UNITED STATES COURT OF FEDERAL CLAIMS

MICHAEL E. KELLY, FBOP CORPORATION, RIVER CAPITAL ADVISORS, INC. and FBOP CORPORATION ON BEHALF OF CALIFORNIA NATIONAL BANK, PARK NATIONAL BANK, SAN DIEGO NATIONAL BANK, PACIFIC NATIONAL BANK, BANKUSA, NORTH HOUSTON BANK, MADISON STATE BANK, COMMUNITY BANK OF LEMONT, CITIZENS NATIONAL BANK AND RIVER CAPITAL ADVISORS, INC. Plaintiffs, v. THE UNITED STATES OF AMERICA, Defendant.	No. 21-1949C Judge Kathryn C. Davis **[PROPOSED] AMENDED COMPLAINT**

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TABLE OF ACRONYMS AND ABBREVIATIONS

1992 Act	Federal Housing Enterprises Financial Safety and Soundness Act of 1992
Fannie Mae	Federal National Mortgage Association
FHFA	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
GSE	Government Sponsored Enterprise
HERA	Housing and Economic Recovery Act of 2008
HUD	U.S. Department of Housing and Urban Development
MBS	Mortgage-Backed Security
OFHEO	Office of Federal Housing Enterprise Oversight
SPSPAs	Senior Preferred Stock Purchase Agreements
Treasury	U.S. Department of Treasury

Plaintiffs Michael E. Kelly ("***Mr. Kelly***"), FBOP Corporation ("FBOP"), River Capital Advisors, Inc. ("***River Capital***"), and (1) Park National Bank; (2) San Diego National Bank; (3) Pacific National Bank; (4) BankUSA; (5) North Houston Bank; (6) Madison State Bank; (7) Community Bank of Lemont; (8) Citizens National Bank; (9) California National Bank (together, "***FBOP Subsidiaries***") (collectively, "***Plaintiffs***"), allege as follows:

NATURE OF THE ACTION

1. This action seeks just compensation for the Government's taking of Plaintiffs' Tier 1 Capital and the rights and protections that adhered to their ownership of preferred shares in the government sponsored enterprises, Federal National Mortgage Association ("***Fannie Mae*")** and Federal Home Loan Mortgage Corporation ("***Freddie Mac***") (together, the "***GSEs***").

2. Plaintiff Michael E. Kelly is the CEO and sole common shareholder of Plaintiff FBOP Corporation. FBOP is a bank holding company that held nine banks, the FBOP Subsidiaries, each a Plaintiff. Plaintiff River Capital Advisors, Inc. is a non-bank subsidiary of FBOP.

3. Between 2007 and early 2008, the FBOP Subsidiaries and River Capital invested more than $900 million in GSE preferred shares because the Government had promised that those investments were as good as cash and a safe use for up to 100% of the FBOP Subsidiaries' Tier 1 Capital.

4. The purchase of those GSE preferred shares was based on certain investment-backed expectations, including but not limited to, that: (1) the GSE preferred shares were a safe use of up to 100% of the FBOP Subsidiaries' Tier 1 Capital; (2) the Government would not take any action that would undermine the value of the GSE preferred shares and force the FBOP Subsidiaries into receivership due to regulatory undercapitalization; (3) the FBOP Subsidiaries had

certain voting rights, dividend rights, and liquidation preferences by virtue of their ownership of the GSE preferred shares; and (4) the GSE management would hold those investments in trust as fiduciaries who operated the GSEs to increase shareholder value.

5. In September 2008, the Government destroyed these investment-backed expectations when it coerced GSE management to "acquiesce" to a conservatorship under the Housing and Economic Recovery Act of 2008 ("***HERA***") and took for the benefit of the United States the rights and protections that ownership of the preferred shares had guaranteed. The Department of Treasury then obtained the exclusive right to decide when to terminate the conservatorship and has in effect made the conservatorship perpetual. In fact, the conservatorship continues today, almost 15 years later.

6. Through this forced "nationalization" of the GSEs, the GSEs stopped operating for the benefit of their shareholders, and the Government took for a public use the rights, protections, and duties that adhered to the ownership of the GSE preferred shares. As a result of this taking, the stock price of the preferred shares plummeted and any investment of a bank's Tier 1 Capital vanished. The ultimate consequence of this Government action forced the FBOP Subsidiaries into receivership. In short order, the Government took all of Plaintiffs' assets. Plaintiffs demand just compensation for this Government action under the takings clause of the Fifth Amendment to the United States Constitution.

7. The FBOP Subsidiaries and River Capital also seek damages because the Government breached the duties of good faith and fair dealing implied in the GSEs' stock certificates and bylaws. Implied in those contracts are promises that the GSEs would be operated by fiduciaries who would manage the GSEs to increase shareholder value. By coercing the GSEs into the conservatorship, ensuring that the conservatorships would be run perpetually for the

benefit of the United States, and taking actions to the detriment of the shareholders, the Government was put in privity with the FBOP Subsidiaries and River Capital under the stock certificates and bylaws. The Government breached the implied covenants by operating the GSEs for the benefit of the United States and taking action that subordinated shareholder rights and protections to the general public.

8. Finally, Plaintiffs seek damages for the Government's breach of an implied regulatory contract. The only reason the FBOP Subsidiaries and River Capital purchased the GSE preferred shares was because the Government promised that those investments were a safe use of Tier 1 Capital, that 100% of Tier 1 Capital could be used to purchase GSE preferred shares, and that the dividends earned from ownership of the GSE preferred shares would enjoy beneficial tax treatment. The Government made these promises as part of an offer for the banks to recapitalize the GSEs. Implied in that offer and in those promises was that the Government would pass no law or take no action that would render the value of the GSE preferred shares worthless, extinguish the associated Tier 1 Capital, and result in the regulatory undercapitalization of the banks. By using HERA and coercing the conservatorship, by allowing Treasury to decide when the conservatorship ends (in effect, making it perpetual), and by the actions the conservator took, the Government altered the regulatory landscape to such a degree that it could no longer perform its promise that the investment in the GSEs' preferred shares were a safe use of all of Plaintiffs' Tier 1 Capital. Because the Government took the actions that made its regulatory promises impossible to honor, the Government bore the risk if it rendered its performance impossible. Plaintiffs accordingly seek damages for the harm caused to them by the Government's actions that made their GSE investments a detrimental use of their Tier 1 Capital and an unsafe investment.

JURISDICTION AND VENUE

9. This Court has jurisdiction pursuant to 28 U.S.C. §§ 1491(a) and 2501. Venue is proper under 28 U.S.C. § 1491(a).

10. Under 28 U.S.C. § 1491(a)(1), Congress waived sovereign immunity as to certain claims against the United States Government. Specifically, 28 U.S.C. § 1491(a)(1) provides, "[t]he United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort."

TOLLING OF THE STATUTE OF LIMITATIONS

11. A six-year statute of limitations governs the timeliness of Plaintiffs' claims. 28 U.S.C. § 2501.

12. Given the proposed class action then before this Court in *Washington Federal v. United States*, No. 1:13-cv-00385, the statute of limitations on Plaintiffs' individual claims for relief below, both direct and derivative, was tolled between June 10, 2013 (the date the original *Washington Federal* complaint was filed) and July 16, 2020 (the date the Court in *Washington Federal* unsealed its Opinion and Order dismissing that action).

PARTIES

13. Plaintiff FBOP Corporation is an Illinois-based community bank holding company. At the time the conservatorship was imposed on the GSEs, FBOP Corporation was the largest privately owned bank holding company in the United States.

14. Plaintiff Michael E. Kelly is the Chairman and Chief Executive Officer of FBOP Corporation. He was and remains the sole common shareholder of FBOP, which was sole common shareholder of the FBOP Subsidiaries and River Capital. Mr. Kelly is President and sole director of River Capital. Mr. Kelly has third-party standing and asserts direct claims for relief on behalf of himself, FBOP, the FBOP Subsidiaries, and River Capital. Alternatively, Mr. Kelly has standing to bring claims on behalf of himself and FBOP, derivatively on behalf of FBOP and derivatively on behalf of the FBOP Subsidiaries and River Capital. Alternatively, FBOP has standing and asserts claims for relief on behalf of itself.

15. Plaintiff River Capital Advisors, Inc. is an FBOP wholly owned non-bank subsidiary.

16. FBOP has standing and asserts claims for relief on behalf of the nine former FBOP Subsidiaries: (1) Park National Bank; (2) San Diego National Bank; (3) Pacific National Bank; (4) Bank USA; (5) North Houston Bank; (6) Madison State Bank; (7) Community Bank of Lemont; (8) Citizens National Bank; and (9) California National Bank as the assignee and successor in interest to such claims. FBOP also has standing and asserts claims for relief on behalf of River Capital, an FBOP wholly-owned non-bank subsidiary. River Capital alternatively has standing to bring direct claims on its own behalf. FBOP Subsidiaries and River Capital were preferred shareholders of Fannie Mae and/or Freddie Mac.

17. Defendant United States of America (the "***Government***") includes the Federal Housing Finance Agency ("***FHFA***") and its agents acting at its direction, and the United States Treasury ("***Treasury***") and its agents acting at its direction. The FHFA, the Treasury, the Federal Deposit Insurance Corporation ("***FDIC***"), the Office of the Comptroller of the Currency ("***OCC***"),

the Office of Thrift Supervision ("***OTS***"), the Federal Reserve, and the Internal Revenue Service ("***IRS***") are all Government actors.

FACTUAL BACKGROUND

I. Mr. Kelly and FBOP Corporation

18. In 1981, Mr. Kelly formed an investment group that acquired First Bank of Oak Park. Mr. Kelly became its President and CEO. Within five years, the First Bank of Oak Park's worth had doubled and it was frequently rated first in Illinois based on its return on assets and equity. In 1986, Mr. Kelly formed FBOP, a bank holding company with Mr. Kelly as the sole common shareholder. FBOP acquired 100% of the First Bank of Oak Park.

19. In the 1990s, FBOP began to expand. FBOP had developed significant expertise in restructuring loans in the midst of economic crises that provided growth opportunities. During the farm crisis in the Midwest, and then during a real estate crisis in Texas, FBOP purchased failed assets from the FDIC in areas where the FDIC had closed banks. FBOP's on-the-ground efforts enabled its personnel to meet with individual loan holders to create realistic payment plans. This strategy proved successful, served communities struggling with economic crises, and fueled FBOP's tremendous growth. FBOP's success provided it with sufficient capital to acquire several other banks.

20. For more than twenty-five consecutive years, FBOP experienced enormous success and posted record profits. What was initially a $60 million community bank in 1981 became a large multi-bank holding company. FBOP had nine subsidiaries: (1) Park National Bank; (2) San Diego National Bank; (3) Pacific National Bank; (4) Bank USA; (5) North Houston Bank; (6) Madison State Bank; (7) Community Bank of Lemont; (8) Citizens National Bank; and (9)

California National Bank. Together, the FBOP and FBOP Subsidiaries owned $19.4 billion in assets and operated 150 branches, approximately one-third of which were in low- to moderate-income census tracts. FBOP became the largest privately held bank holding company in the country and employed approximately 2,400 people.

21. Although FBOP was a large holding company, FBOP's banks operated as community banks committed to providing financial products and services to individuals, local businesses, and not-for-profit corporations, including small businesses and borrowers who would have been rejected by larger lenders.

22. FBOP was committed to community investments even in times of macroeconomic distress. In 2007 and 2008, for example, FBOP's banks made charitable and other community investments totaling $55 million, which represented 28% of its profits in those years. FBOP also made $17 million in contributions at the holding company level. In late 2007, six of the nine FBOP Subsidiaries were rated "outstanding" for their community reinvestment efforts, a rating bestowed on only 8% of banks in the United States.

23. FBOP Subsidiaries never engaged in subprime lending, predatory lending, or excessive executive compensation. FBOP did not once pay a common stock dividend to its sole common shareholder, Michael Kelly. All profit was reinvested in the banks or the community.

II. Fannie Mae and Freddie Mac

A. Background and Share Structure

24. Congress charted Fannie Mae in 1938 and it was privatized in 1968 under the Housing and Urban Development Act. Congress chartered Freddie Mac in 1970 and it was privatized in 1989 under the Financial Institutions Reform, Recovery, and Enforcement Act. Both

Fannie Mae and Freddie Mac were created to provide increased liquidity and stability to the secondary mortgage market by securitizing mortgage loans as mortgage-backed securities.

25. As for-profit, publicly traded companies, Fannie Mae and Freddie Mac were able to raise funds from the private capital market. Both were traded on the New York Stock Exchange until June 2010.

26. Before the financial crises, Fannie Mae had issued close to 600 million preferred shares in 17 different series (with a total redemption value of approximately $21 billion) and one billion common stock shares outstanding (with a value of more than $7 billion). Freddie Mac had similarly issued more than 460 million preferred shares in 24 different series (with a total redemption value of approximately $14 billion) and approximately 650 million common stock shares outstanding (with a value of approximately $3.3 billion).

27. GSE preferred shares, like those purchased by FBOP Subsidiaries, had certain rights attached. For example, shareholders had the right to receive a portion of the company's assets in the event of liquidation or dissolution. They also had the right to receive (and did receive) dividend payments. Shareholders were also entitled to vote on amendments to the certificate of designation for their share series. Finally, shareholders had the right to transfer their shares.

B. Pre-Conservatorship Regulation and Investment Incentives

28. From 1992 until late July 2008, the GSEs were regulated under the terms of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("***the 1992 Act***") and the GSE congressional charters ("***GSE Congressional Charters***").

29. Under the 1992 Act, the Department of Housing and Urban Development ("***HUD***") and the Office of Federal Housing Enterprise Oversight ("***OFHEO***") were joint GSE oversight

bodies. The 1992 Act granted HUD general regulatory power over the GSEs. HUD was charged with establishing housing goals and a non-discretionary obligation to maintain the sound financial condition of the GSEs.

30. The 1992 Act established the OFHEO as the chief regulator of the GSEs. OFHEO had a non-discretionary obligation to ensure that the GSEs were adequately capitalized and operating safely. This included the power to set capital requirements, to undertake safety and soundness examinations of the GSEs, as well as various enforcement powers.

31. The 1992 Act and the GSE Congressional Charters provided certain shareholder protections which included a reasonable economic return.

32. In 2006, the OFHEO imposed increased capital requirements on the GSEs totaling approximately $36 Billion ("***2006 Consent Agreements***"). To meet these requirements, the GSEs issued new series of preferred shares. Despite some interest from corporate treasuries, to attract sufficient interest in GSEs' preferred shares quickly, it was necessary to create a market for the GSEs' preferred shares that would specifically appeal to banks with cash readily available to recapitalize the GSEs.

33. The Government had created strong regulatory incentives targeted to induce banks to invest heavily in the GSEs in order to support and accomplish the recapitalization goals of the GSEs under the 2006 Consent Agreements. These incentives were established and promulgated by the Treasury, the OCC, the OTS, the Federal Reserve, the FDIC, and the IRS.

34. The incentives provided by the Government to banks who invested in GSE preferred shares included the following:

a. Banks were permitted to invest, "without limitation up to 100% of Tier 1 Capital," in perpetual GSE preferred shares, including bank funds designated as Tier 1 Capital. Normally, banks were not allowed to invest in equity investments; U.S. Government and Agency bonds were the only other asset class in which a bank could invest in.

b. Banks received special tax advantages associated with the GSE preferred share investments. IRS rules were amended to provide the banks with a 70% tax deduction on GSE preferred share dividends.

c. The OCC assigned a 20% capital risk-weight for GSE shares—the same weight applicable to Treasury Bonds, AAA rated investments, and cash. Most other investments were assigned a 50% or 100% risk weighting. The OCC adopted this 20% risk-weight based upon the "unique government relationship with Fannie Mae and Freddie Mac [and] to reflect the quasi-governmental nature of the entities."

35. At the time that the FBOP Subsidiaries and River Capital made their investments in the incentivized GSE preferred shares, the FDIC publicly stated that these investments did not represent a significant risk to the Deposit Insurance Fund. GSE preferred shares were rated "AA-" by S&P; "A1" by Moody's; and "A+" by Fitch, all considered relatively risk-free.

36. Based on the Government's incentives, the unique quasi-governmental nature of the GSEs, and the strong government and third-party investment ratings, the FDIC permitted banks to invest up to 100% of their Tier 1 Capital in GSE preferred shares. Other investments, as a class, were generally restricted to a limit of 10% of Tier 1 Capital. "Tier 1 Capital" in regulatory terms is defined as a bank's core capital – the minimum adequate funds determined to be needed by a

bank to function on a regular basis. Tier 1 Capital includes cash reserves and approved equity capital, and forms the basis for evaluating a financial institution's strength. Tier 1 Capital must be available when banks need to use it. It is therefore highly monitored and scrutinized by banking regulators.

37. Given the existing regulatory requirements as to maintaining sufficient levels of approved Tier 1 Capital, and the extreme consequences of a bank's failure to do so, the incentives and permission to invest up to 100% of a bank's Tier 1 Capital in GSE preferred shares was a unique and significant regulation and policy decision by the FDIC. The consequences of inadequate Tier 1 Capital are extreme: if a bank fails to maintain its prescribed Tier 1 Capital requirements, it risks being placed in receivership and effectively taken over by government regulators. By investing in the GSE preferred shares, the FBOP Subsidiaries relied on the FDIC and its affirmation that up to 100% of their Tier 1 Capital requirements could be invested in GSE preferred shares. Without such imprimatur and outright inducement by government incentives, the FBOP Subsidiaries would not have—and could not have—purchased the GSE preferred shares. The statements and actions taken by the Government through its various agencies, including the provision of substantial tax and other incentives, the affirmative exception to existing regulatory requirements and limitations, the published rating-weight given to the GSE preferred shares, and the acceptance by regulators of the banks' purchase of high percentage levels of Tier 1 Capital, together with the purposes and benefits obtained by the Government and the GSEs, and the potential catastrophic risk associated with the loss of the Tier I Capital invested in the GSEs, all represented an implied promise that the U.S. Government would refrain from regulatory activity that would vitiate the value of the GSE preferred shares.

38. These incentives and the implied guarantee by the U.S. Government significantly benefitted the GSEs in lowering their funding costs and allowing them to dominate the mortgage market, and provided much-needed liquidity to recapitalize the GSEs in 2007 and 2008. The Government significantly benefitted by avoiding the need to otherwise, through legislation or budgeting, directly provide substantial funding and liquidity to the GSEs.

39. As acknowledged by former FHFA Director James Lockhart, until August 2008, the three major rating agencies classified the GSEs abilities to meet their financial obligations as strong largely in part due to the explicit and implied guarantee of the U.S. Government. On September 24, 2008, in a speech to the nation, President Bush acknowledged that "[b]ecause [… the GSEs] were chartered by Congress, many believed they were guaranteed by the federal government." This implicit guarantee was a reoccurring consideration echoed by almost all investors in GSE shares and by the banking regulators themselves before and after the conservatorship of the GSEs.

40. Due to strong Government incentives, regulatory approval, and the implied guarantee, many banks invested substantial Tier 1 Capital in GSE preferred securities. Former chairman of the FDIC, William Isaac, has noted that over 2,700 community banks had relatively "major investments" in GSE shares and suffered significant losses following the imposition of conservatorship on the GSEs. Mr. Isaac emphasized that "[t]hose banks were encouraged to buy that paper by the low-risk ratings' regulators assigned to the paper […]. It was an ambush, and it caused a number of banks to fail.'"

41. The banking industry in the United States is one of the most heavily regulated. U.S. banking regulators communicate with their regulated entities through statutes, regulations, and regulatory guidance or interpretive letters. Banking regulators notify regulated entities of new or

updated statutes and regulations. In turn, regulated entities must immediately comply with those new statutes, regulations, and regulatory guidance or interpretive letters. Statutes, regulations, regulatory guidance or interpretive letters govern the permissible activities, risk ratings and leverage ratios of community banks. Most statutes, regulations and regulatory guidance or interpretive letters are negative statements, prohibiting or limiting community bank activities.

42. In adhering to banking regulations and the oversight of banking regulators, when making their Tier 1 Capital investments in the GSE preferred shares, Plaintiffs presumed and understood that they could reasonably rely upon the actions and statements of banking regulators when they represented and confirmed the soundness of these GSE investments and their explicit approval of the unlimited use of Tier 1 Capital to make them.

43. For example, at least one of the FBOP Subsidiaries, California National Bank (which held the largest investment in GSE preferred shares by the FBOP Subsidiaries), was assigned a full-time on-site OCC examiner to monitor California National Bank's activities and investments. The OCC examiner encouraged California National Bank to invest in the GSE preferred shares, highlighting the various advantages provided by banking regulations for investing in GSEs and the implied guarantee of the U.S. Government. That OCC regulator, fully aware of California National Bank's switch to heavily investing its Tier 1 Capital in the GSEs, never raised a single question or concerns at any time.

44. On January 21, 2010, Mr. Kelly testified at a hearing before the U.S. House of Representatives, Subcommittee on Financial Institutions and Consumer Credit. His written statement entered for the record ("***Kelly Statement***") and other testimony are available online.[1] As

[1] *The Condition of Financial Institutions: Examining the Failure and Seizure of an American Bank*, Hearing Before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services,

part of that testimony, Mr. Kelly was asked whether he would have concentrated such a large investment in the GSEs but for the FDIC rule that allowed 100 percent of GSE preferred stock to count against Tier 1 Capital – Mr. Kelly responded: “Absolutely not.”

45. Mr. Kelly also testified that none of the FBOP Subsidiaries were ever criticized by regulators for the GSE investments, or the large concentration percentage of Tier 1 Capital deployed in them. When asked if his mistake was to trust the Government, which told him to go out and invest in the GSEs, Mr. Kelly testified that he and the management of the FBOP Subsidiaries believed that GSE preferred stock investments were backed by the Government. Persons directing questions to Mr. Kelly stated that they had learned that investments in the GSEs were “mainly at the behest of the Federal Government, that they encouraged you, and highly encouraged you to make that type of investment.” This was exactly the message that banking regulators had conveyed to the FBOP Subsidiaries.

46. Convinced by the Government incentives, and relying on Government regulators, in late 2007 and early 2008, the FBOP Subsidiaries and River Capital purchased GSE preferred shares. These shares had a Combined Net Book Value of $898,448,392.

47. FBOP Subsidiaries and River Capital purchased Series O Fannie Mae preferred stock. Series O stock had a dividend rate of 7% and a liquidation preference of $50.00 per share. Holders of Series O preferred shares had the right to vote on proposed changes to the terms of their stock series. Subject to certain enumerated exceptions, Fannie Mae could not take an action that

U.S. House Of Representatives, One Hundred Eleventh Congress, Second Session (Jan. 21, 2010) at pp. 10-12 (opening testimony); pp. 14-26, 32-37, 46-48 (legislator comments and questioning); and pp. 112-30 (Kelly Statement), https://archives-financialservices.house.gov/Media/file/hearings/111/Printed%20Hearings/111-97.pdf (last visited September 30, 2021).

materially and adversely affected the interests of the shareholders of Series O Preferred Stock without the shareholders' consent .

FBOP Subsidiaries Series O Fannie Mae Preferred Stock Share Holdings and Share Values as of September 10, 2008			
Name of Bank	**Book Value of Shares**	**Book Value Per Share**	**Number of Shares**
Park National Bank	$63,389,491	$49.14	1,290,000
California National Bank	$157,364,390	$51.77	3,039,618
San Diego National Bank	$84,699,020	$48.62	1,742,071
Pacific National Bank	$42,640,605	$52.50	812,202
North Houston Bank	$21,258,917	$42.52	500,000
Madisonville State Bank	$11,884,833	$42.45	280,000
Bank USA	$5,090,000	$42.42	120,000
Citizens National Bank	$2,546,750	$42.45	3,039,618
River Capital Advisors, Inc. [FBOP Non-Bank Holding]	$4,992,333	$42.67	117,000

48. In addition, California National Bank purchased 1,600,000 shares of Series S preferred stock in Fannie Mae, which as of September 10, 2008, had a total book value of $40,056,000, and a per share book value of $25.04. Series S stock had a dividend rate of 8.25%

and a liquidation preference of $25.00 per share. Holders of Series S shares had the right to vote on proposed changes to the terms of their stock series. Subject to certain enumerated exceptions, Fannie Mae could not take an action that materially and adversely affected the interests of the shareholders of Series S Preferred Stock without the shareholders' consent.

49. FBOP Subsidiaries and River Capital purchased Series Z preferred stock in Freddie Mac. Series Z stock had a dividend rate of 8.375% and a liquidation preference of $25.00 per share. Holders of Series Z shares had the right to vote on proposed changes to the terms of their stock series. Subject to certain enumerated exceptions, Freddie Mac could not take an action that materially and adversely affected the interests of the shareholders of Series Z Preferred Stock without the shareholders' consent.

FBOP Subsidiaries Series Z Freddie Mac Preferred Stock Share Holdings and Share Values as of September 10, 2008			
Name of Bank	**Book Value of Shares**	**Book Value Per Share**	**Number of Shares**
Park National Bank	$48,804,368	$25.69	1,900,000
California National Bank	$237,400,318	$25.87	9,176,900
San Diego National Bank	$86,455,926	$25.71	3,363,100
Pacific National Bank	$41,656,000	$25.40	2,452,202
North Houston Bank	$25,000,000	$25.00	1,000,000
Madisonville State Bank	$14,000,000	$25.00	560,000

FBOP Subsidiaries Series Z Freddie Mac Preferred Stock Share Holdings and Share Values as of September 10, 2008			
Name of Bank	**Book Value of Shares**	**Book Value Per Share**	**Number of Shares**
Citizens National Bank	$3,000,000	$25.00	120,000
Bank USA	$6,000,000	$25.00	240,000
River Capital Advisors, Inc. [FBOP Non-Bank Holding]	$2,209,441	$16.37	135,000

50. Government regulators monitored and were aware that FBOP Subsidiaries had invested a substantial portion of their Tier 1 Capital in these GSE preferred shares. As part of their annual reviews of the FBOP Subsidiaries for the year 2007, neither the OCC nor the FDIC raised concerns about the soundness of these Tier 1 Capital investments. The OCC and FDIC are mandated, as a prudential supervisors, to ensure that banks operate in a safe and sound manner. In fact, the OCC had an Examiner-in-Charge to supervise FBOP and the FBOP Subsidiaries on a full-time basis.

51. But for the Government incentives and the bank regulators implicit and express approval, the FBOP Subsidiaries and River Capital would not have made such a substantial investment in GSE stock. Without banking regulators approval, the FBOP Subsidiaries would not have been able to maintain these investments as Tier 1 Capital investments under U.S. banking regulations.

III. Financial Crisis, Federal Government Action, and Imposition of the Conservatorship

A. Government Actions in 2007 and 2008

52. At the end of 2007, the U.S. economy was in decline. The Government took certain actions that affected the operations of and market confidence in the GSEs.

53. On February 13, 2008, Congress raised the conforming loan limits for the GSEs to $729,750. This increased the exposure of the GSEs to losses related to subprime loans. potentially affecting their financial health. As the then-Director of the FHFA acknowledged, the GSEs "have been reducing risks in the market but concentrating mortgage risks on themselves."

54. On March 10, 2008, Barron's published a critical article about Fannie Mae that suggested the company could be insolvent. The article was sourced from the Bush White House with full knowledge of the Treasury. As detailed by the Financial Crisis Inquiry Commission ("***FCIC***"), in advance of the article, a member of the Bush Administration sent the Undersecretary to the Treasury (via email) a report identified as the source for the Barron's article, stating that the report should be used to "help inform potential internal Treasury discussions about the potential costs and benefits of nationalization" of the GSEs.

55. On March 19, 2008, the OFHEO (at Treasury's behest) eased capital restraints on the GSEs in exchange for an agreement by the GSEs to raise significant capital at some undetermined point in the future. This change resulted in a greater accumulation of government mandated high-risk holdings by the GSEs. By requiring the GSEs to take on such additional risk, the Government laid the groundwork for the potential government takeover of the GSEs.. As detailed by author Timothy Howard in *The Mortgage Wars*, the former CFO of Fannie Mae later stated that Treasury Secretary Henry Paulson's "action to not just allow but actually encourage Fannie Mae and Freddie Mac to add new mortgages with no firm commitment to raise capital to

back them is understandable only if by then he had concluded that Treasury would be able to use the road map from the GSE insolvency paper . . . to put the GSEs into receivership or conservatorship."

56. Although not publicly revealed until 2011, throughout the summer of 2008, the Government continued to destabilize the GSEs by leaking information to the press and Wall Street executives and hedge fund managers that a government takeover was imminent. This included a July 21, 2008 meeting where Secretary Paulson met with Wall Street executives and hedge fund managers before the passage of HERA in which Secretary Paulson revealed that the GSEs would be placed into conservatorship.

57. These leaks of information by the Government caused the GSE share prices to plummet.

58. This conduct by the government is not uncommon preceding a nationalization or expropriation involving a major industry or sector.

59. However, during this same time period, Government officials and bank regulators made repeated public statements, in direct conflict with what hedge funds and Wall Street managers were told privately, emphasizing the sound financial status of the GSEs.

60. On March 31, 2008, for example, the Director of OFHEO classified the GSEs as adequately capitalized. On July 10, 2008, Secretary Paulson and Chairman of the Federal Reserve Ben Bernanke testified before the House of Representatives that both GSEs were adequately capitalized, and the Director of the OFHEO issued a news release stating the same. Secretary Paulson specifically emphasized that there was no sudden deterioration in the conditions of the GSEs that motivated Treasury support for using HERA to gain government control.

61. On July 24, 2008, with Treasury's support, Congress enacted HERA. HERA replaced OFHEO with the FHFA, which was granted express authority to put the GSEs into conservatorship or receivership under certain enumerated, non-discretionary conditions.

62. After the passage of HERA the GSEs remained solvent. Fannie Mae declared dividends on its preferred and common stock in August 2008. Dividends are only allowed where the GSEs are solvent. On August 22, 2008, the FHFA notified the GSEs that they were adequately capitalized and exceeded their regulatory capital requirements. Likewise, on August 25, 2008, the respected investment firm BlackRock, retained by the FHFA to offer an independent opinion, concluded that Freddie Mac's "long-term solvency does not appear endangered—we do not expect Freddie Mac to breach critical capital levels even in stress case."

B. <u>The Government's Action in Taking Control of the GSE's and Seizing all Shareholder Assets.</u>

63. On September 6, 2008, the Government moved to place both GSEs into conservatorship. The GSEs and its shareholder banks were blindsided. The decision and action by the Government, which resulted in the government takeover of control of the GSEs and all assets of the shareholders, was made and taken at the highest levels of the Executive branch of the U. S. Government. The decision was made by the Secretary of the Treasury and the Federal Reserve Chairman, and explicitly approved by the President of the United States. The final decision in regard to the GSEs future came during a series of marathon meetings over Labor Day weekend at Treasury. Attendees included Secretary Paulson; a dozen Treasury officials; Chairman Bernanke; Federal Reserve Governor Kevin Warsh; the Federal Reserve general counsel; Art Murton of the FDIC, a top banking official; Morgan Stanley; Director Lockhart and Mr. Lockhart's team, which

included FHFA outside legal counsel from Arnold & Porter and Wachtell, Lipton, Rosen & Katz phoning in from New York.

64. According to Secretary Paulson's memoir, *On the Brink, Inside the Race to Stop the Collapse of the Global Financial System*, Sheila Bair, chairperson of the FDIC, sent her best examiner to "help write the case" and finally Director Lockhart "managed to get his examiners to sign off on what [... was] needed. Either [... Director Lockhart] had worn those examiners down or they had come to realize that immediate conservatorship was the best way for them to resolve this dangerous situation with their reputation intact." Treasury Secretary Paulson stated in regard to the FHFA, "They needed to be led to the conclusion they know was right. Doing so would in effect overturn the work they'd done for years."

65. In *On the Brink*, Secretary Paulson recalled that he met with President George W. Bush a mere three days before the conservatorship and informed him: "We're going to move quickly and take them by surprise. The first sound they'll hear is their heads hitting the floor." He acknowledged that the plan was to "ambush Fannie and Freddie" "[f]or the good of the country." Had they attempted to discuss the plan with the GSE boards, Secretary Paulson knew "they'd fight." Lacking the necessary statutory basis to impose a conservatorship based on the GSEs' financial condition, the Government had to rely on another statutory basis: consent of the GSE boards. The only way the Government could gain their consent was to take them by surprise and quickly coerce their agreement. In effect, the government's, through Secretary Paulson, imposed the conservatorship on the GSEs for public interest purposes.

66. The Bush Administration was anxious about pursuing what Secretary Paulson was describing as a "hostile takeover". And the idea of unilaterally putting the GSEs in Chapter 11 was unfathomable; these were privately owned entities with obligations to shareholders and

bondholders. The Government also had to contend with the fact that Fannie's and Freddie's regulator from the FHFA, James Lockhart, had written letters to both companies over the summer of 2008 saying that they were considered adequately capitalized.

67. Nevertheless, on August 26, 2008, Secretary Paulson called President Bush to inform the President of "his plan to mount the equivalent of a financial invasion on Fannie and Freddie." President Bush gave Secretary Paulson permission to proceed with the planned conservatorship, but emphasized that, "we have to make clear that what we are doing now is transitory, because otherwise it looks like nationalization."

68. As also detailed in *On the Brink*, Paulson indicated that he would go after the GSE leadership personally if they did not agree. He told the boards that if they consented to conservatorship, he would make clear that they were not to blame: "Obviously we preferred that they voluntarily acquiesce. But if they did not, we would seize them. . . . I left unspoken what I would say publicly if they didn't acquiesce." Those present at the meetings reported that the Government suggested that if they did not agree their reputations were at risk.

69. On September 4, 2008, the FHFA wrote to the boards of the GSEs and informed them that they were undercapitalized and required immediate recapitalization. The FHFA did not give the GSEs any time to address the concerns raised in these letters. The next day, on September 5, 2008, Paulson, Bernanke, and Lockhart, representing government action by the executive branch, met with representatives of the GSEs and directed them to give their consent to conservatorship. If they did not agree, the Government "would seize them."

70. Under these circumstances, according to Secretary Paulson, the GSE Boards did not resist. On September 6, 2008, the GSE Boards met with Treasury and the FHFA and provided

consent to conservatorship. Daniel Mudd, the former CEO of Fannie Mae, has stated that "we were given 24 hours to accede to a government takeover—or else the government would effectively go to war against the company." Mr. Mudd made clear that the Government's approach was not regulatory practice, as the GSEs were not afforded any opportunity to address the Government's concerns. Rather, as detailed by the FCIC, the Government's plain goal "was really to force conservatorship." The FCIC would later conclude, "[e]ssentially the GSEs faced a Hobson's choice: take the horse offered or none at all."

71. Neither the GSE boards nor the GSE shareholders had any advance notice of the Government's plan. The Government did not publicly express concern about the solvency of the GSEs, provide warnings or allow for solvency plans. To the contrary, at all times prior to imposing conservatorship, in public the Government repeatedly expressed its confidence in the financial health of the GSEs. As former Fannie Mae CEO Daniel Mudd testified before the FCIC, the FHFA "had never before communicated the kind of criticisms leveled in the September 4 [... Conservatorship Memo]. The FCIC concurred that a " review of the examination reports and other documents provided by FHFA to the FCIC largely supports Mudd's view on this specific point."

72. While OFHEO's examination reports noted concerns about increasing credit risk and slow remediation of deficiencies required by the May 2006 consent agreement, they do not include the sweeping criticisms contained in the September 4 [... Conservatorship Memo]." Former Secretary Paulson would later state in regard to the regulatory infractions which resulted in conservatorship of the GSEs "[the infractions] didn't amount to much, frankly; they were more like parking tickets in the scheme of things."

73. The government acting through Secretary Paulson took direct action to take control of the GSEs and, thereby, confiscate all the assets of the GSE shareholders.

74. At the time conservatorship was imposed on the GSEs, Fannie Mae's excess core capital was $9.4 billion and Freddie Mac's was $2.7 billion. Contemporary reporting affirmed that the GSEs were not in crisis. FHFA Director Lockhart later admitted to the FCIC that "[Fannie Mae] was adequately capitalized the day we put them into conservatorship."

75. The Government had considered the option to nationalize the GSEs. But outright nationalization would require including GSE operations in the federal budget, effectively doubling the U.S. deficit—a politically untenable solution at the time. Furthermore, nationalization would require significant compensation to the GSE shareholders.

76. The Government imposed the conservatorship, and the governmental taking of the shareholders' property and rights that necessarily occurred, including the rights and property of the FBOP Subsidiaries and River Capital, to facilitate its public policy goals.

77. The conservatorship over the GSEs were part of a plan developed and implemented by the Bush Administration. On the morning of the takeover of the GSE, Secretary Paulson made a statement to the press that: "The agencies encourage depository institutions to contact their primary Federal regulator if they believe that losses on their holdings of Fannie Mae and Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce the regulatory capital below well-capitalized. The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with capital regulations.'' The Government was fully aware that the immediate effect of its decision to impose the conservatorship and to take over the GSEs was that banks that had been encouraged and permitted to invest and maintain up to 100% of their Tier 1 Capital in the GSE preferred shares would be substantially harmed, even to the point of failure.

C. The Government Used the GSEs as Public Policy Tools to Confront the 2008 Economic Crisis

78. The GSEs were used as public policy tools beginning in January 2008 in confronting the worsening economic crisis. The use of the GSEs as public policy tools significantly increased GSE risk and violated safety and soundness requirements under the 1992 Act.

79. In February 2008, during testimony before the Senate Banking, Housing and Urban Affairs, then FHFA Director James Lockhart noted that the expanding the GSE housing mission would include jumbo loans for the first time. Jumbo loans were for the most part subprime loans. Director Lockhart stated, "The GSEs have become the dominant funding mechanism for the entire mortgage system in these troubling times. They are fulfilling their mission of providing liquidity, stability, and affordability to the mortgage markets. In doing so, they have been reducing risks in the market, but concentrating mortgage risks on themselves. [...] The risks are beginning to take their toll. [...] Their missions, as well as Congressional and many other pressures, are demanding that they do more and take on more risks in areas new to them—subprime and jumbo mortgages. Public disclosures indicate that Freddie Mac will report annual losses for the first time its history and Fannie Mae for the first time in 22 years. [... The GSEs] did fulfill their critical mission of providing liquidity and stability to the conforming loan market. In doing so, however, the systemic risk of the secondary market has become more concentrated in the housing GSEs, especially Fannie Mae and Freddie Mac. [...] Jumbo loans would present new risks to the already challenged GSEs. The prepayment and credit risks are different than those of conforming loans. The provision also pushes the GSEs to increase their geographic concentration in some of the riskiest real estate markets. Roughly half of all jumbos are in California. [...] The key question is whether

Fannie Mae and Freddie Mac will be able to continue to support the conforming mortgage market in a safe and sound manner while assuming additional responsibilities in the subprime and jumbo markets."

80. The GSEs were thus required to absorb significant risk in violation of the 1992 Act where regulators were tasked with "the need to maintain the sound financial condition of the enterprises." Throughout the economic crisis, the Government sought to use the GSEs in order "to unlock the frozen overburdened banks."

81. A number of foreign governments held significant GSE debt: Japan held $120 billion, Russia held $170 billion, and China held $350 billion. These foreign governments had purchased GSE debt with the understanding that the GSE debt was guaranteed by the U.S. Government.

82. During the economic crisis, Russian officials had urged the Chinese government to sell off GSE holdings to force the U.S. Government to guarantee GSE debt. A sell-off would cause significant harm to the U.S. economy in the midst of the worsening economic crisis. But the U.S. Government would not provide an explicit guarantee as this would have placed the GSEs on the U.S. Government books and doubled the U.S. deficit.

83. A sell-off by Russia began in January 2008, followed by a sell-off by China in July 2008. This sell-off "exacerbated the growing credit crunch." While the Government needed to find a way to reassure foreign holders of the stability of the GSE debt to stem the sell-off, an express guarantee or nationalization of the GSEs were politically untenable solutions. Furthermore, nationalization would require compensation of GSE shareholders.

84. The imposition of a perpetual conservatorship over the GSEs in September 2008 was the Government's chosen solution to reassure foreign investors holding GSE debt. As former Secretary Paulson stated to the media in 2014, the Chinese sell-off of GSE debt "just drove home to me how vulnerable I felt until we had put Fannie and Freddie into conservatorship."

85. On September 7, 2008, following the takeover of the GSEs, then Secretary Paulson called "Zhou Xiaochuan, the head of the central bank of China, and Wang Qishan, vice premier in charge of China's financial and economic affairs. It was important to relay what was going on to the Chinese, who owned a vast quantity of U.S. securities, including hundreds of billions of dollars of GSE debt. They had trusted our assurances and held on to this paper at a crucial time in a shaky market. Fortunately, I knew both men well, and we had been able to speak frankly to one another throughout the crisis. 'I always said we'd live up to our obligations,' I reminded Wang. 'We take them seriously.'"

86. Following the imposition of conservatorship, China would later increase GSE holdings to $430 billion, which would help support the U.S. economy in the midst of the worsening economic crisis.

87. The GSEs would be further used as public policy tools following the imposition of conservatorship as the GSEs were "no longer managed with a strategy to maximize shareholder returns."

88. The GSEs never envisioned the possibility of conservatorship. The GSEs were convinced of their solvency in September 2008 and believed any shortfalls would be met through asset sales. In fact, the GSEs were solvent and profitable at all relevant times and apparently satisfied the three solvency tests: cash-flow solvency test, the balance-sheet solvency test, and

capital-adequacy solvency. Furthermore, the GSEs held $1.5 trillion in their investment portfolios which should have been more than sufficient to meet any shortfalls. Additionally, the GSEs had access to two separate credit facilities, but the GSEs had no need to access these credit facilities. The GSEs were able to turn over short-term debt throughout 2008 and 2009.

89. The day after the conservatorship was put in place, on September 7, 2008, Treasury entered into Senior Preferred Stock Purchase Agreements ("***SPSPAs***") with both GSEs, whereby Treasury invested billions of dollars into the GSEs in exchange for $1 billion in senior preferred shares. These senior preferred shares also included a liquidation preference and dividend rights. The SPSPAs also gave Treasury warrants to purchase a majority of GSE common stock, on a fully diluted basis.

90. Furthermore, the SPSPAs gave to treasury the exclusive right to keep the GSE in conservatorship and took away the FHFA's discretion to end the conservatorship (Covenant 5.3: "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 . . . other than in connection with a receivership . . .). The SPSPAs thereby ensured that the GSEs remained under Government control and would never return to their previous status as shareholder-owned companies.

91. As analyst Derek Pilecki suggested, the dividends paid on the Treasury draws became, by the Government's design, a debt trap. Mr. Pilecki stated: "I call the dividend payments on the Treasury's senior preferred stock Zombie Dividends because Treasury Secretary Paulson wanted the GSEs dead at the time he put them into Conservatorship. He forced them to pay a 10% dividend rate to the Treasury on its senior preferred stock investment. No other financial institution has had to actually pay to the government a 10% rate like the GSEs have."

92. Additionally, the Government implemented foreclosure mitigation programs including the Home Affordable Modification Program, the Second-Lien Modification Program, the Home Affordable Foreclosure Alternatives, the Home Affordable Unemployment Program and the Principal Reduction Alternative Program, further increasing GSE risk.

93. Beginning in October 2008, the FHFA directed the GSEs to purchase $40 billion a month in underperforming mortgage bonds from other financial institutions, possibly effecting a backdoor bailout of those financial institutions, to the severe detriment of the GSEs.

D. The Government Derived Significant Financial Benefit and Public Purpose from Non-Cash Accounting Adjustments and Net Worth Sweeps

94. Once conservatorship was imposed, the FHFA had discretionary accounting authority over the GSEs under HERA. The GSEs were directed to implement non-cash accounting adjustments which provided *post facto* justification for conservatorship. These non-cash adjustments severely depressed reported earnings in that year by hundreds of billions of dollars, resulting in a net worth deficit.

95. If the FHFA had not exercised this discretionary accounting authority, Treasury draws would have been determined based on actual cash needs, instead of easily manipulated non-cash "accounting adjustments." Under the HERA and the SPSPAs, the resulting net worth deficit forced the GSEs to take on significant debt in the form of Treasury draws. The non-cash accounting adjustments forced the GSEs to draw the vast majority of more than $191.5 billion in Treasury draws. It could be argued that at least $161 billion of the Treasury draws related directly to the FHFA's decision to force the GSEs to improperly write-down the value of their assets through the non-cash accounting adjustments.

96. These valuation allowances would later provide great benefit to the Government. The FHFA had overestimated the GSEs' likely losses and underestimated the possibility of a return to profitability. More than $234 billion had been set aside by the GSEs to absorb loan losses, whereas losses of just over $125 billion were actually realized.

97. The FHFA ordered the reversal of the 2008 valuation allowances in 2013. Thus, under net worth sweeps provided under 2012 Amendments, billions of dollars were swept into Treasury coffers.

IV. Conservatorship Eliminated Shareholder Rights and Transferred Shareholder Value to the Government

98. As with any other publicly traded company, owners of the GSE shares were vested with specific rights attendant to their ownership. These rights were specifically enumerated in each GSE's by-laws and the prospectuses and registration statements for each GSE's common and series of preferred shares.

99. The offering documents for the GSE preferred shares enumerated specific rights held by its preferred shareholders typical of those rights often held by preferred stockholders in a shareholder-owned company. For instance, these shares were transferrable. Likewise, the offering circular for Fannie Mae's Series O preferred shares and Freddie Mac's Series Z preferred shares, like numerous other series of its preferred share offerings, indicated that holders of those shares would have the right to receive a portion of the GSE's assets in the event of dissolution or liquidation. In addition, preferred shareholders had the right to vote on amendments to their series' certificate of designation, subject only to narrow exceptions.

100. The GSEs were ordered to cease paying dividends on their preferred and common stock. Although this stock would remain outstanding, on June 16, 2010, the FHFA ordered the GSEs to delist their common and preferred shares from the New York Stock Exchange. The loss of rights and value suffered by shareholders on account of the Government's actions is noted in Fannie Mae's Form 10-K for the year ending December 31, 2011, issued under the FHFA's control: "Because we are in conservatorship, our common shareholders currently do not have the ability to elect directors or to vote on other matters. The conservator eliminated common and preferred stock dividends (other than dividends on the senior preferred stock issued to the Treasury) during the conservatorship, and we are no longer managed with a strategy to maximize shareholder returns."

101. The imposition of conservatorship under HERA also resulted in an economic taking of the value of the shares. On September 8, 2008, Fannie Mae common stock shares closed trading at $0.73 per share. Freddie Mac common stock shares closed trading at $0.88 per share. The preferred shares' book value dropped from approximately $50.00 (for Fannie Mae) and $25 (for Freddie Mac) to $3.00. The conservatorship rendered the shares effectively worthless. In the case of FBOP, the single government action of GSE conservatorship wiped out $885 million.

102. The Government offered no compensation to GSE shareholders despite its seizure of shareholders' voting and dividend rights, and the taking of share value that resulted directly from the taking of ownership. Indeed, as detailed in his memoir *On the Brink,* Secretary Paulson himself stated that "[c]ommon and preferred shareholders alike were being wiped out." Furthermore, the Government had no plan to restore their lost property. Again, Secretary Paulson admitted as much in *On the Brink* when he informed shareholders that "the odds were low that

they would ever recapture the equity value that had been lost" and admitted that "we'd basically killed the shareholders" of the GSEs.

V. Plaintiffs had a Reasonable Investment-backed Expectation that the Government Would Not Appropriate Shareholder Value and Rights in the Companies

103. Plaintiffs had a reasonable investment-backed expectation that the Government would not take their private property rights and interests without just compensation.

104. For approximately 25 years, the GSEs had been owned and controlled by private shareholders and publicly traded on the New York Stock Exchange. They operated successfully for decades, raising capital from investors through the public equity and private capital markets, generating profits and increasing shareholder value, much like any other publicly traded, shareholder-owned company.

105. As discussed above, the owners of GSE preferred shares were vested with specific rights attendant to their ownership. Private investors and Government regulators long considered the GSE securities to be popular, sound, conservative investments. The popularity, transferability, and soundness of the GSE shares, prior to the conservatorship, were clearly evidenced by, among other factors, the extent to which these shares were traded on the open market.

106. Under the 1992 Act, absent an egregious refusal to accede to OFHEO directives, or the willing consent to a conservatorship by the GSEs' boards of directors or their shareholders, the only justification for imposing a conservatorship over the GSEs would stem from a condition of financial distress. This draconian measure had never been used. In short, there was no reason to believe that there would ever be a reason to impose a conservatorship over the GSEs and, in the unlikely event that one was implemented, their investors had a reasonable expectation that any

such conservatorship would be done for legitimate reasons in accordance with the applicable statutory provisions for doing so, and that such conservatorships if truly necessary at some point in time would be used to protect and preserve the GSEs' assets, as the statutory provisions were designed to ensure.

107. The passage of HERA in July 2008 significantly increased the powers of the Government over the GSEs, well beyond the regulatory powers that existed under the prior statute that was in place when the Plaintiffs and the vast majority of the GSEs' shareholders purchased their common and preferred stock. Although members of Congress and other Government officials including then Secretary Paulson, strongly indicated that they never anticipated that the new powers under HERA would need to be exercised, the Government invoked these powers a mere ten weeks after its passage.

108. Plaintiffs had no reasonable expectation that the Government would impose conservatorship in this manner and use them for these purposes, based on purported capitalization concerns that did not exist, especially when the Government had so often assured the public of the Companies' solvency, even weeks before the imposition of conservatorship.

109. While HERA contemplated a conservatorship designed to return the GSEs to financial health, the Government used conservatorship to reassure foreign governments holding GSE debt and to support the economy by forcing the GSEs to assume the liabilities of other institutions and provide increased liquidity to the mortgage market. Although taken for public benefit, conservatorship required the payment of just compensation to the shareholders of the GSEs who suffered the nearly complete destruction of the value of their private property interests.

110. Government regulators, including the OCC, had reviewed the FBOP Subsidiaries investment in the GSE preferred shares and never flagged the investment as a concern. The OCC and FDIC had also determined that the FBOP Subsidiaries were "Well Capitalized" for purposes of their Tier 1 Capital requirements during the periods after the GSE preferred shares were purchased. "Well Capitalized" was the highest rating available.

111. Moreover, none of the conditions required under HERA for the imposition of a conservatorship existed or were publicly expressed by the Government. The GSEs were adequately capitalized and representatives from the Treasury, the Federal Reserve, Congress, and the FHFA repeatedly represented this fact in the months and weeks leading up to the Government's imposition of the conservatorship. Based on those representations, Plaintiffs were not and could not have been aware that the Government believed the conditions necessary to assert a conservatorship existed.

112. Therefore, Plaintiffs could not have reasonably anticipated that the Government would impose the conservatorship.

VI. The Government's Seizure of Control of the GSEs By Imposing Conservatorship Directly Resulted in the Failures of the FBOP Subsidiaries and the Government's Taking of Them and Their Assets

A. <u>The Action of the Executive Branch of the U. S. Government Was a Taking of the FBOP Subsidiaries' Tier 1 Capital</u>

113. Prior to the imposition of the conservatorship, Plaintiffs enjoyed a strong financial position. The FBOP Subsidiaries were all well-capitalized. Regulators recognized FBOP's sound financial state, based upon strong positions in Tier 1 Capital. For example, immediately prior to

the conservatorship, FBOP had received approval by three regulatory agencies to acquire a $3 billion problem financial institution in Southern California. Indeed, FBOP's position in meeting its Tier 1 Capital requirements was so sound that the corporation received those approvals within forty-eight hours.

114. The governmental action by the Secretary of the Treasury and other administration officials in imposing conservatorship on the GSEs changed everything and proved catastrophic for Plaintiffs. The FBOP Subsidiaries and River Capital immediately lost their voting, dividend rights, and liquidation preferences. The total value of their shares dropped from $896 million to less than $1 per share. The shares representing Tier 1 Capital were written down by $885 million, reflecting a diminution of share value greater than 98%. Seven of the nine FBOP Subsidiaries were consequently unable to meet their capital requirements. Regulators understood that the FBOP Subsidiaries' failure to meet capital requirements resulted directly from the GSE conservatorship.

115. However, this taking by Government action of the investment property of the FBOP Subsidiaries was not merely the loss of investment value. Instead, due to previous Government incentives, promotions, imprimaturs, and regulatory approvals, this Government action was a direct taking of Tier 1 Capital of the investor banks, the loss of which put many of them immediately out of regulatory compliance and at risk of insolvency.

116. This confiscation of Tier 1 Capital by the Government's action of imposing the GSE conservatorship, and the potentially catastrophic consequences to banks that had been encouraged and permitted to invest Tier 1 Capital in GSE stock was recognized by Secretary Paulson himself. Shortly after the conservatorship were implemented, Secretary Paulson made a press statement that: 'The [federal government] agencies encourage depository institutions to contact their primary Federal regulator if they believe that losses on their holdings of Fannie Mae

and Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce the regulatory capital below well-capitalized. The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with capital regulations.'

117. Further recognizing the direct tasking of capital critical to the banks' survival, the Government created the Troubled Asset Relief Program ("***TARP***"), as a loan program for banks, to address the harm it had imposed.

118. The Comptroller of the Currency, John C. Dugan, contacted Mr. Kelly personally by phone prior to TARP being announced on October 14, 2008. The Comptroller called to inform Mr. Kelly that TARP funding would be available, urging Mr. Kelly to immediately seek TARP funding. Comptroller Dugan explained that "this is the solution—this is designed for you."

119. TARP assistance was not a cash giveaway. TARP assistance was in effect an exchange of Tier 1 Capital for debt in the form of TARP draws, which regulators agreed to treat as Tier 1 Capital, thereby allowing banks to meet their capital threshold requirements. Under TARP, the FBOP Subsidiaries would in effect be able to assume debt in order to replace their GSE losses, where GSE preferred shares had been purchased at full market value with cash.

120. Days after the conservatorship was imposed, on September 9, 2008, FBOP "began to work with its investment bankers […] in an effort to raise $600 million in capital to offset the [… GSE] losses. In later September and early October, […] FBOP met with a series of potential investors. Despite the market's general antipathy at the time for bank capital instruments, the FBOP story resonated with investors and was favorably received." With "the announcement of [… TARP] in October 2008 and the encouragement of the regulators that TARP funds would be

available to help recapitalize [… the FBOP Subsidiaries, Mr. Kelly was led] to believe that [… a solution had been found to the] GSE losses."

121. FBOP began to focus on obtaining TARP funding in light of TARP special provisions giving preference to financial institutions which suffered losses on GSE holdings. Also, as a consequence of TARP, private capital and debt markets froze and obtaining private capital infusions for institutions such as FBOP became impossible.

122. FBOP applied for TARP funds on October 14, 2008. On October 20, 2008, FBOP received a verbal assurance from the OCC that its application had been approved. However, on October 21, 2008, its application was deferred because FBOP, unlike the other large banks that applied for funding, was not publicly traded. The OCC advised that FBOP would have to wait until the next round of TARP funding.

123. On November 17, 2008, the Treasury issued TARP guidelines for non-publicly traded institutions. FBOP resubmitted its application. FBOP was again deferred with regulators requesting additional information. When the new Barack Obama Administration took office in January 2009, TARP was suspended. By the time the program reopened, FBOP's financial situation had deteriorated to the point that FBOP no longer met TARP criteria.

124. FBOP attempted to find additional capital throughout 2009 in a capital market that was unreceptive to privately held bank capital needs, particularly for organizations stigmatized by not receiving TARP.

125. Furthermore, regulators were unreceptive to efforts to recapitalize the FBOP Subsidiaries. For example, shortly before the FBOP Subsidiaries were taken by the Government, Mr. Kelly, through his 100% owned entity, Tremont Capital, injected $40 million into FBOP.

Those monies were then distributed to FBOP Subsidiaries to meet necessary capital requirement shortfalls. Not only did the FDIC disallow this capital infusion as not meeting regulatory approval, but the FDIC then refused to return the $40 million to Tremont Capital, thereby taking those funds when it took the FBOP Subsidiaries.

126. In October 2009, FBOP asked for a one-week extension from the FDIC head of liquidation in Chicago, in anticipation of the passage of the Workers, Homeowners, and Business Assistance Act of 2009 ("***WHBAA***") and the recapitalization of the FBOP Subsidiaries. WHBAA was a bill introduced in the U.S. House of Representatives on September 10, 2009. WHBAA allowed loss carryforwards to be used in certain circumstances as regulatory capital. Under generally accepted accounting principles ("***GAAP***"), if a bank is profitable, the bank is allowed loss carryforwards on net operating losses. Under WHBAA, an exception to GAAP accounting was created so banks would not be placed in jeopardy due to any losses arising during the worsening economic crisis. Under the exception, banks were allowed loss carryforwards, which would be *immediately* recognized as regulatory capital whether or not profit could be shown. On September 22, 2009, the House approved WHBAA by a 331-83 margin. It was widely known WHBAA would also pass the Senate. In the case of FBOP, the WHBAA exception represented more than $250 million in regulatory capital on balance sheets. Significantly, the $250 million in regulatory capital would have permitted each FBOP Subsidiary to be well or adequately capitalized. Under law, the FDIC cannot place well or adequately capitalized banks in receivership. The FDIC was thus placed on notice by FBOP that WHBAA was soon to be passed into law and that all FBOP Subsidiaries would be well or adequately capitalized. Despite notice that WHBAA was strongly supported in both houses (unanimously in the Senate) and soon to be enacted into law enabling the recapitalization of all FBOP Subsidiaries, the FDIC in fact

accelerated the closure of the FBOP Subsidiaries on October 30, 2009. As anticipated, the Senate passed WHBAA by 98-0 on November 4, 2009. President Obama signed the bill on November 6, 2009. The legislation would have allowed the realization of more than $250 million of additional capital for the FBOP Subsidiaries. The FBOP Subsidiaries would have survived if the FDIC had allowed the one-week extension.

127. As a direct result of the Government's action in imposing the conservatorship and taking of the FBOP Subsidiaries' Tier 1 Capital, on October 30, 2009, seven of the nine FBOP Subsidiaries, no longer able to meet their Tier 1 Capital regulatory requirements, were placed in receivership by the FDIC.

128. The two remaining FBOP Subsidiaries were healthy and viable. But the FDIC invoked *rarely used* cross guaranty authority to place these two remaining FBOP Subsidiaries in receivership. According to the Board of Governors of the Federal Reserve System, the FDIC had "issued cross-guaranty liability assessments related to eight banks from 1989—1992 with none again until FBOP." The cross guaranty was intended to mitigate FDIC costs and prevent abuses that had occurred during the thrift crisis when holding companies moved bad assets to troubled banks and allowed "good banks" to flourish. This situation did not apply to the FBOP Subsidiaries. The FBOP Subsidiaries' problems were directly related to the unexpected GSE losses that were solely related to the Government actions. The FBOP Subsidiaries' problems were not related to concentrating bad assets in troubled banks.

129. All of the FBOP Subsidiaries and all of their assets were taken by Government action without any compensation.

130. On October 30, 2009, the FDIC entered into a purchase and assumption agreement with U.S. Bank, to assume all of the deposits and essentially all of the assets of the nine FBOP Subsidiaries. During his January 21, 2010, testimony at a hearing before the U.S. House of Representatives, Subcommittee on Financial Institutions and Consumer Credit, Mr. Kelly stated that: "I believe—and this is strictly my perception—that the regulators already had U.S. Bank lined up. They had marshaled their forces; they were ready to close the bank. They have a big job to do, there are lots of banks out there, and they basically just did not want to extend more time."

131. On the exact same day that the FBOP Subsidiaries were placed in receivership, then Treasury Secretary Geithner was in Chicago to award $50 million in investment tax credits for worthy projects which provided substantial community benefit. The investment tax credits were to be awarded to FBOP and Park National Bank "to fund schools, health care facilities and new retailers." The investment tax credits were to be presented personally to Mr. Kelly in recognition of FBOP's community efforts. At the last minute, then Secretary Geithner cancelled his appearance at the awards ceremony.

132. FBOP was, in turn, rendered insolvent due to the failure of the FBOP Subsidiaries. Due to this insolvency, FBOP was forced to liquidate assets. FBOP was forced to sell the $40 million in GSE shares held by River Capital in January 2009 at deeply discounted prices.

133. On October 5, 2012, FBOP entered into an Assignment for the Benefit of Creditors ("***ABC Agreement***"), whereby FBOP assigned charters, articles of incorporation, corporate records, stock certificates, ownership, and/or indicia of ownership, of its subsidiaries, and other assignable assets, to an ABC Trust for the benefit of FBOP creditors. The ABC Trustee liquidated and distributed significant proceeds to beneficiaries of the ABC Trust.

134. Subsequent to distribution of all other monetizable assets of FBOP's former subsidiaries, all charters, articles of incorporation, corporate records, stock certificates, ownership, and/or indicia of ownership, of FBOP's former subsidiaries, reverted back and/or were assigned to FBOP. To the extent initially transferred to the ABC Trust, if at all, any and all claims arising out of or related to ownership, valuation, control or use of common or preferred stock interests issued by either GSE that could have been brought by FBOP's former subsidiaries also reverted back and/or were assigned to FBOP by operation of law through a trust transfer agreement. FBOP currently owns and controls 100% of all interests, if any, in former subsidiaries, and owns and controls all rights to assert any and all claims arising out of or related to ownership, valuation, control or use of common or preferred stock interests issued by either GSE that could have been brought by FBOP's former subsidiaries.

135. The FBOP Subsidiaries failed due to GSE holdings alone. The collapse of the FBOP Subsidiaries was a direct result of governmental act of imposing the GSE conservatorship. The Government would later recognize that the failure of FBOP, the FBOP Subsidiaries and River Capital were the direct result of GSE holdings. As Tara Rice and Jonathan Rose of the Federal Reserve noted in *When Good Investments Go Bad: The Contraction in Community Bank Lending after the 2008 GSE Takeover*, FBOP Subsidiaries failed *solely* due to GSE holdings. In fact, during subsequent sworn testimony before Congress, a representative of OCC, FBOP's primary regulator, did not dispute that it was the imposition of the conservatorship that directly caused the failure of FBOP, rather than bad lending decisions or other unsound banking practices. In the lawsuit captioned *O'Donnell v. Bank of America*, the United States Attorney for the Southern District of New York admitted that the proximate cause of the failure of the FBOP Subsidiaries was the diminution of value in the banks' GSE holdings due to the Government's actions.

136. The Government placed the FBOP Subsidiaries into receivership and forced the divestment of the $19.4 billion in combined assets.

137. Mr. Kelly lost his banks and virtually his entire net worth.

CAUSES OF ACTION

FIRST CLAIM FOR RELIEF
TAKING OF TIER 1 CAPITAL AND ALL OF THE ASSETS OF PLAINTIFF BANKS

138. Plaintiffs incorporate by reference and reallege each and every allegation of the preceding paragraphs as though fully set forth herein.

139. As explained above, the Government induced and encouraged the FBOP Subsidiaries to purchase the GSE preferred shares by assigning a 20% capital risk weighting for to the GSE preferred shares (which was the same risk weighting as cash) and permitting banks to invest up to 100% of their Tier 1 Capital in the preferred shares. As intended by the Government, the FBOP Subsidiaries recapitalized the GSEs by purchasing the GSE preferred shares as their Tier 1 Capital.

140. Tier 1 Capital is a bank's core capital and includes disclosed reserves and equity capital. Tier 1 Capital must be available when banks need to use it. The Government closely regulates and monitors Tier 1 Capital and disallows or greatly restricts a bank's ability to use Tier 1 Capital to invest in other equity securities.

141. The Government's regulatory treatment of a bank's investment in Tier 1 Capital broadcast to the FBOP Subsidiaries that investing their Tier 1 Capital in the GSEs would not risk bank failure and that investing even up to 100% of the Tier 1 Capital in GSE preferred shares left the banks in a secured capitalized position and operationally secure. But for these regulatory incentives and promises, the FBOP Subsidiaries would not have invested their Tier 1 Capital in GSE preferred shares. The Government knew that banks like the FBOP Subsidiaries relied on the preferred shares to satisfy their Tier 1 Capital requirements. The Government knew that the ability

to use the GSE preferred shares as Tier 1 Capital was the primary beneficial use of the preferred shares for the FBOP Subsidiaries.

142. FBOP and the FBOP Subsidiaries had reasonable investment-backed expectations that the investments in the GSEs were stable and not subject to a risk of immediate substantial losses capable of leaving the FBOP Subsidiaries undercapitalized. FBOP and the FBOP Subsidiaries had reasonable investment-backed expectations that the United States would not take actions that would destroy the value of the shares that it had previously encouraged the FBOP Subsidiaries to use as Tier 1 Capital.

143. In the immediate aftermath of the financial crises, the Government made the decision to take control of the solvent and profitable GSEs for the express purpose of eliminating the GSEs independent board and management. By taking control of the GSEs' operations, the Government wanted to conform their operations to meet various policy goals of the Government, to reassure various foreign governments holding significant GSE debt, and to maintain confidence in the marketplace that the GSEs would remain stable and solvent. The decision to take control of the GSEs was determined and executed by the Secretary of the Treasury, with active consent of the Chairman of the Federal Reserve, and with the express approval of the President of the United States.

144. In order to take control of the GSEs, the Government had three options: provide an explicit Government guarantee of the GSE debt, nationalize the GSEs, or use the provisions and powers outlined in HERA to impose a perpetual conservator that allowed the Government to take control of the entities.

145. The Government rejected an explicit guarantee or nationalization because of the immediate negative implications that these would have had on the national deficit and budget. HERA, however, provided the Government a way to take total control of the GSEs and eliminate the GSEs' independent board and management while reassuring foreign governments holding significant GSE debt.

146. Under HERA, the FHFA had the discretion to impose a conservatorship on the GSEs in limited circumstances where the GSEs were operationally unsound or insolvent. *See* 12 U.S.C. § 4617(2)-(3). Because the GSEs were solvent and operationally sound, however, the only way that the Government could impose a conservatorship was with the consent of the GSEs' board of directors.

147. Because the GSEs shareholders and directors would not willingly consent to the imposition of the conservatorship, the Secretary of the Treasury, with the president's approval, embarked on a course of action to coerce the GSEs' boards to "acquiesce" to it. Though described in detail above, the various post-hoc admissions that the Government has made related to this coercion is worth repeating:

a. In August 2008, Secretary Paulson called President Bush to tell him "his plan to mount the equivalent of a financial invasion of Fannie and Freddie," which the President approved.

b. In the days leading up to the imposition of the conservatorship, Secretary Paulson told President Bush: "We're going to move quickly and take them by surprise. The first sound they'll hear is their heads hitting the floor." In his words, the plan was to "ambush Fannie and Freddie" because it was "[f]or the good of the country."

c. Secretary Paulson knew he had to ambush the GSEs because "they'd put up a fight" because the conservatorship would "in effect overturn the work they'd done for years." The Government recognized that what they were planning to do constituted a "hostile takeover."

d. Secretary Paulson recognized the coercive nature of his plan: "Obviously we preferred that they voluntarily acquiesce. But, if they did not, we would seize them. . . . I left unspoken what I would say publicly if they didn't acquiesce."

148. The GSEs also viewed the conservatorship as coerced. For example, the CEO of Fannie Mae has stated that "we were given 24 hours to accede to a government takeover—or else the government would effectively go to war against the company."

149. Through this coercion, the Government imposed the conservatorship on the GSEs. The Government, knowing that it had encouraged banks to invest up to 100% of their Tier 1 Capital in the GSEs, knew that the imposition of the conservatorship would be a devastating taking of the banks' Tier 1 Capital and would render banks like the FBOP Subsidiaries insolvent. The Government knew that the result of the conservatorship would (and in fact did) (1) result in the loss of the banks' Tier 1 Capital; (2) would cause the banks to immediately default on their Tier 1 Capital requirements barring additional Government action; (3) would cause the banks to become insolvent under the regulations that governed their operation; and (4) would result in Government seizure of banks. Secretary Paulson stated:

> 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." [United States Department of the Treasury, *Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers*, September 7, 2008

150. With knowledge of the consequences, the Government imposed the conservatorship which resulted in the taking of the FBOP Subsidiaries' private property: The banks' Tier 1 Capital in the form of the GSE investment was confiscated; the banks were declared insolvent for failing to meet regulatory capital requirements; and the banks and all of their substantial assets were seized and confiscated by the Government. The Government also effectuated a taking of FBOP's 100% ownership interest in the banks.

151. One month after conservatorship was imposed, in October 2008, the Congressional Budget Office (CBO) concluded that the GSEs "had effectively become government entities whose operations should be included in the federal budget" as the Government operates and controls the GSEs.

152. As a direct result of HERA, the conservatorship, and the SPSPAs, the United States destroyed the reasonable investment-backed expectations of the FBOP Subsidiaries and, effectively "took" the Tier 1 Capital represented by the investments in the GSEs. As a direct result, the FDIC put the FBOP Subsidiaries into receivership. This took place despite the Government's prior commitments regarding the safety of the investment and its specific efforts to encourage banks like FBOP Subsidiaries to put their Tier 1 Capital in the GSEs.

153. In taking private property, the Government is required to adhere to due process of law and to respect the legal rights of affected parties.

154. The Government violated the statutory, contractual, and constitutional rights of Plaintiffs in taking the Tier 1 Capital required to keep the banks operational. As a result, the Government violated the statutory, contractual, and constitutional rights of Plaintiffs by taking the private property of the FBOP for public purposes without just compensation.

155. The harm that Plaintiffs suffered as a result of the taking of the Tier 1 Capital and the closing of the FBOP Subsidiaries and the loss of all of their assets through insolvency is a distinct harm from that suffered by the GSEs.

156. Plaintiffs are therefore entitled to just compensation for the Government's taking of their property in an amount to be determined at trial.

SECOND CLAIM FOR RELIEF
TAKING OF SHAREHOLDER RIGHTS & PROTECTIONS

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

158. When the Government coerced the GSEs to acquiesce to the conservatorship, the Government also took for a public purpose all the rights, protections, and investment-backed expectations that adhered to the shares that the FBOP Subsidiaries and River Capital had purchased.

159. When the FBOP Subsidiaries and River Capital purchased preferred GSE shares, the FBOP Subsidiaries and River Capital obtained valuable contractual rights and guarantees. Included in those rights and guarantees were certain voting rights and protections against actions that could have a material adverse effect on their rights as preferred stockholders; certain liquidation preferences; and certain dividend rights.

160. By virtue of their ownership of the preferred shares, the FBOP Subsidiaries and River Capital also enjoyed a fiduciary relationship with the Directors and Officers of the GSEs and had a reasonable investment-backed expectation that their investment in the GSEs would be managed in trust and that the GSEs would be managed to maximize the value of their investments.

161. When the FBOP Subsidiaries and River Capital purchased GSE preferred shares, the banks and non-bank subsidiary had no reason to believe that the United States would impose a conservatorship on the GSEs that would destroy all the rights and protections that made the shares have any value and utterly destroyed any share value by terminating the rights and protections that adhered to ownership of those shares; and would delegate to Treasury the sole

discretion to terminate the conservatorship under the SPSPAs that the Government executed with the conservators.

162. When the FBOP Subsidiaries and River Capital purchased preferred shares, the GSEs were financially sound. In the lead up to the conservatorship, Government representatives had repeatedly affirmed the financial health, including the solvency and adequate capitalization, of the GSEs. FBOP Subsidiaries therefore had no reason to expect that the Government would destroy and take for government purposes the total value of the investments. When conservatorship was imposed, the GSEs were solvent and profitable.

163. When the FBOP Subsidiaries and River Capital purchased the GSE preferred shares, they had the reasonable investment-backed expectations that (1) the GSEs would be managed and operated to increase shareholder value; (2) their investment would be held in trust by the GSEs and that the directors of the GSEs would manage the enterprises as their fiduciaries; (3) that their voting rights and the voting rights of the common stock would operate to protect their investments; (4) that they or other shareholders would have claims against the directors of the GSEs in the event the directors mismanaged the enterprises or caused harm to the enterprises; and (5) that the Government would not step in to seize their investments, take away all of their value, force their banks into insolvency and take the banks as well.

164. Keeping in mind that the U.S. banking system is the most heavily regulated industry in the world in order to ensure the safety of the financial system, regulatory incentives would reflect that need for safety. Unlike non-bank purchasers of GSE preferred shares, the FBOP Subsidiaries also had reasonable investment-backed expectations that their investment in the GSE preferred shares was low-risk and that the value of those shares was stable (not volatile) and not subject to a high risk of immediate and substantial value loss because the United States allowed

the FBOP Subsidiaries to invest 100% of their Tier 1 Capital in the shares, examined the investments of the FBOP Subsidiaries, never registered any concern, and rated the risk of the investment the same as cash.

165. When the conservatorship was imposed, a succession clause was triggered that took for a public purpose all voting rights, liquidation preferences, and dividend rights that the FBOP Subsidiaries and River Capital obtained by virtue of their ownership of the preferred shares because under HERA the conservator succeeded to "all rights, titles, powers, and privileges of the [GSEs], and ***any stockholder***, officer, or director of such [GSE] with respect to the [GSE] and the assets of the [GSE]." 12 U.S.C. § 4617(b)(2)(A)(i).

166. When the conservatorship was imposed, the Government also took for a public purpose the fiduciary relationship that existed between the preferred shareholders and the GSEs because HERA authorized the FHFA as conservator to "take any action . .. . which the [FHFA] determines is in the best interests of the GSE or the FHFA." 12 U.S.C. § 4617(b)(2)(J)(ii); *see also* 12 U.S.C. 1719(g)(1)(B)(iii) (allowing Treasury to purchase the GSE senior preferred shares where such actions necessary to protect taxpayers); *Fairholme Funds Inc. v. United States*, 26 F.4th 1274, 1297 (Fed. Cir. 2022) ("We do not find shareholders' arguments that HERA provides a source of fiduciary duty availing. The Supreme Court's analysis of HERA in *Collins* is highly instructive. Notably, **the Supreme Court held that, because HERA authorizes the FHFA to act in the best interests of the [GSEs] *or itself*, the agency 'may aim to rehabilitate the [GSEs] in a way that, while not in the best interests of the [GSEs], is beneficial to the [FHFA] and, by extension, the public it serves.**").

167. By passing HERA, the United States also took for a public purpose the right of preferred shareholders to challenge the GSEs' decisions to consent to the conservatorship because

under HERA the directors of the GSEs are not liable for acquiescing in the appointment of a conservator. 12 U.S.C. § 4617(a)(6).

168. By passing HERA, the United States took for a public purpose the preferred shareholders' rights to seek meaningful judicial review of GSEs actions. *See* 12 U.S.C. § 4617(a)(5)(A) ("If the [FHFA] is appointed conservator . . . under this section, the [GSE] may, within 30 days of such appointment, bring an action in the United States district court for the judicial district in which the home office of such [GSE] is located, or in the United States District Court for the District of Columbia, for an order requiring the [FHFA] to remove itself as conservator . . . ."); 12 U.S.C. § 4617(a)(5)(B) ("Upon the filing of an action under subparagraph (A), the court shall, upon the merits, dismiss such action or direct the [FHFA] to remove itself as conservator . . . .")

169. In its public disclosures following imposition of the conservatorship, Fannie Mae, in part, recognized that the conservatorship was in effect a taking of the fiduciary protections and rights that the shareholders previously enjoyed.

170. These actions, both together and separate, destroyed the investment-backed expectations articulated throughout this complaint.

171. Immediately following the imposition of the conservatorship, the value of the preferred shares plummeted—reflecting the value of the rights and claims the United States took from the preferred shareholders.

172. The imposition of the conservatorship amounts to a government taking of the rights and protections that adhered to the shares because the conservatorship was the first step in a plan to nationalize the GSEs, and the Government ensured that the GSEs board of directors had no

choice in the matter. The executive branch of the Government made the decision to orchestrate the taking by taking actions to gain control of the GSEs. This decision was made at the highest levels of the Executive Branch. Once the plan to take control over the GSEs by extinguishing all the rights and protections the adhered to the preferred shares, Treasury executed the plan, with active consent of the Chairman of the Federal Reserve, and with the approval of the President of the United States, who Secretary Paulson acknowledged was anxious about the "hostile takeover."

173. At this time, the GSEs were solvent and the express purpose of implementing Government control of the GSEs was to eliminate the independent board and management of the GSEs and dictate the actions and policies of the GSEs. The Government had several incentives to do so including, but not limited to, get the GSEs in line with its plans and policies to navigate the financial crises, to reassure foreign governments holding significant GSE debt, and to maintain confidence in the marketplace. Because express nationalization was out of the question on account of the negative implications for the national deficit and budget, Treasury saw opportunity in the conservatorship provisions of HERA. Because the Government could not trigger the conservatorship by any of the enumerated basis, the Government had to coerce the GSEs board of directors to agree to conservatorship. The Government did just that by ensuring that the GSEs and their shareholders would be "taken by surprise" and by making sure the "first sound they'll hear is their heads hitting the floor." This was an "ambush . . . for the good of the country," and the Government knew the GSEs and their shareholders would "put up a fight." To that end, Paulson, Bernanke, and Lockhart met with representatives of the GSEs and directed them to give their consent to the conservatorship. If they did not agree, "we would seize them." Paulson also threatened that he "ha[d] the grounds to do this on an involuntary basis," and that the Government

would "goo that course if needed," even though there was not a statutory basis supporting that threat.

174. Furthermore, once the conservatorship was coerced, the Government took action through the conservatorship that would ensure that it had complete control over the conservatorship and could keep the conservatorship in place perpetually. Immediately following the imposition of the conservatorship, in executing a government function, the conservator caused the SPSPA to be executed with Treasury that give to the Treasury the sole authority to end the conservatorship and making its existence perpetual. The SPSPA and the amendments that followed were government actions that the Conservator took to ensure and further subordinate the preferred shareholders and rights and protections to the Government and public.

175. In taking private property, the Government is required to adhere to due process of law and to respect the legal rights of affected parties.

176. The Government violated the statutory, contractual, and constitutional rights of Plaintiffs by taking all of the rights, claims, and remedies as well as the investment-backed expectations that adhered to pre-conservatorship ownership of the preferred shares and thus the value of the preferred shares without providing any compensation.

177. Through the conservatorship, in violation of the Fifth Amendment, the United States seized the rights attached to the shares and rendered the shares effectively worthless. The FBOP Subsidiaries and River Capital were thereby deprived of all use and benefit of their shares. As the shares had been rendered worthless, the FBOP Subsidiaries and River Capital could no longer make economically beneficial use of the shares; their sale value was negligible, particularly since they no longer had voting or dividend rights attached to the shares.

178. By imposing conservatorship on the GSEs, the Government took Plaintiffs' property to facilitate public policy aims. The Government never compensated FBOP Subsidiaries or River Capital for taking of their private property and interests in the GSEs. The Government thereby disproportionately impacted a small group to benefit the public in violation of Plaintiffs' Fifth Amendment rights. Here Mr. Kelly, FBOP, FBOP Subsidiaries, and River Capital were disproportionately impacted over and over and over again while the public received great benefit.

179. Plaintiffs suffered harm distinct from that suffered by the GSEs. Plaintiffs' dividend and voting rights as well as the other rights and protections that adhered to the preferred shares were not held by the GSEs; they belong only to shareholders. Furthermore, Plaintiffs were directly harmed by the destruction of their share value because FBOP Subsidiaries and River Capital were placed into receivership as a direct result of the Government's taking of their property rights in the GSE preferred shares, which resulted in the loss of their Tier 1 Capital.

180. Plaintiffs are therefore entitled to just compensation for the taking of their property in an amount to be determined at trial.

THIRD CLAIM FOR RELIEF
SHAREHOLDER DERIVATIVE TAKINGS CLAIMS

181. Plaintiffs incorporate by reference and reallege each and every allegation of the preceding paragraphs as though fully set forth herein.

182. The GSEs are controlled by the FHFA, which as conservator has the powers of the board of directors. The unlawful takings described in this complaint are the direct result of Government action, specifically the FHFA and Treasury action. The Government therefore has a clear conflict of interest, and a pre-suit demand to initiate a derivative action would have been futile.

183. In bringing the shareholder derivative claims, Mr. Kelly, FBOP, the FBOP Subsidiaries, and River Capital will fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the rights of the GSEs. This action is not a collusive one to confer jurisdiction that this Court would otherwise lack.

184. Plaintiffs aver that they reasonably believe all factual allegations, made upon information and belief and the investigation of counsel, will likely have evidentiary support after a reasonable opportunity for further investigation through discovery.

185. The FBOP Subsidiaries and River Capital were shareholders of the GSEs at the time of the transactions complained of in this complaint.

186. In the alternative to the direct takings claims outlined under Plaintiffs' Second Claim for Relief, Plaintiffs make a derivative claim for takings as holders of preferred GSE shares as of the date of the conservatorship.

187. The Fifth Amendment provides for due process of law and that no private property shall be taken for public use, without just compensation.

188. As a preferred shareholder at the time of the conservatorship, FBOP Subsidiaries and River Capital have standing to bring a derivative claim for unlawful takings on behalf of the GSEs.

189. As CEO and sole common shareholder of FBOP, Mr. Kelly is permitted to bring a derivative claim on behalf of FBOP, the FBOP Subsidiaries and River Capital.

190. Each GSE had a property interest in its net worth, which was decimated by the imposition of the conservatorship.

191. The GSEs are therefore entitled to just compensation for the Government's taking of their property in an amount to be determined at trial.

FOURTH CLAIM FOR RELIEF
BREACH OF IMPLIED COVENANTS

192. Plaintiffs incorporate by reference and reallege each and every allegation of the preceding paragraphs as though fully set forth herein.

193. The covenant of good faith and fair dealing is an implied duty that each party to a contract owes to its contracting partner. The covenant imposes obligations on both contracting parties that include the duty not to interfere with the other party's performance and not to act so as to destroy the reasonable expectations of the other party regarding the fruits of the contract. The duty applies to the Government just as it does to private parties.

194. Fannie Mae adopted bylaws that promised corporate governance in accord with the Delaware General Corporation Law. Under Freddie Mac's pre-conservatorship bylaws, Freddie Mac was to follow the corporate governance practices and procedures of the law of the Commonwealth of Virginia, including without limitation the Virginia Stock Corporation Act.

195. The GSEs' pre-conservatorship bylaws were a contract with the preferred shareholders. Likewise, the preferred shares that the FBOP Subsidiaries and River Capital purchased represent a contract between the GSEs and the preferred shareholders.

196. Because the imposition of the conservatorship was coerced, the conservator transferred the right to terminate the conservatorship to Treasury (ensuring that the GSEs would operate for the benefit of the Government in perpetuity), and the conservator took actions that were governmental in character, the imposition of the conservatorship put the Government in privity with the FBOP Subsidiaries with respect to the GSE bylaws and preferred share certificates.

197. The imposition of the conservatorship also makes the Government a necessary party to the bylaws and the stock certificates. Treasury and the FHFA have dominated the GSEs.

The GSEs separate legal existence as financial institutions to be operated for the benefit of their shareholders has been completely ignored and Treasury and the FHFA have operated the GSEs for their benefit and the benefit of the American public. This complete domination and control over the GSEs allowed the Government to commit serious wrongs against Plaintiffs. This complete dominion and control of the Government over the GSEs is also reflected in the disparate bargaining power that the Government used to coerce the GSEs into "acquiescing" to the conservatorship.

198. Under the GSE bylaws and as preferred shareholders, the FBOP Subsidiaries and River Capital had a reasonable expectation that the GSEs would be managed to maximize long-term shareholder value. *See N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del.2007) ("The directors of Delaware corporations have the legal responsibility to manage the business of a corporation for the benefit of its shareholder[ ] owners."); *Unocal Corp. v. Mesa Petroleum Co*., 493 A.2d 946, 955 (Del.1985) ("the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders"); *see also* Leo E. Strine, Jr., et al., Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law, 98 Geo. L.J. 629, 634 (2010) ("[I]t is essential that directors take their responsibilities seriously by actually trying to manage the corporation in a manner advantageous to the stockholders.").

199. The preferred shareholders also had a reasonable expectation that the GSEs officers and directors would manage the GSEs consistent with the duties of good faith, loyalty, and care to maximize shareholder value.

200. The preferred shareholders also had a reasonable expectation that GSE officers and directors would work to maximize shareholder value consistent with these duties even in the event the GSEs were in danger of insolvency. *See Gheewalla*, 930 A.2d at 101 ("When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not

change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners."); *Prod. Res. Gp., L.L.C. v. NCT Gp., Inc*., 863 A.2d 772, 790 (Del. Ch. 2004) ("Having complied with all legal obligations owed to the firm's creditors, the board would ... ordinarily be free to take economic risk for the benefit of the firm's equity owners, so long as the directors comply with their fiduciary duties to the firm by selecting and pursuing with fidelity and prudence a plausible strategy to maximize the firm's value."); *Blackmore P'rs, L.P. v. Link Energy LLC*, 864 A.2d 80, 85–86 (Del. Ch. 2004) ("[T]he allegation that the Defendant Directors approved a sale of substantially all of [the company's] assets and a resultant distribution of proceeds that went exclusively to the company's creditors raises a reasonable inference of disloyalty or intentional misconduct.).

201. The GSEs published and codified these expectations in various ways, including in pre-conservatorship public disclosures.

202. For example, prior to the imposition of the conservatorship, Freddie Mac had a Code of Conduct for Members of Freddie Mac's Board of Directors that articulated part of its mission as "delivering lasting value to all those who invest in Freddie Mac." In accomplishing that mission, the Code of Conduct recognized that "[a]s a shareholder-owned, government-sponsored enterprise," its "obligation to uphold principles of ethical conduct is greater than that of other companies." Freddie Mac's published Governance Guidelines recognized that one of the primary responsibilities of the Board of Directors was to "promote . . . the interests of the Company's stockholders." Moreover, Freddie Mac's "Directors must exemplify high standards of integrity and be committed both to Freddie Mac's public mission and to the interests of its stockholders."

203. Likewise, Fannie Mae's public disclosures recognized that, prior to the imposition of the conservatorship, its shareholders had specific voting rights, that its directors owed the shareholders fiduciary duties, and that the enterprise would be managed to maximize shareholder value.

204. To that end, the bylaws of the GSEs provided common shareholders with rights to elect a majority of each of the GSEs' board of directors, which had the power to determine each enterprise's general policies governing operations of the corporation and which owed fiduciary duties to all of the stockholders. Common shareholders of Fannie Mae could also remove directors. Common and preferred shareholders also had various specified voting rights. These voting rights further solidified the preferred shareholders' investment-backed expectations that the GSEs would be managed with their interest in mind in a way that would maximize the value of their shares.

205. The United States also worked to promote these investment-backed expectations through various agencies that rated investments in the GSEs as being as safe as cash and by creating regulatory incentives aimed at enticing community banks like the FBOP subsidiaries to invest in the GSEs.

206. These investment-backed expectations were especially acute for the FBOP Subsidiaries because the United States Government allowed the FBOP Subsidiaries to invest 100% of their Tier 1 Capital in preferred GSE shares and approving of those investments once they were made. But for this regulatory treatment, the FBOP Subsidiaries and River Capital would not have purchased GSE preferred shares.

207. The conservator succeeded to all power and authority of the GSEs' Board of Directors, management, and shareholders.

208. With this authority, the conservator, exercising a government function, then caused the GSEs to issue preferred shares to Treasury and warrants to purchase a majority of the of the common stock on a fully-diluted basis. Under these stock purchase agreements, Treasury obtained a superior liquidation preference and dividend rights as well as the right and authority to prevent the conservator from delegated the power to end the conservatorship to Treasury. *See* Covenant 5.3 ("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 . . . other than in connection with a receivership . . .).

209. Through these actions, the Government breached the duties of good faith and fair dealing implied in the GSE bylaws and preferred shares by destroying Plaintiffs' investment-backed expectations that: (1) a fiduciary relationship with the directors and officers of the GSEs protected their investment; (2) the directors of the GSEs would operate and managed the enterprises to increase shareholder value; (3) the investments were low risk; and (4) that the FBOP Subsidiaries could invest 100% of its Tier 1 Capital without risking undercapitalization and failure.

210. Fannie Mae's own public disclosures following the imposition of the conservatorship confirm the existence of many of these implied promises and the breach of these promises that the United States caused when imposing the conservatorship:

Topic	Before Conservatorship	As of February 26, 2009
Authority of Board of Directors, management and shareholders	• Board of Directors with right to determine the general policies governing the operations of the corporation and exercise all power and authority of the company, except as vested in shareholders or as the Board chooses to delegate to management • Directors with duties to shareholders • Board of Directors delegated significant authority to management • Shareholders with specified voting rights	• FHFA, as conservator, succeeded to all of the power and authority of the Board of Directors, management and the shareholders • The conservator has delegated authority to a newly constituted Board of Directors. The Board is required to consult with and obtain the consent of the conservator before taking action in specified areas. The conservator may modify or rescind this delegation at any time • Directors do not have any duties to any person or entity except to the conservator. • The conservator has delegated authority to management to conduct day-to-day operations so that the company can continue to operate in the ordinary course of business. The conservator retains overall management authority, including the authority to withdraw its delegations to management at any time • Shareholders have no voting rights
Management Strategy	• Maximize shareholder value over the long-term • Fulfill our mission of providing liquidity, stability and affordability to the mortgage market	• Directed to provide liquidity, stability and affordability in the mortgage market and immediately provide additional assistance to this market and the struggling housing market, and to the extent not in conflict with our mission, to maintain positive net worth • No longer managed with a strategy to maximize common shareholder returns • Focus on foreclosure prevention

211. With respect to HERA, HERA imposes no limitations on Plaintiffs' contract claims; does not preempt or abrogate contract rights; does not allow the conservator to breach contracts at will, and a breach of the covenant of good-faith and fair dealing would not have been an action within the conservator's power.

212. Based on the foregoing, Plaintiffs seek damages for breaches of these implied covenants in an amount to be proven at trial.

FIFTH CLAIM FOR RELIEF
IMPLIED REGULATORY CONTRACT

213. Plaintiffs incorporate by reference and reallege each and every allegation of the preceding paragraphs as though fully set forth herein.

214. The Government controls the GSEs' capital requirements and, in 2006, increased the GSEs' capital requirements. In order to meet this Government mandate, the GSEs issued new series of preferred shares, which did not receive adequate interests from corporate treasuries. In order to meet the Government imposed capital requirements, the GSEs needed to tap into a new market for capital.

215. In order to create that market and avoid having to recapitalize the GSEs itself, the Government offered banks like the FBOP Subsidiaries the opportunity to invest in the GSEs.

216. In consideration for an acceptance of that offer, the Government gave the banks and FBOP Subsidiaries special regulatory treatment and benefits that included: (1) permission to invest 100% of Tier 1 Capital in the GSEs; (2) special tax advantages under the IRS's rules that made GSE dividends eligible for a 70% tax reduction; and (3) a 20% capital risk rating for the GSEs. In other words, the Government promised that the GSE preferred shares would be as safe and secure as cash if the FBOP Subsidiaries accepted its offer to participate in the recapitalization of the GSEs.

217. The FBOP Subsidiaries and River Capital accepted the Government's offer by purchasing into three different series of GSE preferred shares. The FBOP Subsidiaries' and River Capital's acceptance was supported with more than $900 million in cash consideration. The purchase of these GSE preferred shares recapitalized the GSEs. This consideration provided real

value to the Government because the Government and the taxpayer would not have to pick up the tab for the shortfall during a financial crisis.

218. Implied in the Government's offer to the FBOP Subsidiaries was a promise that the Government would assume the risk in the event a change in the regulatory landscape prevented the Government from honoring its promise that the investments in the GSEs were a safe and secure investment and use of Tier 1 Capital.

219. Here, it is certain banks would not have purchased GSE shares if they had known the Government intended to vitiate those shares of all economic value and within months of purchase. With the Government's imposition of the conservatorship, the Government breached its promise that the investments in GSE preferred shares would be a safe cash alternative use for the FBOP Subsidiaries' Tier 1 Capital.

220. Because the Government bore the risk of paying damages in the event it or its agencies took action that prevented its own performance of the contract, the Government is liable for breaching the implied regulatory promises described above. In Justice Scalia's words

> Their claim is that the Government quite plainly promised to regulate them in a particular fashion, into the future. They say that the very subject matter of these agreements, as an essential part of the *quid pro quo*, was Government regulation; unless the Government is bound as to that regulation, an aspect of the transaction that reasonably must be viewed as the *sine qua non* of their asset becomes illusory. I think they are correct. If . . . The Government committed only to providing certain treatment unless and until there is subsequent action, then the Government in effect said "we promise to regulate in this fashion for as long as we choose to regulate in this fashion"—which is an absolutely classic description of an illusory promise.

United States v. Winstar, 518 U.S. 839, 921 (1996) (Scalia, J., concurring) (some internal punctuation and citations omitted).

221. Accordingly, Plaintiffs seek damages to be proven at trial for the Government's breach of the regulatory contract implied in the Government's promise that Plaintiffs' GSE investments were as safe and secure as cash and that it was appropriate to place 100% of their Tier 1 Capital in GSE preferred shares.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs demand judgment in their favor on their direct and derivative causes of action against Defendant, the United States of America, as follows:

A. Finding that the Defendant has taken Plaintiffs' private property in violation of the Due Process and Takings Clauses of the United States Constitution;

B. Determining and awarding Plaintiffs damages suffered by them by virtue of the Defendant's taking in an amount to be determined at trial;

C. Determining and awarding Plaintiffs damages for breach of the implied covenant of good faith and fair dealing;

D. Determining and awarding Plaintiffs damages for breach of implied regulatory contract;

E. Prejudgment and post-judgment interest, together with any and all further costs, disbursements and reasonable attorneys' and experts' fees; and

F. Granting all other relief as this Court may deem just and appropriate.

DATED: March 6, 2023

Respectfully submitted,

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