpaid dividends for prior Dividend Periods).

* * *

7. Voting Rights; Amendments.

* * *

(b) Without the consent of the Holders of Series T Preferred Stock, Fannie Mae will have the right to amend, alter, supplement or repeal any terms of this Certificate or the Series T Preferred Stock (1) to cure any ambiguity, or to cure, correct or supplement any provision contained in this Certificate of Designation that may be defective or inconsistent with any other provision herein or (2) to make any other provision with respect to matters or questions arising with respect to the Series T Preferred Stock that is not inconsistent with the provisions of this Certificate of Designation so long as such action does not materially and adversely affect the interests of the Holders of Series T Preferred Stock; provided, however, that any increase in the amount of authorized or issued Series T Preferred Stock or the creation and issuance, or an increase in the authorized or issued amount, of any other class or series of stock of Fannie Mae, whether ranking prior to, on a parity with or junior to the Series T Preferred Stock, as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, or otherwise, will not be deemed to materially and adversely affect the interests of the Holders of Series T Preferred Stock.

(c) Except as set forth in paragraph (b) of this Section 7, the terms of this Certificate or the Series T Preferred Stock may be amended, altered, supplemented, or repealed only with the consent of the Holders of at least two- thirds of the shares of Series T Preferred Stock then outstanding, given in person or by proxy, either in writing or at a meeting of stockholders at which the Holders of Series T Preferred Stock shall vote separately as a class. On matters requiring their consent, Holders of Series T Preferred Stock will be entitled to one vote per share.

108. Thus, the Plaintiffs had contractual rights to dividends, liquidation distributions and voting rights, as well as a right to exclude the Companies and a federal agency acting on their behalf from repudiating these rights. Plaintiffs paid valuable consideration in exchange for these contractual rights, and in doing so helped provide financial support for Fannie

Mae and Freddie Mac's business—financial support that existed both before and after the imposition of the conservatorship.

109. The Government neither sought nor obtained the permission of the Companies' stockholders before entering into the Third Amendment. There can be no doubt that the Third Amendment made "materially adverse" changes to rights of the stockholders, such that it violated Plaintiffs' contractual rights. The Certificates of Designation prohibited any such material adverse change to the rights of Plaintiffs and their fellow shareholders absent a shareholder vote approving the change, with the sole exception to that requirement of a vote being if the Companies issued a new series of stock. In executing the Third Amendment, FHFA, Fannie Mae, and Freddie Mac have *not* purported to issue a new series of stock. Indeed, in prior litigation, FHFA and Treasury have vigorously disputed that the Third Amendment was an issuance of stock, since such an issuance would have been illegal because Treasury's authority to acquire securities in the Companies expired at the end of 2009. 12 U.S.C. §§ 1455(l)(4), 1719(g)(4). Moreover, FHFA and Treasury previously *won* the argument that the Third Amendment was not the issuance of new securities. *Perry Capital LLC v. Lew,* 70 F. Supp. 3d 208, 224 (D.D.C. 2014) ("Treasury did *not* purchase new securities under the Third Amendment.") (emphasis added). FHFA and Treasury should not now be allowed to have it both ways. The Third Amendment was not the issuance of new securities. It was instead a gross violation of the rights of other shareholders that was as "materially adverse" to private Preferred Shareholders as anything could be, and was never approved by any shareholder vote. It thereby violated Plaintiffs' contractual rights under their Certificates of Designation (*i.e.*, shareholder contracts).

110. Through the Third Amendment, the Government breached and repudiated these contracts by eliminating the stockholders' contractual rights to receive dividends and to receive a pro rata distribution of any liquidation proceeds available after the Government received full recovery of the face amount of its Senior Preferred Stock. Thus, the Third Amendment amended, altered, and repealed the terms of the Certificates of Designation (*e.g.*, the contractual terms governing the holders' rights to receive liquidation distributions) in a manner that materially and adversely affected—indeed, completely destroyed—the rights and interests of the private preferred stockholders.

111. Fannie Mae's and Freddie Mac's agreement to the Third Amendment did not purport to create and issue any other class or series of Fannie Mae or Freddie Mac stock, nor did it purport to be an increase in the authorized or issued amount of any other class or series of Fannie Mae or Freddie Mac stock. Rather, the Third Amendment that the Government imposed in August 2012 was described simply as an amendment to the terms of the Senior Preferred Stock that Fannie Mae and Freddie Mac had issued to Treasury in September 2008. Accordingly, the amendment, alteration, and repeal of the terms of the Certificates via their agreement to the Third Amendment was not exempt from the two-thirds vote requirement set forth in the Certificates.

112. In addition to their explicit terms, inherent in the Certificates was an implied covenant by Fannie Mae and Freddie Mac, and FHFA (as their conservator) to deal fairly with the stockholders and to fulfill the issuers' contractual obligations in good faith. This covenant required FHFA not to take actions that would violate the stockholders' reasonable expectations regarding their dividend and liquidation rights.

113. Plaintiffs had a reasonable expectation that the Companies and FHFA (as their conservator) would not completely nullify their contractual dividend and liquidation rights in exchange for no meaningful consideration from Treasury. Plaintiffs also had reasonable expectations that the Companies and FHFA (as their conservator) would not exercise their discretion regarding dividends and liquidation preference in bad faith with the purpose of harming the Shareholders. And Plaintiffs had a reasonable expectation that the Companies would be operated at a profit for the benefit of *all* stockholders; that the Companies would exercise their discretion to pay dividends in good faith; that the Companies would not self-liquidate to avoid and eliminate stockholders' liquidation rights; and that even if the Companies were liquidated (or put on a path to liquidation), the private shareholders would receive their pro rata distributions in accordance with the established priority scheme, without the Treasury being given 100% of all surplus value no matter how large.

114. By executing the Third Amendment, the Government has violated the reasonable expectations of Plaintiffs and other class members regarding the fruits of their agreements with Fannie Mae and Freddie Mac. Under the Third Amendment, Plaintiffs and class members are absolutely and forever precluded from ever being eligible to receive a dividend, liquidation distribution, or any value from these contractual rights. Similarly, under the Third Amendment, the companies are no longer operated at a profit for the benefit of all stockholders, but rather are operated for the sole and exclusive benefit of a single controlling stockholder: the U.S. Treasury. Further, under the Third Amendment, the Government has ensured that the Companies are not exercising their discretion to pay dividends in good faith with regard to all stockholders, but rather are continuously paying enormous dividends only to a single, controlling stockholder: the U.S. Treasury. And, under the Third Amendment, the

Government has required the Companies to pay all of their Net Worth each quarter to the U.S. Treasury without diminishing Treasury's outstanding liquidation preference. Further, the Net Worth Sweep (and the recent December 2017 amendment) absolutely guarantee than in a liquidation it is impossible for any private shareholder to ever receive anything, no matter how much surplus value exists in that liquidation, because 100% of the net worth must be paid to Treasury. Accordingly, by executing the Third Amendment, the Government has not only breached the express terms of the Plaintiffs' shareholder contracts, but has also acted unfairly and in bad faith with respect to the stockholders and breached the implied covenant of good faith and fair dealing.

XI. CLASS ACTION ALLEGATIONS.

115. Plaintiffs bring this action on behalf of themselves and as a class action pursuant to the Court of Federal Claims' Rule of Civil Procedure 23on behalf of: a class consisting of all persons and entities who held shares of any series of Fannie Mae Preferred Stock on August 17, 2012 and who were damaged thereby, and their successors in interest (meaning current shareholders) (the "Fannie Preferred Class"); and a class consisting of all persons and entities who held shares of any series of Freddie Mac Preferred Stock on August 17, 2012 and who were damaged thereby, and their successors in interest (meaning current shareholders) (the "Freddie Preferred Class"). Excluded from both classes are the Defendants.

116. The members of the Classes are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown to Plaintiffs at this time and can only be ascertained through appropriate discovery, Plaintiffs believe that there are at least thousands of members in the proposed Classes. As of August 17, 2012, and the date of the filing of this action, there were hundreds of millions of shares of Fannie Mae and Freddie Mac Preferred Stock outstanding. As of December 31, 2017, there were 556 million shares of Fannie

Mae Preferred Stock outstanding. As of December 31, 2017, there were 464 million shares of Freddie Mac Preferred Stock outstanding. Record owners and other members of the Classes may be identified from records maintained by Fannie Mae and Freddie Mac and/or their transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

117. Plaintiffs' claims are typical of the claims of the other members of the Classes, as all members of the Classes were similarly affected by Defendants' wrongful conduct that is complained of herein.

118. Plaintiffs will fairly and adequately protect the interests of the members of the Classes, and have retained counsel competent and experienced in class action, derivative, securities, and constitutional litigation. Plaintiffs have no interests that are adverse or antagonistic to the Classes.

119. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Because the damages suffered by individual members of the Classes may be relatively small, the expense and burden of individual litigation make it impracticable for Class members individually to seek redress for the wrongful conduct alleged herein.

120. Common questions of law and fact exist as to all members of the Classes and predominate over any questions solely affecting individual members of the Classes. Among the questions of law and fact common to the Classes are:

(a) Whether Defendant took Plaintiffs' property without just compensation;

(b) Whether Defendant illegally exacted Plaintiffs' property;

(c) Whether Defendant breached the terms of the Certificates for the Fannie Preferred Stock, the Freddie Preferred Stock, and/or the implied covenant of good faith and fair dealing inherent in those Certificates;

(d) Whether Defendant breached its fiduciary duties;

(e) Whether Defendant is liable for just compensation or damages to the members of the Classes, and the proper measure thereof, for taking, illegal exaction, breach of contract, breach of the implied covenant of good faith and fair dealing, and/or breach of fiduciary duties.

121. The prosecution of separate actions by individual Class members would create the risk of inconsistent or varying adjudications with respect to the individual Class members, or adjudications with respect to individual Class members that would, as a practical matter, be dispositive of the interests of the other members not parties to the adjudications or substantially impair their ability to protect their interests.

122. Defendant has acted on grounds generally applicable to the Classes with respect to the matters complained of herein, thereby making appropriate the relief sought herein with respect to the Classes as a whole.

COUNT I

TAKING WITHOUT JUST COMPENSATION

123. Plaintiffs incorporate by reference and reallege each and every allegation contained in the preceding paragraphs, as though fully set forth herein.

124. The Fifth Amendment provides that no person shall "be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

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125. As holders of Preferred Stock, Plaintiffs owned fully vested property rights in the form of the rights to receive dividends, liquidation proceeds, or other distributions in accordance with the terms of their Preferred Stock. These property rights included a claim on the companies' equity that could be paid out in the form of dividends or liquidation payment. They also included a right to protect those economic rights through voting rights that would prevent a material adverse change to their property rights.

126. These property rights survived the events of 2008, including the enactment of HERA, the imposition of conservatorships over the Companies, and the issuance of Senior Preferred Stock to the U.S. Treasury pursuant to the PSPA.

127. At all relevant times up to the imposition of the Third Amendment, Plaintiffs had a reasonable, investment-backed expectation that their property rights would be preserved and would not be taken by the Government without just compensation.

128. By imposing the Net Worth Sweep, the Government took Plaintiffs' vested property rights without just compensation. The Net Worth Sweep expropriated Plaintiffs' property interests, destroyed Plaintiffs' investment-backed expectations, and deprived Plaintiffs of all economically beneficial uses of their Preferred Stock.

129. The Net Worth Sweep was implemented by two federal agencies – the FHFA and the U.S. Treasury – to advance the economic and political interests of the U.S. Government. The U.S. Government (including FHFA and Treasury) provided no compensation whatsoever, let alone just compensation, to Plaintiffs and other private holders of Preferred Stock for the expropriation of their property rights.

130. Plaintiffs are entitled to just compensation for the Government's taking of their property.

131. Plaintiffs suffered harm as a direct and proximate result of the foregoing unconstitutional taking. Plaintiffs' injuries are direct and independent of any injury to the Companies and any recovery for this Taking claim would benefit the stockholders directly, and not the Companies.

COUNT II

TAKING WITHOUT JUST COMPENSATION (CAUSES OF ACTION)

132. Plaintiffs incorporate by reference and reallege each and every allegation contained in the preceding paragraphs, as though fully set forth herein.

133. The Fifth Amendment provides that no person shall "be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

134. As holders of Preferred Stock, Plaintiffs had the right to protect their investment by filing certain causes of action, including derivative lawsuits and claims seeking injunctive and declaratory relief.

135. These causes of action constitute property rights protected by the Fifth Amendment.

136. After the Government imposed the Third Amendment, Plaintiffs filed direct claims seeking to enjoin the Third Amendment, as well as derivative claims on behalf of the Companies challenging the Third Amendment. The D.C. Circuit has ruled that these derivative claims, which accrued to Plaintiffs on August 17, 2012 – the date of the Third Amendment – were taken away from Plaintiffs by the Government. That D.C. Circuit decision conflicts with a decision of the Federal Circuit in *First Hartford Corp. Pension Plan & Tr. v. United States*, 194 F.3d 1279 (Fed. Cir. 1999). The D.C. Circuit also ruled that all of Plaintiffs' claims for injunctive relief were barred by HERA.

137. To the extent Plaintiffs are prevented from receiving a full remedy for the harm caused by the Third Amendment by virtue of any court's holding that certain HERA provisions block legal actions needed to fully remedy the harm caused by the Third Amendment, the application of those provisions to the Plaintiffs' challenges to the Third Amendment constitute a taking of private property without payment of just compensation.

138. Plaintiffs suffered harm as a direct and proximate result of the foregoing unconstitutional taking. Plaintiffs' injuries are direct and independent of any injury to the Companies and any recovery for this Taking claim would benefit the stockholders directly, and not the Companies.

COUNT III

ILLEGAL EXACTION

139. Plaintiffs incorporate by reference and reallege each and every allegation contained in the preceding paragraphs, as though fully set forth herein.

140. The Fifth Amendment provides that no person shall "be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

141. As holders of Preferred Stock, Plaintiffs had vested property rights to participate in the Companies' income stream and share their residual value. These property rights included a claim on the companies' equity that could be paid out in the form of dividends or liquidation payment.

142. These property rights survived the events of 2008, including the enactment of HERA, the imposition of conservatorships over the Companies, and the issuance of Senior Preferred Stock to the U.S. Treasury.

143. Plaintiffs had a reasonable, investment-backed expectation that their property rights would not be illegally exacted by the Government.

144. By imposing the Net Worth Sweep, the Government expropriated Plaintiffs' vested property rights and now has the Plaintiffs' money in its pocket.

145. The Net Worth Sweep was developed and implemented by two federal agencies – the FHFA and the U.S. Treasury – to advance the economic and political interests of the U.S. Government.

146. By agreeing to and implementing the Third Amendment, FHFA and Treasury each violated the scope of their statutory authority under HERA.

147. Plaintiffs are entitled to damages to compensate them for the loss of these illegally exacted property rights and funds.

148. Plaintiffs suffered damages as a direct and proximate result of the foregoing illegal exaction. Plaintiffs' injuries are direct and independent of any injury to the Companies and any recovery for this claim would benefit the stockholders directly, and not the Company.

COUNT IV

BREACH OF CONTRACT AND ANTICIPATORY REPUDIATION

149. Plaintiffs incorporate by reference and reallege each and every allegation contained in the preceding paragraphs, as though fully set forth herein.

150. The Certificates for the Fannie Mae and Freddie Mac Preferred Stock constitute contracts between Plaintiffs, on the one hand, and Fannie Mae and Freddie Mac, on the other.

151. These contracts include certain rights to dividends, liquidation payments, and voting rights as alleged above.

152. Plaintiffs paid valuable consideration in exchange for these contractual rights.

153. FHFA assumed the responsibility to act consistently with the Companies' contractual obligations when it became the Companies' conservator.

154. The Net Worth Sweep was developed and implemented by the FHFA and the U.S. Treasury to advance the economic and political interests of the U.S. Government.

155. By entering into the Third Amendment, the Government has deprived Plaintiffs of any possibility of receiving any dividends or any liquidation distribution, and has done so without providing Plaintiffs any opportunity to vote. Accordingly, the Government has breached and unequivocally repudiated the Plaintiffs' contractual rights.

156. Plaintiffs suffered damages as a direct and proximate result of the foregoing breach of contact. Plaintiffs' injuries are direct and independent of any injury to the Companies and any recovery would benefit the stockholders directly, and not the Companies.

COUNT V

BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

157. Plaintiffs incorporate by reference and reallege each and every allegation contained in the preceding paragraphs, as though fully set forth herein.

158. The Certificates for Fannie Mae and Freddie Mac Preferred Stock were and are, for all purposes relevant hereto, contracts between the Plaintiffs and the Companies.

159. The Certificates provide for certain rights to dividends, liquidation payments, and voting rights. Also inherent in these contracts was, and is, an implied covenant of good faith and fair dealing, requiring the Companies to deal fairly with Plaintiffs, to fulfill their obligations in good faith, and not to deprive Plaintiffs of the fruits of their bargain.

160. Plaintiffs paid valuable consideration in exchange for these contractual rights.

161. FHFA assumed the responsibility to act consistently with the Companies' contractual obligations when it became the Companies' conservator, including the covenant of good faith and fair dealing.

162. The Net Worth Sweep was developed and implemented by two federal agencies – the FHFA and the U.S. Treasury – to advance the economic and political interests of the U.S. Government.

163. By entering into the Third Amendment with the purpose of depriving Plaintiffs of any possibility of receiving dividends or a liquidation preference without any opportunity to vote, the Government has breached the implied covenant of good faith and fair dealing inherent in the Certificates for the Preferred Stock.

164. Plaintiffs suffered damages as a direct and proximate result of the foregoing breach of the implied covenant of good faith and fair dealing. Plaintiffs' injuries are direct and independent of any injury to the Companies and any recovery for this claim would benefit the stockholders directly, and not the Company.

COUNT VI

BREACH OF FIDUCIARY DUTY

165. Plaintiffs incorporate by reference and reallege each and every allegation contained in the preceding paragraphs, as though fully set forth herein.

166. The conservatorship provisions of HERA create a fiduciary relationship between an agency of the United States Government (FHFA), on the one hand, and the Companies' shareholders, on the other. The Government therefore has a fiduciary responsibility

to manage the conservatorships of Fannie and Freddie for the benefit of the Companies' shareholders—or at least in a manner that is not expressly understood and intended to be directly adverse to the interests of the shareholders, and intended to benefit the Government and to harm the shareholders.

167. Given the existence of a fiduciary relationship between FHFA and the Companies' shareholders, it follows that the Government should be liable in damages for the breach of its fiduciary duties.

168. The Net Worth Sweep is a self-dealing transaction between two sister agencies of the Government, and improperly (and in bad faith) expropriates the economic interest in Fannie and Freddie held by the Companies private Preferred Stockholders for the benefit of the Government.

169. The Net Worth Sweep was neither entirely fair nor intrinsically fair. It was manifestly unfair.

170. The Net Worth Sweep constituted waste, gross and palpable overreaching and a gross abuse of discretion.

171. The Net Worth Sweep did not further any valid business purpose or reasonable business objective of Fannie and Freddie, did not reflect FHFA's good faith business judgment of what was in the best interest of Fannie and Freddie or their shareholders, and was unfair to the Companies and their Preferred Stockholders.

172. Thus, by entering the Net Worth Sweep, FHFA violated its fiduciary duty to Plaintiffs.

173. Plaintiffs suffered damages as a direct and proximate result of the foregoing breach of fiduciary duties. Plaintiffs' injuries are direct and independent of any injury

to the Companies and any recovery for this claim would benefit the stockholders directly, and not the Company.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs pray for relief and judgment, as follows:

1. Certifying that this action is a proper class action under Rule 23 of the Rules of the United States Court of Federal Claims on behalf of the Classes defined herein;

2. Finding that the Defendant has taken Plaintiffs' property without just compensation, has illegally exacted Plaintiffs' property, and has breached the express and implied terms of Plaintiffs' contracts;

3. Determining and awarding to Plaintiffs the just compensation and/or damages sustained by them as a result of the violations set forth above;

4. Awarding Plaintiffs prejudgment interest on any damages or just compensation to which Plaintiffs are entitled;

5. Awarding Plaintiffs their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

6. Granting such other and further relief as the Court may deem just and proper.

Respectfully Submitted,

Dated: March 8, 2018

/s/ Hamish P.M. Hume

Hamish P.M. Hume
Attorney of Record
BOIES SCHILLER FLEXNER LLP
1401 New York Ave. NW
Washington, DC 20005
Tel: (202) 237-2727
Fax: (202) 237-6131
hhume@bsfllp.com

OF COUNSEL:

Interim Co-Lead Class Counsel

BOIES SCHILLER FLEXNER LLP
Stacey K. Grigsby
Jonathan M. Shaw
Alexander I. Platt
1401 New York Ave. NW
Washington, DC 20005
Tel: (202) 237-2727
Fax: (202) 237-6131
sgrigsby@bsfllp.com
jshaw@bsfllp.com
aplatt@bsfllp.com

KESSLER TOPAZ MELTZER & CHECK LLP
Eric L. Zagar
280 King of Prussia Rd.
Radnor, PA 19087
Tel: (610) 667-7706
Fax: (610) 667-7056
ezagar@ktmc.com

Additional Counsel for Plaintiffs

POMERANTZ LLP
Jeremy A. Lieberman
600 Third Avenue, 20th Floor
New York, New York 10016
Tel: (212) 661-1100
Fax: (212) 661-8665
jalieberman@pomlaw.com

Patrick V. Dahlstrom
Ten South LaSalle Street, Suite 3505
Chicago, Illinois 60603
Tel: (312) 377-1181
Fax: (312) 377-1184
pdahlstrom@pomlaw.com

BROWER PIVEN
A PROFESSIONAL CORPORATION
Charles J. Piven
1925 Old Valley Road
Stevenson, MD 21153
Tel: (410) 332-0030
Fax: (410) 685-1300
piven@browerpiven.com

GRANT & EISENHOFER P.A.
Michael J. Barry
123 Justison Street
Wilmington, DE 19801
Tel: (302) 622-7000
Fax: (302) 622-7100
mbarry@gelaw.com

IN THE UNITED STATES COURT OF FEDERAL CLAIMS
NO. 13-465 C
(FILED FEBRUARY 26, 2014)

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FAIRHOLME FUNDS, INC., ET AL

VS. RCFC 12(b); RCFC 12(b)(6); RCFC 56(d)

THE UNITED STATES
-----------------------------x

PROTECTED INFORMATION ONLY TO BE DISCLOSED

IN ACCORDANCE WITH PROTECTIVE ORDER

ORAL DEPOSITION OF MS. SUSAN MCFARLAND

HOUSTON, TEXAS

JULY 15TH, 2015

10:01 A.M.

Reported By:
SAMANTHA DOWNING, CSR
JOB NO. 39652

ORAL DEPOSITION of MS. SUSAN MCFARLAND, produced as a witness at the instance of the Plaintiff, and duly sworn, was taken in the above-styled and numbered cause on the 15TH of JULY, 2015, from 10:01 a.m. to 5:31 p.m., before Samantha Downing, CSR, CLR, in and for the State of Texas, reported by machine shorthand, at the DOUBLETREE BY HILTON, 8181 AIRPORT BOULEVARD, HOUSTON, TEXAS 77061 pursuant to the Federal Rules of Civil Procedure and the provisions stated on the record or attached hereto.

a meeting with Treasury whereby we reviewed our forecasts. I had expressed a view that I believed we were now in a sustainable profitability, that we would be able to deliver sustainable profits over time. I even mentioned the possibility that it could get to a point in the not-so-distant future where the factors might exist whereby the allowance on the deferred tax asset would be released. We were not there yet, but, you know, you could see positive things occurring.

So when the amendment went into place, part of my reaction was they did that in response to my communication of our forecasts and the implication of those forecasts, that it was probably a desire not to allow capital to build up within the enterprises and not to allow the enterprises to recapitalize themselves.

Q. (BY MR. THOMPSON) And with whom at Treasury do you have this meeting?

A. So the -- which meeting?

Q. The one you just referenced where --

A. Where I had the discussion about the forecasts?

Q. Yes.

A. So it was a common practice for us to meet with Treasury on a quarterly basis to review our results from the past quarter and to update them on our forecasts;

hear that the same comments I was making to Treasury, I was making to the Board.

Q. Okay. In the same timetable?

A. I don't remember exactly when the Board meetings were within that window, but it would have been Board meetings shortly before that that I would have reviewed this very same information.

Q. Okay. And when you say that you would have had dialogue with people at FHFA about the deferred tax assets, with who would you have had the dialogue?

Would that have been Mario Ugoletti?

MR. LAUFGRABEN: Object to the form of the question; vagueness as to time period.

A. Yeah.

So early on, it's probably through the Chief Accountant's office of the FHFA, because it is a technical accounting matter.

Q. And do you happen to recall --

A. I can pick him out of a lineup.

Q. Okay. We'll show you some names later on.

A. I tell you, I -- ask me a number, I can probably give it to you. People's names...

It would have started there. Eventually there were conversations with Director DeMarco and key direct reports of his, but that -- the -- those -- the

DeMarco conversations occurred when we were actually in the serious mode of potentially -- we were looking -- we did a full analysis at the end of the second quarter; no release. We did a full analysis at the end of the third quarter; no release.

When we were doing the analysis for the fourth quarter of 2012, we started to get to a point where we were tipping towards release, and that's when I began to have conversations with more senior folks at FHFA on it. But they were already aware of the statement that I made to Treasury. I mean, in general, I put it on people's radar screens that it's something that could happen in the not-so-distant future.

I will say that I believe Mary Miller asked me in this meeting about how large would it be and did I have any idea of when.

Q. Yeah.

A. And I believe my response was around 50 billion, but that could be larger or smaller depending upon when. The further out in time it is, the smaller it probably would be. It is part of the evidence that it might be good.

So the further out in time that it would be released, the smaller the release size would be.

But I said probably in the

50-billion-dollar range and probably sometime mid 2013 at that time when I met with them late July, early August 2012.

But I said we had not done a real in-depth analysis, so I was just kind of giving her kind of my off-the-cuff perspective in the moment.

Q. And FHFA was on notice that you had sent this message to Treasury?

A. Yes.

MR. LAUFGRABEN: Object to the form of the question.

A. Yes.

Q. (BY MR. THOMPSON) And they were on notice of that fact before the Third Amendment; is that right?

MR. LAUFGRABEN: Same objection.

A. Yes.

Q. (BY MR. THOMPSON) Okay. Now, if we look for -- let's look at some of these Board minutes, and we've actually -- we've been going -- well, that's fine.

Does -- do you need a break, or --

A. I am fine right now.

Q. Okay.

A. I am fine right now. If I need water, then I will need a break.

Q. Okay. Very good.

REDACTED

To: Mary Miller
From: Michael Stegman
Subj.: FHFA-Related Discussion at June 25 Morning Meeting
Date: June 25, 2012

The Secretary provided an overview of his and your previous day's meeting with Ed DeMarco. This is the essence of the discussion that took place.

[redacted]

- While he told us he would be directing Freddie Mac to provide same streamlined refinancing benefits to <80% LTV current borrowers that apply to >80% HARP 2.0 borrowers, he no longer thinks the benefits of doing so are worth the costs.

- He has reduced from a major new initiative to a small pilot a rebuild-equity refinancing program for current underwater borrowers. Since he viewed the at-scale program to counter moral hazard of a GSE HAMP-PRA program, shrinking this initiative may signal FHFA's decision not to do principal reduction.

- He is losing interest in REO-to-Rental, saying that the GSE retail REO execution is so efficient and attracting good prices, it's not worth the resources and efforts to do bulk sales.

- His schedule for rep and warranty reform for new books of business has also slipped. While he has announced his intention to direct the GSEs to adopt new reps and warrants featuring 36 month liability for material violations other than fraud, there is no time table for this.

- Through weeks of negotiating terms of possible amendments to the PSPAs, he never questioned the need to adjust the dividend schedule this year. Since the Secretary raised the possibility of a PR covenant, DeMarco no longer sees the urgency of amending the PSPAs this year. He has raised two competing reasons for this new position: (1) the GSEs will be generating large revenues over the coming years, thereby enabling them to pay the 10% annual dividend well into the future even with the caps; and, (2) instituting a net worth sweep in place of the dividend will further extend the lives of the GSEs to such an extent that it would remove the urgency for Congress to act on long-term housing finance reform. He now sees the PSPA amendments as a backdoor way of keeping the GSEs alive—getting to an Option 3-type plan without the need for legislation.

[redacted]

REDACTED

[redacted]

REDACTED

[redacted]

Message

From:	Ugoletti, Mario [/O=FHFA/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=UGDETTIM]
Sent:	8/9/2012 10:52:11 AM
To:	DeMarco, Edward [edward.demarco@fhfa.gov]; Pollard, Alfred [alfred.pollard@fhfa.gov]; Laponsky, Mark [mark.laponsky@fhfa.gov]; Spohn, Jeffrey [jeffrey.spohn@fhfa.gov]; Greenlee, Jon [jon.greenlee@fhfa.gov]; Lawler, Patrick [patrick.lawler@fhfa.gov]; DeLeo, Wanda [wanda.deleo@fhfa.gov]; Satriano, Nicholas [nicholas.satriano@fhfa.gov]
CC:	Brown, Jan [jan.brown@fhfa.gov]
Subject:	PSPA Alert

Close Hold

As a heads up, there appears to be a renewed push to move forward on PSPA amendments. I have not seen the proposed documents yet, but my understanding is that largely the same as previous versions we had reviewed in terms of net income sweep, eliminating the commitment fee, faster portfolio wind down, and a deminimus safe harbor for ordinary course transactions. The one potential difference is not having separate covenants on g-fees, risk reduction, etc., but potentially one covenant requiring the Enterprises to present a plan to Treasury on how they are managing or reducing risk. Depending on the language that could be an improvement.

I am leaving for the day at around 11:00. When I get the proposed language I will have Jan forward it to this group. I have told Treasury we should plan on meeting on Monday morning, perhaps around 11:00 to discuss further. Mario.

REDACTED

[redacted]

REDACTED

[redacted]

FAQs

Questions and Answers on Conservatorship

9/7/2008

Q: What is a conservatorship?

A: A conservatorship is the legal process in which a person or entity is appointed to establish control and oversight of a Company to put it in a sound and solvent condition. In a conservatorship, the powers of the Company's directors, officers, and shareholders are transferred to the designated Conservator.

Q: What is a Conservator?

A: A Conservator is the person or entity appointed to oversee the affairs of a Company for the purpose of bringing the Company back to financial health.

In this instance, the Federal Housing Finance Agency ("FHFA") has been appointed by its Director to be the Conservator of the Company in accordance with the Federal Housing Finance Regulatory Reform Act of 2008 (Public Law 110-289) and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501, et seq., as amended) to keep the Company in a safe and solvent financial condition.

Q: How is a Conservator appointed?

A: By statute, the FHFA is appointed Conservator by its Director after the Director determines, in his discretion, that the Company is in need of reorganization or rehabilitation of its affairs.

Q: What are the goals of this conservatorship?

A: The purpose of appointing the Conservator is to preserve and conserve the Company's assets and property and to put the Company in a sound and solvent condition. The goals of the conservatorship are to help restore confidence in the Company, enhance its capacity to fulfill its mission, and mitigate the systemic risk that has contributed directly to the instability in the current market.

There is no reason for concern regarding the ongoing operations of the Company. The Company's operation will not be impaired and business will continue without interruption.

Q: When will the conservatorship period end?

A: Upon the Director's determination that the Conservator's plan to restore the Company to a safe and solvent condition has been completed successfully, the Director will issue an order terminating the conservatorship. At present, there is no exact time frame that can be given as to when this conservatorship may end.

Q: What are the powers of the Conservator?

A: The FHFA, as Conservator, may take all actions necessary and appropriate to (1) put the Company in a sound and solvent condition and (2) carry on the Company's business and preserve and conserve the assets and property of the Company.

Q: What happens upon appointment of a Conservator?

A: Once an "Order Appointing a Conservator" is signed by the Director of FHFA, the Conservator immediately succeeds to the (1) rights, titles, powers, and privileges of the Company, and any stockholder, officer, or director of such the Company with respect to the Company and its assets, and (2) title to all books, records and assets of the Company held by any other custodian or third-party. The Conservator is then charged with the duty to operate the Company.

Q: What does the Conservator do during a conservatorship?

A: The Conservator controls and directs the operations of the Company. The Conservator may (1) take over the assets of and operate the Company with all the powers of the shareholders, the directors, and the officers of the Company and conduct all business of the Company; (2) collect all obligations and money due to the Company; (3) perform all functions of the Company which are consistent with the Conservator's appointment; (4) preserve and conserve the assets and property of the Company; and (5) contract for assistance in fulfilling any function, activity, action or duty of the Conservator.

Q: How will the Company run during the conservatorship?

A: The Company will continue to run as usual during the conservatorship. The Conservator will delegate authorities to the Company's management to move forward with the business operations. The Conservator encourages all Company employees to continue to perform their job functions without interruption.

Q: Will the Company continue to pays its obligations during the conservatorship?

A: Yes, the Company's obligations will be paid in the normal course of business during the Conservatorship. The Treasury Department, through a secured lending credit facility and a Senior Preferred Stock Purchase Agreement, has significantly enhanced the ability of the Company to meet its obligations. The Conservator does not anticipate that there will be any disruption in the Company's pattern of payments or ongoing business operations.

Q: What happens to the Company's stock during the conservatorship?

A: During the conservatorship, the Company's stock will continue to trade. However, by statute, the powers of the stockholders are suspended until the conservatorship is terminated. Stockholders will continue to retain all rights in the stock's financial worth; as such worth is determined by the market.

Q: Is the Company able to buy and sell investments and complete financial transactions during the conservatorship?

A: Yes, the Company's operations continue subject to the oversight of the Conservator.

Q: What happens if the Company is liquidated?

A: Under a conservatorship, the Company is not liquidated.

Q: Can the Conservator determine to liquidate the Company?

A: The Conservator cannot make a determination to liquidate the Company, although, short of that, the Conservator has the authority to run the company in whatever way will best achieve the Conservator's goals (discussed above). However, assuming a statutory ground exists and the Director of FHFA determines that the financial condition of the company requires it, the Director does have the discretion to place any regulated entity, including the Company, into receivership. Receivership is a statutory process for the liquidation of a regulated entity. There are no plans to liquidate the Company.

Q: Can the Company be dissolved?

A: Although the company can be liquidated as explained above, by statute the charter of the Company must be transferred to a new entity and can only be dissolved by an Act of Congress.

Contacts: Corinne Russell (202) 649-3032 / Stefanie Johnson (202) 649-3030

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FEDERAL HOUSING FINANCE AGENCY
Office of the Director

February 2, 2010

Honorable Christopher Dodd
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

Honorable Richard C. Shelby
Ranking Minority Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Honorable Spencer Bachus
Ranking Minority Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairmen and Ranking Members:

I am writing to update you on the conservatorships of Fannie Mae and Freddie Mac (the Enterprises). Recently there has been considerable speculation regarding how the future direction of the Enterprises' business activities interacts with their status in conservatorship. A key motivation for this letter is to provide greater clarity to policymakers and market participants on the Federal Housing Finance Agency's (FHFA) plans for the Enterprises' business activities while they operate in conservatorship.

The first part of the letter will review the establishment and purposes of the conservatorships, and how the conservatorships are operating. FHFA is focused on conserving the Enterprises' assets and meeting the goals of the conservatorship. The second part of the letter describes FHFA's views on the future direction of the Enterprises' business activities while they are in conservatorship, particularly: loan modifications and mitigating credit losses; retained portfolio; new products; and affordable housing mission.

Background

Establishment and Purposes of the Conservatorships

After careful analysis and in consultation with the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve System, FHFA placed each Enterprise into conservatorship on September 6, 2008. At that time and pursuant to the statute, FHFA set forth the purpose and goals of conservatorship as follows:

> The purpose of appointing the Conservator is to preserve and conserve the Company's assets and property and to put the Company in a sound and solvent condition. The goals of the conservatorship are to help restore confidence in the Company, enhance its capacity to fulfill its mission, and mitigate the systemic risk that has contributed directly to the instability in the current market.

Critical to the establishment of the conservatorships were the actions taken at the same time by Treasury, consistent with its authority granted in the Housing and Economic Recovery Act of 2008 (HERA), to establish three funding facilities. Two of these – the liquidity facility and the mortgage-backed securities purchase facility – expired as scheduled at the end of last year. The third facility – the Senior Preferred Stock Purchase Agreements (PSPAs) – was structured to provide ongoing financial support to the Enterprises to ensure they remain active participants in the marketplace. The PSPAs work by ensuring that the Enterprises maintain a positive net worth, and Treasury's initial financial commitment was up to $100 billion per company. As explained at the time of the conservatorships by Treasury Secretary Paulson:

> These agreements support market stability by providing additional security and clarity to GSE debt holders – senior and subordinated – and support mortgage availability by providing additional confidence to investors in GSE mortgage backed securities. This commitment will eliminate any mandatory triggering of receivership and will ensure that the conserved entities have the ability to fulfill their financial obligations. It is more efficient than a one-time equity injection, because it will be used only as needed and on terms that Treasury has set.

In the face of a potentially catastrophic failure of our nation's housing finance system, these actions, along with the Federal Reserve's decision a few months later to purchase Enterprise debt and mortgage-backed securities, succeeded in maintaining an important measure of stability in the housing finance market. As nearly all other non-governmental participants in housing finance abandoned the market, the Enterprises in conservatorship, operating with the benefit of the PSPAs, have ensured that credit continues to flow to housing. As evidence of this, the Enterprises' share in financing or guaranteeing new single-family mortgage production rose from 54 percent in 2006 to 73 percent in 2008 and 78 percent in 2009 through September. The Enterprises have also played a significant role in multifamily housing finance with their market share growing from 33 percent in 2006 to 79 percent in 2008 and 64 percent in 2009 through September.

FEDERAL HOUSING FINANCE AGENCY

Report to Congress 2010

FEDERAL HOUSING FINANCE AGENCY
FHFA

Conservatorship of the Enterprises

When the deterioration of the subprime mortgage market began in early August of 2007, few were predicting that only one year later, the nation's economy would plunge into crisis. By 2008, most large financial institutions experienced diminished access to credit, and after the Lehman Brothers collapse, even nonfinancial firms could not obtain funds through normal channels.

The housing markets were at the center of the financial crisis. On September 6, 2008, using the power it had been granted just six weeks before in the Housing and Economic Recovery Act of 2008 (HERA), the legislation that created the agency, FHFA placed Fannie Mae and Freddie Mac (Enterprises) into conservatorships.

Extraordinary Action, Extraordinary Task

The government's extraordinary action was designed from the start to maintain access to funds for the production of sound new mortgages. The purpose of the conservatorships was to preserve and conserve each Enterprise's assets and property and restore the Enterprises to a sound financial condition so they could continue to fulfill their statutory mission of promoting liquidity and efficiency in the nation's housing finance markets. Because the private mortgage securitization market had already vanished and there were no other effective secondary market mechanisms in place, the Enterprises' continued operations were necessary to maintain liquidity in the secondary market and for mortgage originations to continue.

As conservator, FHFA has the powers of the management, boards, and shareholders of the Enterprises. However, the Enterprises continue to operate as business corporations. For example, they have chief executive officers and boards of directors, and must follow the laws and regulations governing financial disclosure, including requirements of the Securities and Exchange Commission. Like other corporate executives, the Enterprises' executive officers are subject to the legal responsibility to use sound and prudent business judgment in their stewardship of their companies.

At the inception of the conservatorships, FHFA made clear that the Enterprises would continue to be responsible for normal business activities and day-to-day operations. FHFA continues to exercise oversight as safety and soundness regulator and has a more active role as conservator. While FHFA has very broad authority, the focus of the conservatorships is not to manage every aspect of the Enterprises' operations.

Instead, FHFA reconstituted the boards of directors at each Enterprise and charged the boards with ensuring normal corporate governance practices and procedures are in place. The boards are responsible for carrying out normal board functions, but they remain subject to review and approval on critical matters by FHFA as conservator. The Enterprises are large, complex companies, and this division of responsibilities represents the most efficient structure for carrying out FHFA's responsibilities as conservator.

To manage the work of overseeing the Enterprises' conservatorships, FHFA formed an Office of Conservatorship Operations staffed with a half-dozen

Enterprise Employee Compensation

Setting a compensation strategy in an uncertain environment requires a delicate balancing act. It is difficult to make compensation comparisons to government programs like the Federal Housing Administration and Ginnie Mae, because the underlying structures of those programs were designed over many years to operate with government oversight of private sector participants. This is not the case with the Enterprises where the underlying structure was developed based solely on private sector interactions between the Enterprises and their business partners.

As conservator, FHFA has reduced the Enterprises' compensation for executive officers by an average of 40 percent, putting it at the same level it was 12 years ago. When higher compensated employees leave, the companies seek to fill those positions at lower compensation levels than paid to the departing employee, including at the executive level. FHFA is very mindful of keeping Enterprise compensation costs down, while retaining the talent to carry out the operations of the companies.

FEDERAL HOUSING FINANCE AGENCY

NEWS RELEASE

For Immediate Release
November 10, 2011

Contact: Corinne Russell (202) 414-6921
Stefanie Johnson (202) 414-6376

FHFA Responds to Letter from Senators on Executive Compensation

Today FHFA Acting Director Edward J. DeMarco responded to a letter from numerous U.S. Senators regarding executive compensation at Fannie Mae and Freddie Mac. Attached is the text of the letter.

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The Federal Housing Finance Agency regulates Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. These government-sponsored enterprises provide more than $5.7 trillion in funding for the U.S. mortgage markets and financial institutions

Federal Housing Finance Agency
1700 G Street, N.W., Washington, D.C. 20552-0003
Telephone: (202) 414-3800
Facsimile: (202) 414-3823
www.fhfa.gov

November 10, 2011

Dear Senator:

Thank you for your correspondence regarding executive compensation at Fannie Mae and Freddie Mac. At a time when the country faces persistent unemployment of nine percent or more and has an urgent need to address an enormous budget deficit, I well understand your concern about the possibility of any wasteful spending. Losses at Fannie Mae and Freddie Mac (the Enterprises) have already resulted in more than $170 billion in taxpayer expense, and I consider it the most important part of my job to minimize any further taxpayer costs.

When FHFA put the Enterprises into conservatorship in 2008, the individuals responsible for the Enterprises' failures left the companies and no severance or golden parachutes were permitted. In establishing a new executive compensation program, we reduced senior executive pay by an average of 40 percent, and developed, in consultation with the Treasury Department, a new pay structure similar to that designed for large, special-assistance TARP firms. FHFA announced the executive pay structure in late 2009 and that structure remains in place today. Over the past two years, we have reduced the number of top level positions, and as these positions turn over, we have further reduced pay levels.

By law, the conservatorships are intended to rehabilitate the Enterprises as private firms. Their officers are not public employees, and FHFA has used market compensation measures to target executive compensation at or below the median of comparable private sector positions at financial institutions roughly similar in size and/or complexity as the Enterprises. FHFA has followed the structure set forth for exceptional assistance TARP firms, a structure in keeping with requirements in the Enterprises' own charter acts for significant incentive compensation. Accordingly, one-third of each top executive's target compensation is based on a combination of individual and corporate performance. Furthermore, deferred salary is a significant component of the remainder of target compensation for the top executives in order to incentivize retention – executives who choose to leave the company forfeit it. One-half of deferred salary is based on corporate performance, thereby allowing for a reduction in effective salary should corporate performance lag expectations. Simply put, most of the so-called bonuses are simply deferred salaries.

We have worked hard to follow the law, best practices, and the lead of the Treasury in its compensation structure design for government-dependent firms. This structure helps to focus

Statement of

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

Before the House Financial Services
Subcommittee on Oversight and Investigations

December 1, 2011

Embargoed until delivery – 2PM EST

while policymakers considered and acted on a permanent resolution. More than three years later, we are still waiting for that resolution.

As conservator, FHFA stands in the place of each company's shareholders, boards, and management, with the responsibility to "preserve and conserve the assets and property" of the companies. The statute also charges the conservator with the responsibility to place the companies in "a sound and solvent condition." At the time the conservatorships were established, FHFA was less than six weeks old as an agency, and had fewer than 400 employees. To accomplish these responsibilities, FHFA made the practical judgment that the most effective means to carry out these functions was to replace the boards and senior management, and then delegate to new boards and management day-to-day responsibility. Since then, reconstituted boards of directors have worked with FHFA to define the operational goals in conservatorship and to support FHFA in its work to guide and oversee management in fulfilling these goals. Likewise, the new CEOs and executive officers have worked with FHFA to these same ends.

As conservator and regulator, FHFA has three principal mandates set forth in law that direct and motivate FHFA's activities and decisions involving the Enterprises.

First, as I have noted, FHFA has a statutory responsibility as conservator of the Enterprises 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 and preserve and conserve the assets and property of the regulated entity." As FHFA has stated on numerous occasions, with taxpayers providing the capital supporting the Enterprises' operations, this "preserve and conserve" mandate directs us to minimize losses on behalf of taxpayers.

Second, even though the Enterprises are in conservatorship, without further statutory changes they have the same mission and obligations as they did prior to being placed into conservatorship. FHFA has a statutory responsibility to ensure the Enterprises "operate in a safe and sound manner" and that "the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets." We typically refer to this requirement as "supporting a stable and liquid mortgage market."

Third, under the Emergency Economic Stabilization Act of 2008, FHFA has a statutory responsibility to "implement a plan that seeks to maximize assistance for homeowners and use its authority to encourage the servicers of the underlying mortgages, and considering net present value to the taxpayer to take advantage of … available programs to minimize foreclosures."

These three mandates form the basis for how FHFA views its responsibilities as conservator of the Enterprises. In view of the critical and substantial resource requirements of conserving assets and restoring financial health, combined with a recognition that the Enterprises operate today only with the support of taxpayers, FHFA has focused the Enterprises on their existing core business, including minimizing credit losses. This means that FHFA is not permitting the Enterprises to offer new products or enter new lines of business. Their operations are focused on their core business activities and loss mitigation. This type of limitation on new business activities is consistent with the standard regulatory approach for addressing companies that are

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): September 6, 2008

FEDERAL HOME LOAN MORTGAGE CORPORATION
(Exact name of registrant as specified in its charter)
Freddie Mac

Federally chartered corporation	**000-53330**	**52-0904874**
(State or other jurisdiction of incorporation)	*(Commission File Number)*	*(IRS Employer Identification No.)*

8200 Jones Branch Drive McLean, Virginia	**22102**
(Address of principal executive offices)	*(Zip Code)*

Registrant's telephone number, including area code: **(703) 903-2000**

Not applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions *(see* General Instruction A.2. below):

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c)) of an underwriter or placement agent. A copy of the warrant is attached to this report as Exhibit 10.2.

Under its Congressional charter, securities issued by Freddie Mac are "exempted securities" for purposes of the Securities Act of 1933. Accordingly, no registration statement for the issuance of the senior preferred stock or the warrant has been filed with the SEC.

Item 3.03. Material Modification to Rights of Security Holders

Under the terms of the Purchase Agreement, the senior preferred stock ranks senior to all other existing and future issues of preferred stock, common stock or other capital stock of Freddie Mac.

On September 7, 2008, the Director of FHFA, acting as conservator for Freddie Mac, adopted a resolution eliminating the par value of Freddie Mac's common stock and approving any amendment to the Seventh Amended and Restated Certificate of Designation, Powers, Preferences, Rights, Privileges, Qualifications, Limitations, Restrictions, Terms and Conditions of Voting Common Stock of Freddie Mac (the "Common Stock Certificate") necessary for such elimination. The resolution also increased the number of shares of Freddie Mac common stock authorized for issuance to 4,000,000,000 and approved any amendment to the Common Stock Certificate necessary for such increase. A copy of the amended Common Stock Certificate is attached as Exhibit 4.1 to this report.

As conservator, FHFA has succeeded to all rights and powers of Freddie Mac's common and preferred stockholders. The Purchase Agreement provides that, without the prior consent of Treasury, Freddie Mac shall not make any payment to purchase or redeem its capital stock, or pay any dividends, including preferred dividends (other than dividends on the senior preferred stock). The holders of Freddie Mac's existing common stock and preferred stock (other than the senior preferred stock) will retain all their rights in the financial worth of those instruments, as such worth is determined by the market.

Item 5.01. Changes in Control of Registrant

On September 6, 2008 the Director of FHFA appointed FHFA as conservator of Freddie Mac in accordance with the Reform Act and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992. As conservator, FHFA is in control of Freddie Mac.

Specifically, the Reform Act provides that FHFA, as conservator, has

(i) all rights, titles, powers, and privileges of Freddie Mac, and of any stockholder, officer, or director of Freddie Mac with respect to Freddie Mac and its assets; and

(ii) title to the books, records, and assets of any other legal custodian of Freddie Mac.

As conservator, FHFA is authorized under the Reform Act to, among other things:

U.S. DEPARTMENT OF THE TREASURY

Press Center

Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers

9/7/2008

hp-1129

Washington, DC-- Good morning. I'm joined here by Jim Lockhart, Director of the new independent regulator, the Federal Housing Finance Agency, FHFA.

In July, Congress granted the Treasury, the Federal Reserve and FHFA new authorities with respect to the GSEs, Fannie Mae and Freddie Mac. Since that time, we have closely monitored financial market and business conditions and have analyzed in great detail the current financial condition of the GSEs – including the ability of the GSEs to weather a variety of market conditions going forward. As a result of this work, we have determined that it is necessary to take action.

Since this difficult period for the GSEs began, I have clearly stated three critical objectives: providing stability to financial markets, supporting the availability of mortgage finance, and protecting taxpayers – both by minimizing the near term costs to the taxpayer and by setting policymakers on a course to resolve the systemic risk created by the inherent conflict in the GSE structure.

Based on what we have learned about these institutions over the last four weeks – including what we learned about their capital requirements – and given the condition of financial markets today, I concluded that it would not have been in the best interest of the taxpayers for Treasury to simply make an equity investment in these enterprises in their current form.

The four steps we are announcing today are the result of detailed and thorough collaboration between FHFA, the U.S. Treasury, and the Federal Reserve.

We examined all options available, and determined that this comprehensive and complementary set of actions best meets our three objectives of market stability, mortgage availability and taxpayer protection.

Throughout this process we have been in close communication with the GSEs themselves. I have also consulted with Members of Congress from both parties and I appreciate their support as FHFA, the Federal Reserve and the Treasury have moved to address this difficult issue.

Before I turn to Jim to discuss the action he is taking today, let me make clear that these two institutions are unique. They operate solely in the mortgage market and are therefore more exposed than other financial institutions to the housing correction. Their statutory capital requirements are thin and poorly defined as compared to other institutions. Nothing about our actions today in any way reflects a changed view of the housing correction or of the strength of other U.S. financial institutions.

I support the Director's decision as necessary and appropriate and had advised him that conservatorship was the only form in which I would commit taxpayer money to the GSEs.

I appreciate the productive cooperation we have received from the boards and the management of both GSEs. I attribute the need for today's action primarily to the inherent conflict and flawed business model embedded in the GSE structure, and to the ongoing housing correction. GSE managements and their Boards are responsible for neither. New CEOs supported by new non-executive Chairmen have taken over management of the enterprises, and we hope and expect that the vast majority of key professionals will remain in their jobs. I am particularly pleased that the departing CEOs, Dan Mudd and Dick Syron, have agreed to stay on for a period to help with the transition.

I have long said that the housing correction poses the biggest risk to our economy. It is a drag on our economic growth, and at the heart of the turmoil and stress for our financial markets and financial institutions. Our economy and our markets will not recover until the bulk of this housing correction is behind us. Fannie Mae and Freddie Mac are critical to turning the corner on housing. Therefore, the primary mission of these enterprises now will be to proactively work to increase the availability of mortgage finance, including by examining the guaranty fee structure with an eye toward mortgage affordability.

To promote stability in the secondary mortgage market and lower the cost of funding, the GSEs will modestly increase their MBS portfolios through the end of 2009. Then, to address systemic risk, in 2010 their portfolios will begin to be gradually reduced at the rate of 10 percent per year, largely through natural run off, eventually stabilizing at a lower, less risky size.

Treasury has taken three additional steps to complement FHFA's decision to place both enterprises in conservatorship. First, Treasury and FHFA have established Preferred Stock Purchase Agreements, contractual agreements between the Treasury and the conserved entities. Under these agreements, Treasury will ensure that each company maintains a positive net worth. These agreements support market stability by providing additional security and clarity to GSE debt holders – senior and subordinated – and support mortgage availability by providing additional confidence to investors in GSE mortgage backed securities. This commitment will eliminate any mandatory triggering of receivership and will ensure that the conserved entities have the ability to fulfill their financial obligations. It is more efficient than a one-time equity injection, because it will be used only as needed and on terms that Treasury has set. With this agreement, Treasury receives senior preferred equity shares and warrants that protect taxpayers. Additionally, under the terms of the agreement, common and preferred shareholders bear losses ahead of the new government senior preferred shares.

These Preferred Stock Purchase Agreements were made necessary by the ambiguities in the GSE Congressional charters, which have been perceived to indicate government support for agency debt and guaranteed MBS. Our nation has tolerated these ambiguities for too long, and as a result GSE debt and MBS are held by central banks and investors throughout the United States and around the world who believe them to be virtually risk-free. Because the U.S. Government created these ambiguities, we have a responsibility to both avert and ultimately address the systemic risk now posed by the scale and breadth of the holdings of GSE debt and MBS.

Market discipline is best served when shareholders bear both the risk and the reward of their investment. While conservatorship does not eliminate the common stock, it does place common shareholders last in terms of claims on the assets of the enterprise.

Similarly, conservatorship does not eliminate the outstanding preferred stock, but does place preferred shareholders second, after the common shareholders, in absorbing losses. The federal banking agencies are assessing the exposures of banks and thrifts to Fannie Mae and Freddie Mac. The agencies believe that, while many institutions hold common or preferred shares of these two GSEs, only a limited number of smaller institutions have holdings that are significant compared to their capital.

The agencies encourage depository institutions to contact their primary federal regulator if they believe that losses on their holdings of Fannie Mae or Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce their regulatory capital below "well capitalized." The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with the capital regulations.

Preferred stock investors should recognize that the GSEs are unlike any other financial institutions and consequently GSE preferred stocks are not a good proxy for financial institution preferred stock more broadly. By stabilizing the GSEs so they can better perform their mission, today's action should accelerate stabilization in the housing market, ultimately benefiting financial institutions. The broader market for preferred stock issuance should continue to remain available for well-capitalized institutions.

The second step Treasury is taking today is the establishment of a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Given the combination of actions we are taking, including the Preferred Share Purchase Agreements, we expect the GSEs to be in a stronger position to fund their regular business activities in the capital markets. This facility is intended to serve as an ultimate liquidity backstop, in essence, implementing the temporary liquidity backstop authority granted by Congress in July, and will be available until those authorities expire in December 2009.

Finally, to further support the availability of mortgage financing for millions of Americans, Treasury is initiating a temporary program to purchase GSE MBS. During this ongoing housing correction, the GSE portfolios have been constrained, both by their own capital situation and by regulatory efforts to address systemic risk. As the GSEs have grappled with their difficulties, we've seen mortgage rate spreads to Treasuries widen, making mortgages less affordable for homebuyers. While the GSEs are expected to moderately increase the size of their portfolios over the next 15 months through prudent mortgage purchases, complementary government efforts can aid mortgage affordability. Treasury will begin this new program later this month, investing in new GSE MBS. Additional purchases will be made as deemed appropriate. Given that Treasury can hold these securities to maturity, the spreads between Treasury issuances and GSE MBS indicate that there is no reason to expect taxpayer losses from this program, and, in fact, it could produce gains. This program will also expire with the Treasury's temporary authorities in December 2009.

Together, this four part program is the best means of protecting our markets and the taxpayers from the systemic risk posed by the current financial condition of the GSEs. Because the GSEs are in conservatorship, they will no longer be managed with a strategy to maximize common shareholder returns, a strategy which historically encouraged risk-taking. The Preferred Stock Purchase Agreements minimize current cash outlays, and give taxpayers a large stake in the future value of these entities. In the end, the ultimate cost to the taxpayer will depend on the business results of the GSEs going forward. To that end, the steps we have taken to support the GSE debt and to support the mortgage market will together improve the housing market, the US economy and the GSEs' business outlook.

Through the four actions we have taken today, FHFA and Treasury have acted on the responsibilities we have to protect the stability of the financial markets, including the mortgage market, and to protect the taxpayer to the maximum extent possible.

And let me make clear what today's actions mean for Americans and their families. Fannie Mae and Freddie Mac are so large and so interwoven in our financial system that a failure of either of them would cause great turmoil in our financial markets here at home and around the globe. This turmoil would directly and negatively impact household wealth: from family budgets, to home values, to savings for college and retirement. A failure would affect the ability of Americans to get home loans, auto loans and other consumer credit and business finance. And a failure would be harmful to economic growth and job creation. That is why we have taken these actions today.

IN THE UNITED STATES COURT OF FEDERAL CLAIMS

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FAIRHOLME FUNDS, INC., et al., :

Plaintiffs, : Case No. 13-465C

v. :

THE UNITED STATES, :

Defendant. X

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Washington, D.C.

Tuesday, July 14, 2015

Deposition of JEFFREY ALAN FOSTER, a witness herein, called for examination by counsel for Defendant in the above-entitled matter, pursuant to notice, the witness being duly sworn by MARY GRACE CASTLEBERRY, a Notary Public in and for the District of Columbia, taken at the offices of Cooper & Kirk, 1523 New Hampshire Avenue, N.W., Washington, D.C., at 8:00 a.m., Tuesday, July 14, 2015, and the proceedings being taken down by Stenotype by MARY GRACE CASTLEBERRY, RPR, and transcribed under her direction.

capacity would not be sufficient to cover expected dividend payments.

Q. Now, when did Treasury come up with this idea to restructure the PSPAs to allow for variable dividend payment?

MR. DINTZER: Objection. Vague.

THE WITNESS: Can you be more specific?

BY MR. PATTERSON:

Q. When did Treasury first have the idea to restructure the PSPAs to allow for variable dividend payment based on positive net worth as stated in this document?

A. I don't know when Treasury came up with that idea. I began discussing it with colleagues in 2010.

Q. And with whom did you discuss that?

A. Counsel, Jeffrey Goldstein, Mary Miller, Tim Bowler, others within the department.

Q. Do you remember specifically who else within the department?

A. It went from a small group to a larger group over time. So at some point it included the broader housing finance reform team.

Q. And was this your idea?

MR. DINTZER: Objection. Vague and confusing.

THE WITNESS: I don't know. Other people may have had this idea as well, but I had this idea.

BY MR. PATTERSON:

Q. And how did you come up with this idea?

MR. DINTZER: Objection. Vague. Confusing.

THE WITNESS: The original idea generated from a phone conversation between me and Mario Ugoletti about the challenges of the circularity of drawing to pay ourselves.

BY MR. PATTERSON:

Q. And when did that conversation take place?

A. Sometime in 2010.

Q. And did you discuss the idea of allowing for a variable dividend payment based on positive net worth with Mario Ugoletti at that point?

A. Yes.

Q. And what was Mr. Ugoletti's reaction to

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[redacted]

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[redacted]

Message

From: Goldblatt, Alan [/O=USTREASURY/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=GOLDBLATTA]
Sent: 8/13/2012 12:07:37 AM
To: Chepenik, Adam [adam.chepenik@treasury.gov]; Datta, Ankur [ankur.datta@treasury.gov]; Mlynarczyk, Beth [beth.mlynarczyk@treasury.gov]; Stegman, Michael [michael.stegman@treasury.gov]; Anderson, MatthewDisabled [matthew.anderson@treasury.gov]; Moore, Megan [megan.moore@treasury.gov]; Colbert, Julian (Drew) [drew.colbert@treasury.gov]; Bowler, Timothy [timothy.bowler@treasury.gov]; Foster, JeffDisabled [jeff.foster@treasury.gov]; Dash, Eric [eric.dash@treasury.gov]; Roberts, Benson [benson.roberts@treasury.gov]
Subject: RE: Updated PSPA Q&A
Attachments: 07 PSPA Announcement QA 8_11_12 - ag comments.doc

Please find my suggested edits redlined in the attached.

Alan

From: Chepenik, Adam
Sent: Sunday, August 12, 2012 6:46 PM
To: Datta, Ankur; Mlynarczyk, Beth; Stegman, Michael; Anderson, Matthew; Moore, Megan; Colbert, Julian (Drew); Bowler, Timothy; Foster, Jeff; Goldblatt, Alan; Dash, Eric; Roberts, Benson
Subject: Updated PSPA Q&A

Hi all,

The updated Q&A based on our call today is attached.

It is ready for Michael, Tim and Meghan's review and feedback.

In terms of timing, our goal is to send the document to Mary by tomorrow afternoon.

DRAFT
Sensitive and Pre-Decisional

- Most community banks have previously written-down their preferred stock holdings and therefore these changes should not affect community banks financial positions. [Can we add a citation here to a third-party source???]

[Beth] Doesn't this change mean you could give the GSEs a bigger bailout by providing more headroom under the PSPAs?

- These changes do not change the maximum cap of PSPA support for either GSE. However, it preserves the remaining capacity for true business activity and other financial losses – its original intended use - rather than using the capacity in a circular fashion to pay ~~the~~ Treasury the 10% dividend.

- By sweeping the full income of the GSEs each quarter, Treasury will receive no less from the GSEs as we would have under the previous 10 percent dividend. Essentially, ~~I~~it will ~~simply~~ stop the GSEs from *drawing from* Treasury in order to *pay* Treasury the 10% dividend~~in any given quarter~~ (note: it's actually more complicated).

[Ankur] Why are you providing the GSEs with a capital buffer under this agreement? How does the buffer work?

- The declining capital buffer, initially set to $3 billion, is ~~being~~ provided ~~simply~~ to avoid extraneous quarterly draws on ~~[~~Treasury~~/taxpayer] funds~~ that would otherwise occur as a result of the volatility in earnings arising from the GSEs' normal course of business. The capital buffer will be declining each year going forward and reach zero by 2018. Thus, within six years, the entire capital buffer will be eliminated and paid ~~returned~~ to ~~[~~Treasury~~/the taxpayer]~~.

HOUSING FINANCE REFORM

[Beth] Will this change reduce the urgency for fundamental long-term housing finance reform? Moreover, now that the GSEs are profitable again, can they just continue operating indefinitely as a public utility?

- These changes are consistent with Treasury's policy to wind-down the GSEs. ~~By s~~Sweeping the GSEs' ~~full~~ positive net worth~~income, it~~ helps ensure that the GSEs will not be able to rebuild capital as they are wound down.

- Furthermore, this provides a framework for the GSEs to be transitioned to a future housing finance system that is more reliant on private capital. This agreement sets out clear targets by requiring the GSEs to reducing the size of the mortgage holdings in their retained portfolios by 15 percent per year, a faster pace than before. And it forces the management of the GSEs to set concrete goals and timetables to reduce the operational and financial risk of the enterprises by requiring an annual risk management action plan. In other words, this effectively operationalizes our commitment to wind down the GSEs.

- However, we also recognize the housing market is still fragile and private capital has not yet returned in a robust manner. These changes strike an important balance. They will allow the

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IN THE UNITED STATES COURT OF FEDERAL CLAIMS

WASHINGTON FEDERAL, ET AL.,) Case No. 13-385C
FAIRHOLME FUNDS, ET AL.,) Case No. 13-465C
JOSEPH CACCIAPALLE, ET. AL.,) Case No. 13-466C
BRYNDON FISHER, ET AL.,) Case No. 13-608C
ARROWOOD INDEMNITY COMPANY, ET AL.,) Case No. 13-698C
BRUCE REID, ET AL.,) Case No. 14-152C
LOUISE RAFTER, ET AL.,) Case No. 14-740C
OWL CREEK ASIA I, L.P., ET AL.,) Case No. 18-281C
AKANTHOS OPPORTUNITY MASTER FUND,) Case No. 18-369C
ET AL.,)
APPALOOSA INVESTMENT LIMITED) Case No. 18-370C
PARTNERSHIP I, ET AL.,)
CSS, LLC,) Case No. 18-371C
MASON CAPITAL L.P., ET AL.,) Case No. 18-529C
Plaintiffs,)
vs.)
UNITED STATES OF AMERICA,)
Defendant.)

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Courtroom 4
Howard T. Markey National Courts Building
717 Madison Place, N.W.
Washington, D.C.
Tuesday, November 19, 2019
9:00 a.m.
Oral Argument Defendant's Motion to Dismiss

BEFORE: THE HONORABLE MARGARET M. SWEENEY

Transcribed by: Sara J. Vance, CERT

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APPEARANCES:
ON BEHALF OF THE FAIRHOLME PLAINTIFFS:
CHARLES J. COOPER, ESQ.
DAVID H. THOMPSON, ESQ.
PETER A. PATTERSON, ESQ.
Cooper & Kirk PLLC
1523 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 220-9600 / (202) 220-9601 (fax)
ccooper@cooperkirk.com

ON BEHALF OF THE CACCIAPALLE PLAINTIFFS:
HAMISH P.M. HUME, ESQ.
PATRICK LAFFERTY, ESQ.
Boies Schiller Flexner, LLP
1401 New York Avenue, N.W.
Washington, D.C. 20005
(202) 237-2727 / (202) 237-6131 (fax)
hhume@bsfllp.com

AND

ERIC L. ZAGAR, ESQ.
LEE D. RUDY, ESQ.
Kessler Topaz Meltzer & Check LLP

4

APPEARANCES (cont.):
280 King of Prussia Road
Radnor, Pennsylvania 19087
(610) 667-7706 / (610) 667-7056 (fax)
ezagar@ktmc.com / lrudy@ktmc.com

ON BEHALF OF THE OWL CREEK, AKANTHOS, APPALOOSA, CSS AND MASON PLAINTIFFS:
LAWRENCE D. ROSENBERG, ESQ.
BRUCE BENNETT, ESQ.
Jones Day (DC)
51 Louisiana Avenue, N.W.
Washington, DC 20001-2113
(202) 879-7622 / (202) 626-1700
ldrosenberg@jonesday.com

ON BEHALF OF THE WASHINGTON FEDERAL PLAINTIFFS:
KEVIN K. GREEN, ESQ.
Hagens Berman Sobol Shapiro
533 F Street
Suite 207
San Diego, California 92101
(619) 929-3340
KevinG@hbsslaw.com
AND

APPEARANCES (cont.):
ROBERT ROSEMAN, ESQ.
Spector Roseman & Kodroff
Two Commerce Square
2001 Market Street, Suite 3420
Philadelphia, Pennsylvania 19103
(215) 496-0300 / (215) 496-6611

ON BEHALF OF THE REID AND FISHER PLAINTIFFS:
PATRICK J. VALLELY, ESQ.
EDWARD F. HABER, ESQ.
Shapiro Haber & Urmy, LLP
53 State Street
Boston, Massachusetts 02109
(617) 439-3939 / (617) 439-0134 (fax)
pvallely@shulaw.com

AND

NOAH M. SCHUBERT, ESQ.
Schubert Jonckheer & Kolbe LLP
Three Embarcadero Center, Suite 1650
San Francisco, California 94111-4018
(415) 788-4220 / (415) 788-0161 (fax)
nschubert@sjk.law

APPEARANCES (cont.):
ON BEHALF OF THE RAFTER PLAINTIFFS:
GREGORY P. JOSEPH, ESQ.
CHRISTOPHER J. STANLEY, ESQ.
Joseph Hage Aaronson LLC
485 Lexington Avenue, 30th Floor
New York, New York 10017
(212) 407-1200 / (212) 407-1280 (fax)
gjoseph@jha.com

ON BEHALF OF ARROWOOD PLAINTIFFS:
RICHARD M. ZUCKERMAN, ESQ.
Denton US, LLP
1221 Avenue of the Americas
New York, New York 10020
(212) 768-6700 / (212) 768-6800 (fax)
richard.zuckerman@dentons.com

APPEARANCES (cont.):
ON BEHALF OF THE DEFENDANT:
KENNETH M. DINTZER, ESQ.
ELIZABETH HOSFORD, ESQ.
ERIC LAUFGRABEN, ESQ.
RETA BEZAK, ESQ.
FRANKLIN WHITE, ESQ.
MARIANA ACEVEDO, ESQ.
U. S. Department of Justice - Civil Division
Post Office Box 480
Ben Franklin Station
Washington, DC 20044
(202) 616-0385 / (202) 514-8624 (fax)
kenneth.dintzer@usdoj.gov

P R O C E E D I N G S
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(Proceedings called to order, 9:00 a.m.)

LAW CLERK: The United States Court of Federal Claims is now in session. The Honorable Margaret M. Sweeney presiding, in Washington Federal vs. United States, Case Number 13-385; Fairholme Funds, Incorporated vs. United State 13-465; Cacciapalle vs. United States, 13-466; Fisher vs. United States, 13-608; Arrowood Indemnity Company vs. United States; 13-698; Reid vs. United States, 14-152; Rafter vs. United States, 14-740; Owl Creek Asia I, L.P. vs. United States, 18-281; Akanthos Opportunity Master Fund, L.P. vs. United States, 18-369; Appaloosa Investment Limited Partnership I vs. United States, Number 18-370; CSS, LLC vs. United States, 18-371; Mason Capital, L.P. vs, United States, 18-529.

THE COURT: Thank you, Mr. Hansen. Please be seated.

Good morning to all of you.

COUNSEL: Good morning, Your Honor.

THE COURT: Would Plaintiffs start by identifying themselves for the record, Plaintiffs' counsel.

MR. COOPER: Yes. Good morning, Your Honor, again. Charles Cooper with Cooper & Kirk representing we would -- most of us would not be here if it were not for the Third Amendment. But that doesn't show at all that our claims are derivative.

I do like his idea, however, of asking a hypothetical question because I think, Your Honor, a simple hypothetical will clarify this direct/derivative question absolutely for you. Imagine a Third Amendment that is the same as the actual one in one respect and different in another. It is the same as the actual Third Amendment in that it says 100 percent of any distributions that are ever made from these enterprises in any form -- liquidation, distribution, redemption, whatever -- must only go forever and always to the Treasury. That's what it actually says, in my hypothetical, it still says that. So no matter what, the shareholders get nothing. Okay?

The thing that's different in the hypothetical, imagine that the Third Amendment, however, does not require that that 100 percent get swept out every quarter, but instead allows the enterprises to build capital, to build their businesses, to get back on their feet, to flourish and thieve. But whenever they want to get rid of -- distribute any money, 100 percent has to go to Treasury.

So the enterprises arguably are not harmed by

this hypothetical Third Amendment. They're allowed to flourish. They are allowed to build capital. But the first part of the Third Amendment is the same as the current one. No matter what, the private shareholders get nothing. All profits that are ever distributed -- if there is ever to be a distribution -- must go to Treasury. That hypothetical Third Amendment, Your Honor, there can be no question that the shareholders would have claims, and they would have to be direct because there's no injury to the enterprises.

And that should clarify the whole issue for you because it cannot logically be the case that when you go from the hypothetical Third Amendment to something that's even worse because it hurts the enterprises that that robs us of our direct claim. It doesn't. It's just as bad for the shareholders as the hypothetical. In fact, it's worse for the shareholders.

So our direct claim still exists, just like it would with the hypothetical. The only difference is now the enterprises also have derivative claims. So we have both. There is no question that we are directly injured. If we could just go to Slide -- back to -- well, first to Slide 24, which shows what I just said. Do we have -- we just need help turning on our slides.

So Slide 24, Your Honor, shows what I just

said. Hypothetical Third Amendment, the same in that all distributions must only go to Treasury; different in that it allows the enterprises to build capital, return to safe and sound operations, and thrive. This would injure the shareholders but would not injure the enterprises, so it would clearly give rise to direct claims only. So our proposition is that logically it cannot be the case that we lose our direct claims because the actual Third Amendment is worse than the hypothetical.

And that's really it. And it conforms with state law because state law says that when the capital structure of a company is rearranged to help some shareholders but harm other shareholders, that gives rise to direct claims by the injured shareholders. And I would cite the Court to the Deephaven case, particularly the text -- and Footnote 41 and the text accompanying Footnote 41 that's cited on page 23 of our omnibus opposition. That's an example, but there are others in the state law cases that confirm that when you injure one group of shareholders in favor of another group of shareholders that gives rise to a direct claim.

Now, I would like to address the Government's argument that the D.C. -- sorry, the Federal Circuit's decision in the Starr case is somehow inconsistent with our position here. And I was involved in that case to

some degree. Our firm litigated it. And there's a couple of very, very big differences between that case and this case. And if I may, I'd like to go back to this slide that I showed where we showed the property rights taken in this case.

In this first -- and remember I said this box. This shows what the Treasury got under the original 2008 deal: 10 percent dividends and 79.9 percent of the common stock. We are not challenging this. We -- the class -- the Cacciapalle class, none of the Plaintiffs before you except for the Washington Federal Plaintiffs are challenging this. The AIG case was challenging the equivalent of this deal. It was not a 10 percent deal; it was a -- it was a high-interest-rate loan and 80 percent of the stock -- 79.9 percent of the stock. They were challenging that. And that was held to be derivative because it was held to be a corporate dilution through the issuance of stock.

And it's precisely on page 967 of the Federal Circuit's decision that the Federal Circuit rejects the argument of the AIG shareholders that they had a direct claim by saying -- and there's even a quote of this in the Government's slides from this morning, Slide 49. They rejected the argument that there was a direct claim because there's a material difference between a new