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January 19, 2016

BY EMAIL & CERTIFIED MAIL

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Eugene B. Shanks
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Board of Directors
c/o Corporate Secretary
Freddie Mac
8200 Jones Branch Drive MS 200
McLean, Virginia 22102
boardofdirectors@freddiemac.com

Dear Ladies and Gentlemen of the Board:

We represent Timothy J. Pagliara, the beneficial owner of stock in the Federal Home Loan Mortgage Corporation ("Freddie Mac" or the "Corporation"). We write on our client's behalf to urge you, as members of the Board of Directors of the Corporation (the "Board" or the "Board of Directors"), to satisfy your fiduciary duties under Virginia law by taking the following steps:

1. Publicly clarify the Board's role in declaring and paying dividends to the United States Treasury ("Treasury") on account of its senior preferred stock (the "Senior Preferred Stock");

2. Publicly declare, for reasons detailed herein, including out of concern for the financial soundness of the Corporation, that the Board does not agree with the declaration and payment of dividends to Treasury on account of the Senior Preferred Stock, and certainly not in amounts equal to *all* the profits of the Corporation; and
3. Exercise your authority under Virginia law to cause the Corporation to immediately stop declaring and paying dividends to Treasury on account of the Senior Preferred Stock.

As you know, Freddie Mac is a federally chartered corporation established pursuant to the Federal Home Loan Mortgage Corporation Act (the "Corporation Act"), and owned by private stockholders, including our client. The Corporation Act created "a body corporate under the direction of a Board of Directors." 12 U.S.C. § 1452(a)(1); *see also* Freddie Mac Bylaws § 4.1. Under Freddie Mac's Bylaws, Virginia law is the law of decision governing Freddie Mac's "corporate governance practices and procedures." Freddie Mac Bylaws § 11.3(a).

Virginia law, and specifically the Virginia Stock Corporation Act (the "VSCA"), thus provides the general standards of conduct for the Board of Directors. Va. Code Ann. § 13.1-690. The VSCA's primary command to directors is simple: "[a] director shall discharge his duties as a director, including his duties as a member of a committee, in accordance with his good faith business judgment of the best interests of the corporation." *Id.*

Virginia law also governs the Board's authority to declare and pay dividends. Under Virginia law, dividends are voluntary; declaration and payment of dividends is entrusted to the Board's discretion. *See* Va. Code Ann. § 13.1-653A ("A board of directors *may* authorize and the corporation may make distributions to its shareholders . . .") (emphasis added). Likewise, the Corporation Act states that Freddie Mac may make capital distributions, "as may be declared by the Board of Directors." 12 U.S.C. § 1452(b)(1). Consistent with these statutes, Treasury's Amended and Restated Senior Preferred Stock Certificate, executed *after* the Freddie Mac Board was reconstituted by the Federal Housing Finance Agency ("FHFA" or "Conservator"), states that holders of such stock are only entitled to cash dividend payments "when, as and if declared by the Board of Directors, in its sole discretion, out of funds legally available therefor." Freddie Mac Amended and Restated Senior Preferred Stock Certificate of Designation ¶ 2(a). In exercising its discretion to declare and pay dividends, as in all its actions, the Board must follow its good faith business judgment of the best interests of the Corporation.

Notwithstanding these provisions, in 2012 FHFA and Treasury entered into the Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement (the "Net Worth Sweep"), providing for the quarterly distribution, in perpetuity, of

ultimately all of the net worth of Freddie Mac to Treasury. FHFA and Treasury have both made clear that the Net Worth Sweep “ensures all [Freddie Mac’s] earnings are used to benefit taxpayers.”¹ The declaration and payment of such dividends is plainly not action taken based on good faith business judgment of the best interests of the Corporation or its shareholders.

In addition, under Virginia law, a distribution cannot be properly authorized if it would result (i) in the corporation becoming unable to pay its debts as due in the usual course of business, or (ii) in the corporation’s total assets becoming less than its total liabilities. Va. Code Ann. § 13.1-653; *see also* 12 U.S.C. § 1452(b)(2). The risk the Net Worth Sweep poses to the Corporation is obvious. During the three months “ended March 31, 2015, June 30, 2015, and September 30, 2015, [Freddie Mac] paid dividends of \$0.9 billion, \$0.7 billion, and \$3.9 billion, respectively, in cash on the senior preferred stock at the direction of [FHFA].” *Freddie Mac Quarterly Report on Form 10-Q*, 109 (for quarterly period ended September 30, 2015). In sharp contrast, “no common stock dividends were declared during the nine months ended September 30, 2015.” 2015 10-Q at 109. During the same period, the Corporation’s “Net Worth Amount at September 30, 2015 was below the 2015 Capital Reserve Amount of \$1.8 billion . . . As a result of the net worth sweep dividend we pay to Treasury, [Freddie Mac] cannot retain capital from the earnings generated by our business operations.” 2015 10-Q at 69. Legal commenters have noted that the payment of these dividends to Treasury “sets a horrible precedent and it violates the Housing and Economic Recovery Act of 2008 as well as traditional corporate law practices.” Gretchen Morgenson, *Fannie and Freddie’s Government Rescue Has Come with Claws*, N.Y. Times, Dec. 12, 2015 (quoting Logan Beirne, a fellow at the Information Society Project at Yale Law School).

Freddie Mac has paid out, and continues to pay out, billions of dollars in discretionary cash dividends to Treasury under this Board’s administration while the contractual restraints on capital preservation imposed by the Net Worth Sweep have left it teetering perilously on the edge of insolvency. Courts applying Virginia law have affirmed that directors may be held personally liable for authorizing a distribution under such circumstances. *See, e.g., In re Heilig-Meyers Co.*, 328 B.R. 471, 489 (E.D. Va. 2005) (citing to Section 13.1-653C of the VSCA) (“Virginia law prohibits a corporation from paying a dividend while insolvent or if the dividend would cause insolvency”).

¹ Federal Housing Finance Agency, Conservatorship, “Senior Preferred Stock Purchase Agreements,” available at <http://www.fhfa.gov/Conservatorship/Pages/Senior-Preferred-Stock-Purchase-Agreements.aspx>; *see also* U.S. Dep’t of the Treasury, Press Release, “Treasury Department Announces Further Steps to Expedite Wind Down of Fannie Mae and Freddie Mac,” (Aug. 17, 2012), available at <https://www.treasury.gov/press-center/press-releases/Pages/tg1684.aspx> (Net Worth Sweep will “make sure that every dollar of earnings [Freddie Mac] generates is used to benefit taxpayers”).

The Board is also prohibited from declaring and paying dividends driven by conflicts of interest or that amount to corporate waste. Where a dividend is paid to a controlling stockholder to the detriment of other minority stockholders, as in the case of Freddie Mac's dividend payments to Treasury (the Corporation's controlling stockholder, a related party and FHFA's sister agency), that inherent conflict of interest requires close scrutiny. Such transactions are voidable unless the conflicted controlling party can establish that the transactions were fair to the corporation. *See Dunford Roofing, Inc. v. Earls*, No. 1:00CV00025, 2001 WL 396869, at *8 (W.D. Va. Apr. 12, 2001); *Willard v. Moneta Bldg. Supply, Inc.*, 258 Va. 140, 155, 515 S.E.2d 277, 287 (1999); *Giannotti v. Hamway*, 239 Va. 14, 24, 387 S.E.2d 725, 731 (1990); *accord* Va. Code Ann. § 13.1-691. The Net Worth Sweep, pursuant to which Freddie Mac already has paid *more than \$70 billion* to Treasury in exchange for no additional consideration whatsoever, is in no way fair to the Corporation. Indeed, by approving or permitting the Net Worth Sweep and the ongoing dividends to Treasury, the Board appears to have violated and continues to violate the prohibition against corporate waste. *In re Capital One Derivative S'holder Litig.*, 952 F. Supp. 2d 770, 782 (E.D. Va. 2013) (corporate waste occurs where "the consideration received by the corporation was so inadequate that no person of ordinary sound business judgment" would have approved the transaction) (citing to Delaware law).

A director who votes for or assents to a distribution made in violation of Virginia law is personally liable to the corporation. Va. Code Ann. § 13.1-692A. Liability under Section 13.1-692 applies to directors' actions, and also to any conscious *failure* to act. *See Colgate v. Disthene Grp., Inc.*, 86 Va. Cir. 218 (Buckingham County Cir. Ct. 2013); Allen C. Goolsby & Steven M. Haas, *Goolsby & Haas on Virginia Corporations* § 9.7 (liability under Virginia law "applies not just to actions taken by the directors, but also to any conscious failure to act"). While the Corporation's Bylaws purport to limit the liability of directors on claims brought by or in the name of the Corporation or its shareholders, *see* Bylaws § 8.1, neither the Bylaws nor the VSCA allows for the limitation of liability for willful misconduct. Directors who allow—quarter after quarter—all of the Corporation's profits to go to Treasury are certainly risking exposure to claims of willful misconduct.

To date, public disclosure regarding the Board's role in declaring and paying dividends has been clouded. The Conservator has instructed the Board "that it should consult with and obtain the approval of the Conservator before taking . . . actions involving capital stock [or payment of] dividends . . ." *Freddie Mac Current Report on Form 10-K/A*, 5 (for fiscal year ended December 31, 2008). Stockholders in Freddie Mac, a publicly traded, SEC-registered corporation, deserve to know the extent to which the Board, FHFA, and any other party may be held accountable for the misallocation of the Corporation's capital and the distribution of dividends to Treasury. For this reason, we strongly urge you to remove the cloud hanging over these decisions and publicly clarify your role in the declaration and payment of dividends.

In addition, regardless of whether the Corporation has been declaring and paying dividends with Board approval or as a result of the Board's inaction, the director liability imposed on Freddie Mac directors by Virginia law for the payment of unlawful dividends is not assumed by FHFA as Conservator. The Corporation's actions have made clear that the Board of Directors is a legally constituted board subject to Virginia law. For example, in July 2015 the Corporation amended and restated its Bylaws while under conservatorship, and *retained* Section 11.3 providing that Virginia law is the law of decision governing Freddie Mac's "corporate governance practices and procedures." Likewise, these same Bylaws provide that "[s]ubject to the limitations of law and regulation, the Board of Directors shall determine the general policies that govern the operations of the Corporation, and the Corporation shall be under the direction of the Board of Directors." *Id.* § 4.1. The conservatorship plainly does not absolve the directors from fulfilling their corporate fiduciary duties under Virginia law.

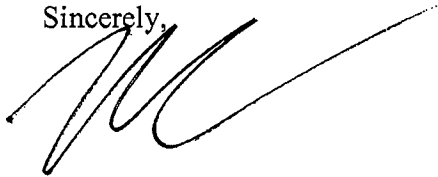
Despite these fiduciary duties (and associated liabilities) of directors under Virginia law, there is no indication that the Board has made *any* effort to ensure that, under its administration, the cash dividends being declared and paid by the Corporation to Treasury on a quarterly basis comply with Virginia law. At a minimum, the Board must confirm that the dividend payments comply with VSCA Section 13.1-653C, that the payments are fair to the Corporation, and that the payments do not constitute corporate waste. Instead of doing so, Freddie Mac's Board has seemingly resolved itself to inaction. This is never an acceptable method for a corporate director to satisfy his or her fiduciary duties. *See, e.g., Colgate, supra; accord In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 123 (Del. Ch. 2009) ("to establish oversight liability a plaintiff must show that the directors *knew* they were not discharging their fiduciary obligations or that the directors demonstrated a *conscious* disregard for their responsibilities such as by failing to act in the face of a known duty to act").

Each of you, as a member of a Virginia-law-governed corporate board of directors, has a duty to the Corporation, and to our client as a stockholder, to prevent Freddie Mac from making improperly motivated and unlawful dividend payments that threaten the Corporation's solvency. You may be held personally liable for failure to do so. As explained in our separate letter, the Board remains subject to liability for breaches of statutory and fiduciary duties despite the pendency of the conservatorship. Even if this were not so, the conservatorship will inevitably end, at which time the Board will undoubtedly be subject to liability for its actions during the conservatorship.²

² Debate in Congress recently confirmed, in connection with approving the Consolidated Appropriations Act, 2016 – Section 702, that the conservatorship has a finite duration, regardless of the Third Amendment and other developments. In discussing provisions in the Consolidated Appropriations Act concerning the Treasury's preferred stock, Senate Minority Leader Harry Reid noted that "As then-Secretary Paulson described, conservatorship was meant to be a 'time out' not an indefinite state of being."

We urge you to take your fiduciary duties as a director seriously, and to make your voice heard by publicly declaring that the Board does not agree with the declaration and payment of unlawful dividends to Treasury. We also urge you to take whatever steps you have at your disposal to cause Freddie Mac to immediately cease declaring and paying dividends to Treasury at the expense of the Corporation's well-being.

Sincerely,



N. Thomas Connally, III

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cc: Timothy J. Pagliara

Banking Committee Ranking Member Senator Sherrod Brown then added: “. . . the FHFA and Treasury Department could have placed the GSEs into receivership if the intent was to liquidate them. The purpose of a conservatorship is to preserve and conserve the assets of the entities in conservatorship until they are in a safe and solvent condition as determined by their regulator.”

Connally, N. Thomas, III

From: Connally, N. Thomas, III
Sent: Tuesday, January 19, 2016 5:01 PM
To: boardofdirectors@freddiemac.com
Subject: Letter to Board of Directors
Attachments: 01.19.2016 Letter to Freddie Mac Board of Directors.pdf

Please see the attached letter to the Board of Directors.

Thank you for your attention to this matter.

Best regards, Tom Connally

N. Thomas Connally

Partner

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