

Statement of

David Einhorn, President
Greenlight Capital, Inc.

Before the

House Committee on Energy and Commerce
U.S. House of Representatives

Hearing on

H.R. 936 – the Prevention of Fraudulent Access to Phone Records Act

March 9, 2007

Chairman Dingell and Members of the Committee, thank you for holding this hearing on the "Prevention of Fraudulent Access to Phone Records Act." Although I did not ask to participate in this hearing, I appreciate the invitation to describe my experience as a victim of pretexting. Having said that, please understand that it is impossible to explain what happened to me without placing it in context.

My testimony is a cautionary tale. It is about a corporation and management team that, in attempting to ensure their survival, placed no limits on the exercise of their power. Pretexting is a brazen invasion of privacy. The thought of an individual engaging in pretexting is unnerving enough. But when a corporation, with millions of dollars at its disposal, has its agents spy on private citizens in order to silence criticism, that threatens more than just the sanctity of the individual's privacy; it threatens the freedom of the securities markets that we take for granted. I believe that the "Prevention of Fraudulent Access to Phone Records Act," which explicitly addresses pretexting, will send a strong message and act as a deterrent to those who feel that they can invade the privacy of citizens simply because they are suspicious of them or disagree with them. That is why I am testifying in support of this legislation.

My name is David Einhorn. I am the President of Greenlight Capital, a long-term oriented value investment company. One of our long-term investments is Allied Capital, a company headquartered a few blocks from here on Pennsylvania Avenue. Some time ago, our research led us to believe that Allied suffered from significant accounting and operational deficiencies, and Greenlight took a short investment position in Allied based upon that belief.

In 2002, I voiced my criticism of Allied publicly at an investment research conference, which was part of a charity fundraiser for a pediatric cancer hospital. I told the audience that I

had sold Allied short based on my research, and pledged to give half my personal profits based on this investment to the children's hospital sponsoring the event.

Our research indicated that Allied hides its problem investments by misleading the public about their value – valuing them at their original cost even as the investments go bankrupt – while stating publicly that the SEC valuation rules do not apply to them. Our research also indicated that Allied inflates its earnings by charging excessive interest rates and fees to companies it controls but does not consolidate in its financial results, while disclosing little about the performance of these companies. And its small business lending unit has defrauded the SBA and the USDA government lending programs out of hundreds of millions of dollars. All the while, we had seen Allied attempt to outgrow its problem investments by raising new capital from unknowing investors.

I discussed Allied's problems at the research conference in 2002. In response to my speech, instead of examining and cleaning up these problems, Allied decided to attack me. The company began a systematic campaign to discredit me, publicly attacking my reputation and my motivations. But ultimately the public – and the regulators – began to see through Allied's tactics. The SEC began an investigation into Allied in 2004 about the very practices I had accused Allied of from the beginning. Later that same year, the U.S. Attorney for the District of Columbia began a criminal investigation.

In its zeal to silence its critics, Allied used extreme measures. But even I did not believe Allied would go so far as to invade the privacy of my home and family. I was wrong. In an apparent attempt to find some piece of information to embarrass and discredit its critics, Allied retained private investigators to obtain its critics' personal and business phone records, including mine.

In 2004, Herb Greenberg, a respected financial journalist for Dow Jones who had publicly criticized Allied, told me that his phone records had been illegally accessed. I subsequently learned that a woman unknown to me had called my long distance provider; identified herself as my wife; provided my wife's social security number; and opened an online account to access our home telephone records. We then learned that the phone records of other known critics of Allied – including other hedge fund managers, a journalist, a research analyst, an individual investor and a former media relations advisor to Greenlight – had been similarly illegally accessed.

The FBI ultimately discovered the identity of the individual who had accessed my phone records, though they could not share that information with me. The phone records investigation was subsequently moved to the U.S. Attorney's Office in Washington D.C., where the criminal probe of Allied was already underway.

In March 2005, I wrote a private letter to Allied's Board of Directors and told them that someone had stolen my wife's social security number and used it to steal my phone records, along with the records of several other prominent Allied critics. I asked the Board to fully investigate what happened. A week later, I received a brush-off response that I had not provided sufficiently specific information for them to conduct an inquiry. A copy of my letter to Allied's Board of Directors and Allied's response is attached.

In September 2006, after Hewlett-Packard's CEO publicly admitted to involvement in very similar conduct and resigned, I wrote another private letter to the Chairman of the Audit Committee of Allied's Board, reminding them of the seriousness of pretexting and once again asking them to investigate. Two weeks later the Board responded that it had looked into my allegations and found no evidence to support my claim. Copies of these letters are also attached

At the same time, Allied's management went on the offensive yet again. On the November 8, 2006 earnings conference call, Allied's CEO, William Walton, spent several minutes attacking my motivations and stating that my concerns about my stolen phone records were "yet just another example of Mr. Einhorn's tactics." He recounted my letters to Allied's Board and their prompt denials. He criticized me for not providing more evidence. And he issued his own denial that anyone at Allied had accessed my records, saying:

There is simply no evidence to support a claim that Allied tried to access Einhorn's phone records. We never received his records and all that the article points to in support of this claim is the word of Einhorn, an individual with a motive to depress Allied Capital's stock.

Only three months later, Allied completely changed its story. On February 6, 2007, Allied issued a press release innocuously titled "Allied Capital Comments on Recent Events." Allied admitted that its "agent" had stolen not only my home phone records, but also Greenlight's records. The release read:

Allied Capital Corporation announced today that, in late December 2006, it received a subpoena from the United States Attorney's Office for the District of Columbia requesting, among other things, the production of records regarding the use of private investigators by Allied Capital or its agents. The Board established a committee, which was advised by its own counsel, to review the following matter.

In the course of gathering documents responsive to the subpoena, Allied Capital has become aware that an agent of the Company obtained what were represented to be telephone records of David Einhorn and which purport to be records of calls from Greenlight Capital during a period of time in 2005.

Also, while Allied Capital was gathering documents responsive to the subpoena, allegations were made that Allied Capital management had authorized the acquisition of these records and that management was subsequently advised that these records had been obtained. The management of Allied Capital states that these allegations are not true.

Until Allied issued this press release, I had not known that Greenlight's phone records had also been stolen. For them to admit this, the evidence must have been extremely clear. After denials since 2005, only a grand jury subpoena from the U.S. Attorney's Office finally pried the truth out of Allied.

The press release was a model of evasion, however, and not at all consistent with the disclosure expected of a public company. Who had made the allegations? Who had obtained the records? Who had authorized the theft, and for what purpose? What did they do with this information? And what else did these agents do to gather information about their critics? The release did not even deny that Allied had authorized the theft of my phone records. It only stated that "management of Allied Capital states" that this was not true. The release said there would be no further comment, effectively refusing to answer these questions or clarify this muddled statement.

For me, the theft of my personal phone records and my wife's personal information has done more than just confirmed my views about Allied. It has struck at my sense of security and the protection I have put around my family and my home. After the Hewlett Packard pretexting scandal, HP immediately apologized to the victims and promised to give the victims a full account. But to date, I have heard nothing from Allied. No one has contacted me to apologize or explain who invaded my privacy and my family's privacy. Allied has not yet admitted to taking anyone else's records. Of course, they don't deny it, either. It is simply not credible that Allied management did not know about this.

This pretexting strikes at the ethical heart of the securities markets, which are based on the free and fair flow of ideas, critical and otherwise. It is a cold reality that companies, left to their own devices, will rarely divulge the full truth about their problems. It is left to others –

regulators, analysts, the media, and investors like myself – to hold these companies accountable. The free exchange of ideas in our market system depends on the very people who were pretexted in this case.

But that system is under attack; more and more, the instinct of a company under attack from critics is to hit back harder, not to address the underlying problem. Unless companies like Allied are told in no uncertain terms to *stop*, this trend will escalate. There are many valuable voices in the marketplace who will choose not to criticize companies for fear of being retaliated against. Nobody wants their privacy violated. As the Committee has noted in this very legislation, actions such as pretexting can lead to harassment and intimidation. It can also lead to less information in the marketplace. A line must be drawn.

I support this legislation. There is no question that pretexting is a criminal activity under any number of federal and state laws. But there is no law specifically designed to address pretexting and the harm that it causes. That a company like Allied believes it can have agents pose as me or my wife in order to steal our personal records is proof that the seriousness of pretexting has not truly been communicated to the public. I believe that the Prevention of Fraudulent Access to Phone Records Act is an important step in raising the public's awareness of this issue and will enhance the protections available to the ordinary citizen against unauthorized invasions of their privacy.



March 11, 2005

Dear Allied Capital Corporation Director:

I write to inform you directly of the continuing misconduct of Allied Capital's management, conduct that I believe warrants an independent investigation by the Board.

As you know, I have been a critic of your company for almost three years and have documented many of my criticisms publicly. These criticisms have largely proven to be true over time and have been bolstered by the ongoing investigations by the U.S. Attorney for the District of Columbia and the SEC into Allied and its small business lending unit, Business Loan Express ("BLX").

Yet, instead of addressing the underlying problems with the company, Allied's management has attempted to deflect attention from such criticism by misrepresenting facts to the public, levying personal attacks against me and using other tactics which are troubling, to say the least. Such actions signal that Allied's management has more interest in concealing the company's problems than in addressing them. This is hardly surprising since it was Allied's management that engineered these problems in the first place. As this has all unfolded, however, it appears that Allied's Board of Directors has remained strangely silent.

As you are no doubt aware, the SEC and the U.S. Attorney's Office in the District of Columbia are investigating Allied and BLX. Management has told the public that these investigations relate to "issues similar to those raised by short sellers over the past two and one-half years,"¹ apparently referring to, among other things, the assignment of several defaulted loans by BLX to Allied in early 2003. That assignment, however, is only one example of the widespread fraud that has occurred at BLX under the stewardship of the current management.

Specifically, Allied has falsely maintained and increased its valuation of BLX through a scheme dependent on the commission of systematic fraud against the Small Business Administration and, as a result, against the taxpaying citizens of the United States. I have learned that BLX has maintained its loan origination volume only by knowingly approving loan applications that fail to comply with SBA regulations. These applications, among other things, have fraudulently inflated property and collateral values, failed to verify equity injections, contained impermissible property splits and property flips, and other violations of SBA rules that were concealed from the agency. Additionally, many of these loans were the subject of improper loan brokering arrangements.

¹ See Allied Press Release dated December 27, 2004, attached to its Form 8-K dated December 27, 2004 as Exhibit 99.1.

By approving such loans, BLX is able to immediately recognize income around the time of loan origination, because it uses gain-on-sale accounting. BLX needs to continually increase its origination volume to support its revenue growth. This pressure to increase origination volume leads to the approval of additional fraudulent loan applications. This pyramid scheme has allowed Allied to recognize enormous fees, interest and dividends from BLX, while it values BLX far above its actual worth. And it is Allied's and BLX's execution of this scheme, I believe, that has led the SEC and the U.S. Attorney's Office to initiate their investigations.

Eventually, when the loans default, BLX receives a guarantee payment from the SBA by concealing the fact that the loans should not qualify for a guarantee because of the fraudulent origination. It would not surprise me if BLX or Allied is ultimately required to repay the government millions of dollars upon completion of the government investigations.

Allied's management, however, has entirely failed to respond to these problems. Instead, management has issued false and misleading public statements dealing with such clearly material facts as the status of government investigations. For example, during Allied's fourth quarter 2002 conference call on February 13, 2003, I asked Ms. Joan Sweeney the following question:

EINHORN: Could you comment at all relating to the office of Inspector General in the SBA that I understand has been calling around people close to Business [Loan] Express, what do you think they're looking into and is there an investigation and if so what do you believe the status to be?

SWEENEY: You know, David, I don't know. I mean, clearly, BLX is a regulated entity by the SBA. They're routinely audited by the SBA. I know that the office of Inspector General typically works with the SBA looking at SBA lenders. It's usually a routine – they are usually routine inquiries, if there is an inquiry. So that's about all I can say. **We don't know the nature of any sort of inquiry.** So, you know, again this happens routinely in the SBA lending market. (Emphasis added.)

Ms. Sweeney made the above statement only weeks after she personally executed the questionable Assignment Agreement and the SBA required Allied/BLX to reimburse it for \$5.3 million in guarantee payments relating to loans that the SBA had investigated and disqualified.

In light of these facts, Ms. Sweeney's claim that "we don't know the nature of any sort of inquiry" was materially false and misleading. Moreover, Allied management chose not to disclose either the SBA investigation, the disqualification of the loans, or the Assignment Agreement until more than a year afterward. This raises serious issues about the honesty of management with its shareholders and perhaps with the Board. As the Board of



Directors could not have sanctioned such public misrepresentations, the question you need to ask is, are they lying to you as well?

Finally, you may already have read a MarketWatch article published on February 1 of this year, which noted that an unknown individual had illegally accessed phone records of several prominent Allied critics. The article further noted that the FBI was conducting an investigation of this incident. Although I have refrained from commenting publicly on this matter, my home phone records were among the records that were illegally accessed. Specifically, according to my long distance provider, someone opened an online account in my wife's name, and directed the phone company to send copies of our bills to an AOL account. Like me, at least four additional individuals have been the victims of this identity theft and access device fraud. The only link that connects the victims is that they have all been critics of Allied.

I am quite familiar with Allied's aggressive tactics against its critics, including attacking them with untrue disparaging statements by management and its agents like Lanny Davis. It would not be surprising to me if the FBI discovered that Allied management was somehow involved in these identity thefts.

In short, there is considerable evidence that Allied's management has conducted business in a dishonest and inappropriate manner. Indeed, I have refrained from including in this letter the bulk of my research, numerous false and misleading statements issued by management and my financial criticism of the company.

I believe you have an obligation to examine the possibly unethical or even criminal behavior of Allied's management and take action to prevent further misconduct. I believe that the Board has a responsibility to ensure that individuals who act in this manner do not serve in a management capacity in a publicly traded company.

Respectfully,



David Einhorn





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March 18, 2005

Mr. David Einhorn
President
Greenlight Capital, LLC
140 East 45th Street
24th floor
New York, NY 10017

Dear Mr. Einhorn:

I write in response to your letter of March 11, 2005, on behalf of the Board of Directors of Allied Capital Corporation.

We are familiar with the allegations you have made in the past with respect to Allied Capital and its management, and have on a number of occasions requested and received information from management and from outside counsel with respect to the facts. That information has not supported your accusations of misconduct. This is combined with what we understand to be your financial stake in depressing Allied Capital's stock price and your efforts to persuade other parties not to do business with Allied Capital.

Pursuant to its charter, the Audit Committee is authorized by the Board to receive and evaluate any evidence of wrongdoing by Allied Capital, its officers or employees. If you provide us with specific information upon which you base your allegations, we can determine whether further action is warranted. Please address any correspondence, marked "confidential", to the Audit Committee Chairman, c/o Corporate Secretary, Allied Capital Corporation, 1919 Pennsylvania Avenue, NW, Washington, DC 20006.

Respectfully,

A handwritten signature in black ink, appearing to read "Brooks H. Browne".

Brooks H. Browne
Chairman of the Audit Committee



September 15, 2006

Brooks H. Browne
Chairman of the Audit Committee
Allied Capital
1919 Pennsylvania Avenue, NW
Washington, DC 20006-3434:

Dear Mr. Browne:

On March 11, 2005, I wrote to you concerning the continuing misconduct of Allied Capital's management. I provided detailed specifics concerning several aspects of the fraud being perpetrated by management against both the public and the government, including: (1) management's scheme to maintain an artificially high valuation of its small-business lending unit, Business Loan Express ("BLX") by defrauding the Small Business Administration; (2) management's misrepresentations to public concerning the performance of Allied and BLX; and (3) illegal attempts to access my confidential, personal information (a technique called "pretexting") by individuals who likely acted at the direction of, or had some connection to, Allied management. As you are well aware, all of these aspects of management conduct are currently under investigation by the Department of Justice and the SEC.

Your response to my March 11 letter contained no specific information and simply said that the information received from management and outside counsel did not support any of the accusations of misconduct. You did not specifically address the "pretexting" issue.

However, recent public events have made clear the degree to which the Board has underestimated the seriousness – and criminal nature – of the conduct described in my earlier letter, including the "pretexting" issue. I therefore write again in the hopes that the Board will now take these issues more seriously.

Regarding pretexting: as the news media has recently reported, Hewlett-Packard's former chairwoman, Patricia Dunn, in an apparent effort to discover the source of boardroom leaks to the media, employed investigators who in turn illegally accessed the phone records of both members of HP's board and reporters for various news organizations who had published articles critical of HP. The methods employed by the investigators hired by Ms. Dunn were essentially identical to the methods used to access my own telephone records. As several news organizations have reported, the contractor falsely used individuals' names, telephone numbers and social security numbers to illegally access their phone records online. This is precisely the manner in which my own records – and the records of several notable Allied critics – were accessed.

As the investigations into HP's conduct plainly demonstrate, illegally accessing an individual's confidential records constitutes criminal conduct. The repercussions to HP

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for use of this technique have gone far beyond mere embarrassment to the company. Ms. Dunn has already resigned. Congress, federal and state prosecutorial and investigatory agencies have all initiated investigations into HP's use of pretexting. The Attorney General of California, Bill Lockyer, has indicated that he has sufficient information to indict several individuals, both within and outside HP.

The only group of individuals with any motive to access my phone records and the records of four other prominent Allied critics is Allied management. In light of the public outcry and potential criminal indictments resulting from HP's conduct, the Board cannot pretend that such use of pretexting is not a serious matter. Indeed, the pretexting in this case does not merely concern leaks, but is far more serious. If Allied management was involved in illegally accessing the phone records of its critics, such pretexting constitutes an attempt by a company to interfere with and chill its critics and therefore skew the flow of information which is critical to the securities markets. The Board clearly has an obligation to investigate such potential criminal conduct by Allied's management.

In short, the Board owes a fiduciary duty to Allied and its shareholders to conduct a thorough investigation to determine whether in fact Allied management was involved in any way in the pretexting scheme. If criminal conduct was committed, appropriate steps must be taken including but not limited to reporting that conduct. I will be happy to provide the Board with any additional information that will be of assistance in such an investigation, subject to any restrictions placed on such information by governmental agencies currently investigating the same matter. If you deny that Allied management or its agents were involved in any way in pretexting or accessing my telephone records then please confirm that fact for me; otherwise, I will assume that the clear inference that Allied management engaged in this illegal conduct is in fact true.

Yours,



David Einhorn





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September 29, 2006

Mr. David Einhorn
President
Greenlight Capital, LLC
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Dear Mr. Einhorn:

On behalf of the Board of Directors of Allied Capital Corporation, I write in response to your letter dated September 15, 2006, which was addressed to Brooks Browne, former Chairman of Allied's Audit Committee.

We have looked into your allegations that Allied's management played a role in an attempt to access your phone records and have found no evidence to support your claim. As noted in Mr. Browne's March 16, 2005, letter to you, the Allied Board remains skeptical of the motive behind your allegations, given your history of making broad accusations of misconduct against Allied management while simultaneously having an apparent financial motive to depress Allied's stock price. The Board is therefore not disposed to credit your claims without corroborating evidence. Notwithstanding our March 16, 2005 invitation for you to provide us with any supporting evidence of your own, you have supplied none.

As Mr. Browne explained in his March 16, 2005 letter, Allied's Board has authorized the Audit Committee to receive and evaluate any evidence of wrongdoing by Allied management that you are prepared to provide. In the event that we receive any such material, we will consider what, if any, further action is warranted. Please address any correspondence, marked "confidential", to the Audit Committee Chairman, c/o Corporate Secretary, Allied Capital Corporation, 1919 Pennsylvania Avenue, NW, Washington, DC 20006.

Respectfully,

A handwritten signature in black ink, appearing to read "Ann Torre Bates".

Ann Torre Bates
Chairman of the Audit Committee