

1 IN THE UNITED STATES COURT OF FEDERAL CLAIMS
2 - - - - - X
3 FAIRHOLME FUNDS INC, et al., :
4 Plaintiffs, :
5 v. : Case No. 13-465C
6 THE UNITED STATES, :
7 Defendant. :
8 - - - - - X

Washington, DC

Thursday, May 7, 2015

11 CONFIDENTIAL - PROTECTED INFORMATION TO BE
12 DISCLOSED ONLY IN ACCORDANCE WITH PROTECTIVE ORDER
13 Videotaped Deposition, of EDWARD DEMARCO,
14 a witness herein, called for examination by counsel
15 for Plaintiffs in the above-entitled matter, pursuant
16 to notice, the witness being duly sworn by REBECCA L.
17 STONEROCK, a Notary Public in and for the District of
18 Columbia, taken at the offices of Cooper & Kirk, 1523
19 New Hampshire Avenue NW, Washington, DC, at 9:11
20 a.m., Thursday, May 7, 2015, and the proceedings
21 being taken down by Stenotype by REBECCA L.
22 STONEROCK, RPR, and transcribed under her direction.

1 even, you know, say that I was in a position to know
2 what the various alternatives were.

3 This discussion took place over an eight-
4 or nine-month period and, you know, I suspect in that
5 time period a number of various approaches were
6 considered, but I cannot answer your question as to
7 what else they all were.

8 Q. Who was the point person, Mario Ugoletti?

9 A. Mario Ugoletti was the point person for
10 FHFA in discussions with the Treasury Department
11 regarding these changes as became known the third
12 amendment to the PSPA.

13 Q. Was there any discussion in the run-up to
14 the third amendment of allowing the companies to pay
15 down the principal, and thereby alleviate the amount
16 of the fixed dividend?

17 A. I do not recall such discussion. It was
18 not allowed for in the original agreement and I don't
19 recall there being subsequent discussions to -- to do
20 that.

21 Q. Wouldn't that have been a potential way to
22 solve the problem of having dividends they couldn't

1 pay in cash?

2 A. When the agreement was first struck no one
3 would know, could know, where this thing was going to
4 end up. And certainly the circumstances that we were
5 looking at in late 2011 when these discussions
6 commenced, you know, is quite a different
7 environment. And we've come a long way from August
8 and September of 2008.

9 Q. But when you say the discussions commenced
10 in late 2011, is that when you first became a party
11 to conversations about sweeping the income of the
12 companies and giving them relief from the fixed cash
13 dividend?

14 A. That's not what I said.

15 Q. It was a question.

16 A. Oh, I'm sorry. No. No. You ask a lot of
17 your questions in that declarative way, Mr. Thompson.
18 I apologize to you for misconstruing the way you
19 phrased this one.

20 The discussions with the Treasury
21 Department over making a third amendment to the PSPA,
22 my recollection -- my first recollection of it is in

1 a discussion with the Treasury secretary in late
2 2011.

3 Q. Okay. Do you recall whether this concept
4 of a sweep -- income sweep was part of that initial
5 conversation with --

6 A. I do -- I do not recall that.

7 Q. Okay. Do you remember anything else about
8 that?

9 A. No. What I remember generally was that
10 Treasury acknowledged my concern that at the end of
11 2012 we were going to have a cap on the remaining
12 capital support that was available, and that there
13 was a series concern that the regular 10 percent
14 dividend that was going to be required at that point
15 might be insufficient -- to be paid out of -- out of
16 earnings, and hence, we could be reducing the
17 remaining capital support.

18 Q. So this next document is DeMarco 12, and
19 it's labeled Treasury 201 through 203.

20 (DeMarco Exhibit No. 12 was marked
21 for identification.)

22 BY MR. THOMPSON:

1 Q. And this is a document from December 20,
2 2010 and it's from Mr. Goldstein, who is at Treasury
3 Department. And if we look at the second page of
4 this document, it says, "Reasons to set the PCF."
5 And it says, "Makes clear the Administration's
6 commitment to ensure existing common equity holders
7 will not have access to any positive earnings from
8 the GSEs in the future."

9 And my question is: Is that a commitment,
10 Mr. DeMarco, that you shared?

11 A. Excuse me, Mr. Thompson, I'm just --

12 Q. Sure.

13 A. -- making sure where I am in the document.

14 Q. No problem.

15 A. Okay. I'm sorry, now that I'm
16 familiarized, can do the question again.

17 Q. Sure. Yeah, sure. So it says on that
18 second page under "Reasons to Set the PCF," it says,
19 "Makes clear the Administration's commitment to
20 ensure existing common equity holders will not have
21 access to any positive earnings from the GSEs in the
22 future."

1 Department as the other party to this agreement had
2 its own responsibilities given to it in HERA that it
3 was going to have to interpret and understand for
4 itself, and that a mutual understanding between these
5 two parties was going to be necessary to make these
6 changes.

7 Q. Under the third amendment, is it your
8 understanding that in fact common equity holders will
9 not have access to any positive earnings from the
10 GSEs in the future?

11 A. It is my understanding that whatever any
12 class of equity that exists at Fannie Mae and Freddie
13 Mac is going to get or receive upon the ultimate
14 resolution of these conservatorships is at this point
15 unknown and unknowable, because it depends upon
16 things that I couldn't possible tell you about when
17 this takes and how it take place.

18 Q. But if the third amendment isn't changed,
19 doesn't matter when it take place, the common will
20 never get a penny, correct?

21 MR. SCHWIND: Objection, it's vague, asks
22 for -- asks the witness to speculate, and it's asked

1 and answered.

2 THE WITNESS: So I believe this third
3 amendment made the companies stronger and better
4 equipped to carry out their public mission, the
5 mission of the companies, which as conservator I was
6 responsible for ensuring took place, for an
7 indefinite period of time through unknown future
8 economic circumstances. And by making the companies
9 sounder and giving us a basis to allow the companies
10 to continue to successfully operate in -- in this
11 condition, I did not know what the final outcome
12 would be. And so, no, I -- I'm going to leave it
13 there.

14 BY MR. THOMPSON:

15 Q. What was your understanding of the public
16 mission of the companies that you were trying to
17 effectuate as conservator?

18 A. So both Fannie Mae and Freddie Mac, part
19 of what makes them a government-sponsored enterprise,
20 one of the characteristics of a called GSE, is that
21 unlike most any other corporation in the United
22 States, they don't receive their corporate charter

1 from a state. They receive it from an act of
2 Congress.

3 And so this act of Congress set up Fannie
4 Mae and Freddie Mac, as well as the other GSEs, with
5 a charter that Congress controlled. That charter,
6 rather than a general business charter in which you
7 can take your business charter and typically do
8 whatever you want to do with it, the charter actually
9 limits the business functions, the
10 permissible business functions of the companies. It
11 also gives the companies a set of -- let's call them
12 benefits, subsidies, access to the market, privileges
13 that are generally unavailable to other companies.

14 And in -- in this package is expressing,
15 through the charter, a set of public purposes to the
16 companies. We want to limit you to these business
17 activities for the fulfillment of this public
18 purpose. And those things are all spelled out in the
19 Fannie Mae charter act and the Freddie Mac charter
20 act and so forth.

21 So the charter acts, without -- you know,
22 we'd have to pull up the acts to go through the

1 details, but let's say that Fannie Mae and Freddie
2 Mac's charters, as set forth by Congress, says you've
3 got a general responsibility to create secondary
4 market facilities that are going to maximize the
5 application of private capital to supporting and
6 financing mortgage credit in the United States. And
7 there's a series of things that you're supposed to do
8 to accomplish that, and there are certain things
9 you're supposed to do with regard to ensuring that
10 this liquidity is broadly available, including
11 affordable housing markets and so forth. So these
12 details are spelled out, and these are the
13 responsibilities of the companies under their public
14 charter. That's part of what makes a GSE such a
15 unique entity, is that it is a private company, but
16 it is given a public purpose through its charter by
17 Congress.

18 And again, only the Congress of the United
19 States could amend, multiply, or reduce the number of
20 these charters. FHFA, while it could put a company
21 in conservatorship or receivership, ultimately had no
22 power to modify, alter, increase the number, or

1 decrease the number of these charters.

2 Q. Our next exhibit is going to be DeMarco
3 13.

4 (DeMarco Exhibit No. 13 was marked
5 for identification.)

6 BY MR. THOMPSON:

7 Q. Now, this is another memo from
8 Mr. Goldstein dated January 4, 2011. And if we look
9 to page 3 of this document, under "Affirm Our Current
10 Obligations" it says, "The remaining PSPA capacity
11 must be managed so that market participants are
12 assured GSE obligations will be met, regardless of
13 the outlook for legislation."

14 And then it says, "Ensure \$275 billion of
15 funding capacity available after 2012 is not used to
16 pay dividends. This may require converting preferred
17 stock into common or cutting or deferring payment of
18 the dividend."

19 Do you recall whether one of the
20 alternatives that FHFA and Treasury discussed was
21 converting the preferred into common?

22 MR. SCHWIND: Objection, vague. Do you