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Fannie Mae Investor Wants Records To Probe Profit Sweep

Share us on: By **Matt Chiappardi**

Law360, Wilmington (March 14, 2016, 9:04 PM ET) -- A [Fannie Mae](#) shareholder launched a demand in the Delaware Chancery Court on Monday to see corporate records and investigate possible director wrongdoing connected to a change in the [U.S. Treasury Department](#)'s stock purchase deal that essentially hands over the company's entire net income to the government.

In the books and records demand, Federal National Mortgage Association shareholder Timothy J. Pagliara claims that Fannie Mae's board members knew that the change in 2012, known as a net worth sweep, would be "blatantly unfair" and either acquiesced to the U.S. Treasury's demands or did nothing to stop it, both of which would be a breach of their fiduciary duties to stockholders.

"There could be no scenario in which the net worth sweep would be better for Fannie Mae than the pre-existing dividend," the complaint states. "Nothing could be worse for Fannie Mae and its stockholders than the forfeiture of Fannie Mae's entire net worth. In approving or acquiescing in the [change] or simply failing to oppose it, the board breached its fiduciary duty of loyalty."

The issue has its roots in the economic crisis-era U.S. Housing and Economic Recovery Act of 2008 that led to Fannie Mae and fellow government-sponsored enterprise [Freddie Mac](#) being placed into a form of receivership called a conservatorship as well as a combined \$187.5 billion taxpayer bailout in large part due to losses on mortgage-backed securities stuffed with subprime home loans.

The Treasury Department also purchased newly issued Fannie Mae preferred stock, which under the deal was to yield an annual dividend of 10 percent cash or 12 percent in securities. But that agreement was amended in 2012 to increase the dividend to Fannie Mae's entire net income, a move that has increased dividends paid to the U.S. Treasury by \$78.2 billion, according to the complaint.

Pagliara, who is also the CEO of investment management firm CapWealth Advisors LLC, claims the change came just as Fannie Mae was actually about to realize historically high profits and “a massive increase in its net worth from the reversal of its prior write-offs of deferred tax assets and increases in loss reserve.”

Fannie Mae’s board was “supine” in the face of the government’s demand for the change but should have protected the company and its other stockholders by several available means, including seeking some intervention from the courts, Pagliara said.

“A board may not sit idly by while a controlling stockholder loots the corporation,” the complaint states. “Even if the dividends were somehow paid without the board’s approval, the board failed to oppose them, such as by directing Fannie Mae’s personnel not to pay them, stating its opposition to them or seeking declaratory or injunctive relief.”

Under state law in Delaware, where Fannie Mae is organized, shareholders can have the Chancery Court compel a company to cough up its books and records, provided it has a proper purpose for doing so, such as investigating corporate wrongdoing.

On Monday, a representative for Fannie Mae said in an emailed statement, “We are confident that we’ve met our responsibilities under conservatorship, and we are focused on continuing our strong progress.”

The conditions surrounding the net worth sweep have been challenged in the courts several times before, with most lawsuits targeting the [Federal Housing Finance Agency](#), the regulatory arm created by the HERA and the U.S. Treasury Department, instead of Fannie Mae’s board.

A lawsuit in the District of Columbia federal court [was thrown out](#) in 2014, on grounds the grievance was really with policy created by Congress.

A similar lawsuit [was thrown out](#) in Iowa on essentially the same grounds.

Pagliara is represented by C. Barr Flinn, Emily V. Burton, Lakshmi A. Muthu, Benjamin M. Potts and Meryem Y. Dede of [Young Conaway Stargatt & Taylor LLP](#).

Counsel information for Fannie Mae was not immediately available Monday.

The case is Pagliara v. Federal National Mortgage Association, case number 12105, in the Delaware Court of Chancery.

--Additional reporting by Evan Weinbegrer and Jeff Zalesin. Editing by Aaron Pelc.

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