UNITED STATES OF AMERICA
OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

In the Matter of: **FRANKLIN D. RAINES,** **J. TIMOTHY HOWARD, and** **LEANNE G. SPENCER,** **Respondents.**	**Notice No. 2006-1** **Judge William B. Moran**

RESPONDENT FRANKLIN D. RAINES'S
RESPONSE TO OFHEO'S "MOTION TO DOCKET
EX PARTE LETTER FROM RESPONDENT RAINES"

By letter dated December 18, 2006, counsel for Mr. Raines requested that Director James B. Lockhart III recuse himself from this matter. Consistent with Administrative Law Judge Cregar's ruling in the *Brendsel* matter and OFHEO's own position, the request was submitted to the Director rather than raised in the adjudicatory proceeding. The request promptly received widespread publicity, including articles in the *Washington Post*, the *New York Times*, the *Chicago Tribune*, and *USA Today*. The same day the request was submitted, the General Counsel of OFHEO announced to the press that Director Lockhart would not recuse himself.

Despite the fact that OFHEO previously (and successfully) has taken the position that requests for recusal are not within the jurisdiction of the presiding ALJ and must be submitted instead directly to the Director, and despite the extensive publicity given to the request for recusal along with the prompt announcement by OFHEO that Director Lockhart would not recuse himself, the Agency now contends that the request must be docketed in this Court and

should be treated as an improper *ex parte* communication. OFHEO seeks (1) to have the request docketed in this proceeding, and (2) to set a schedule for submission of briefs concerning the request, including "a recommendation whether sanctions should be imposed." OFHEO's Proposed Order at 2.

OFHEO's motion should be denied.

Precedent, and OFHEO's own prior position, establishes that the request for recusal should not be part of the adjudicatory proceeding at all—and thus the request should not be docketed, nor should the Court call for briefs concerning the request. At OFHEO's own urging, in *Brendsel* Administrative Law Judge Cregar expressly held that "the presiding officer's powers include the authority to rule on motions and other procedural matters 'appropriate in an adjudicatory proceeding.' 12 C.F.R. § 1780.5(b)(7). *Disqualifiying an agency director . . . is not a matter appropriately included in an adjudicatory proceeding. . . .* For a decision on the issue of disqualifying the Director, the Respondent should submit a motion to the Director directly." Order Regarding Mot. to Disqualify OFHEO Dir. Armando Falcon, Jr. at 1-2 (May 5, 2004), *In re Brendsel*, HUDALJ 04-056-NA, Notice No. 2003-2 (Ex. 1) (emphasis added). Thus, the request for recusal is outside the Court's jurisdiction. Plainly, the Court should neither order the docketing of a request that is outside its jurisdiction, nor call for briefs in response to such a request.

OFHEO's suggestion that the briefing should address whether Mr. Raines's recusal request was an *ex parte* communication and whether sanctions should issue is frivolous. The request for recusal "does not concern the merits of an adjudicatory proceeding" and thus is not a prohibited *ex parte* communication. 12 C.F.R. § 1780.8(a)(2). The request was directed not to the merits but to whether Director Lockhart is biased. Nor were the purposes of the ban on

ex parte communications concerning the merits implicated, for OFHEO received prompt notice of the request as a result of the extensive publicity it received, and OFHEO's General Counsel quickly announced that Director Lockhart would not recuse himself, thus eliminating any possible reason for OFHEO to respond to the request.

In short, the request for recusal is outside the Court's jurisdiction as is OFHEO's request for briefing on recusal. Moreover, there was no *ex parte* communication and further briefing on that issue is entirely unnecessary. Accordingly, OFHEO's motion should be denied.

BACKGROUND

OFHEO filed a Notice of Charges ("NOC") against Mr. Raines, Mr. Howard, and Ms. Spencer on December 18, 2006. That same day, after receiving the NOC, counsel for Mr. Raines, Kevin M. Downey, wrote to Director Lockhart requesting that Director Lockhart recuse himself from adjudicating the charges in the NOC. *See* Ex. 1 to OFHEO's Motion. [1]

The request for recusal was widely reported in the press, and thus OFHEO and its lawyers promptly received ample notice of the request. In fact, OFHEO's General Counsel commented on the request the very same day it was submitted.

The press coverage was extensive and included the following articles on December 19:

—The *New York Times* reported that "[a] lawyer representing Mr. Raines, Kevin M. Downey, . . . said in a letter to Ofheo that Mr. Lockhart was a 'fatally biased regulator' . . . . He called on Mr. Lockhart to remove himself immediately from any further regulatory action." Eric Dash, *Fannie Mae Ex-Officers Sued by U.S.*, N.Y. Times, Dec. 19, 2006, at C1 (Ex. 4).

—In a front-page story, the *Washington Post* reported that "Raines's lawyer called on Lockhart to withdraw from the matter, saying he was 'fatally biased' because he repeatedly accused Raines of wrongdoing before bringing charges." David S. Hilzenrath, *Fannie Mae Ex-Officials Are Sued for Disputed Pay*, Washington Post, Dec. 19, 2006, at A01 (Ex. 5).

—The *Chicago Tribune* reported that "Raines' attorney, Kevin Downey, . . . called on Lockhart to recuse himself. . . . Lockhart is 'a fatally biased regulator,' . . . Downey said." Bloomberg News, *Ex-Fannie Mae Officers Sued*, Chicago Tribune, Dec. 19, 2006, at C2 (Ex. 6).

—*USA Today* reported that "Raines' attorney, Kevin Downey of Williams & Connolly, demanded Monday that Lockhart recuse himself from the case. In a letter to Lockhart, he called the OFHEO director 'a fatally biased regulator' . . . ." Edward Iwata, *Ex-Fannie Execs Face Civil Charges*, USA Today, Dec. 19, 2006, at 1B (Ex. 7).

The press discussed the recusal request with OFHEO the same day the request was submitted, December 18. The December 19 article in the *Chicago Tribune* reported that OFHEO's General Counsel, Alfred Pollard, had stated that Director Lockhart would not recuse himself from the matter. *See* Ex. 6, at C2. In keeping with that position, Director Lockhart has ignored requests by Respondents J. Timothy Howard and Leanne G. Spencer that he recuse himself. *See* Exs. 8-10.

On January 17, Mr. Raines filed a petition for writ of mandamus in the U.S. Court of Appeals for the District of Columbia Circuit seeking an order disqualifying Director Lockhart and mandating that any further proceedings be conducted pursuant to 12 U.S.C. § 4632, which

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[1] Subsequent related correspondence between Mr. Downey and Mr. Pollard is attached hereto as Exhibits 2 and 3.

permits OFHEO to issue a temporary order embodying the relief it deems appropriate and permits the affected parties to challenge the order in district court. *See In re Franklin D. Raines*, No. 07-1011. Ms. Spencer filed a similar petition on January 31. *See In re Leanne G. Spencer*, No. 07-1024. On February 2, the Court of Appeals directed that OFHEO and Director Lockhart file responses to the petitions by February 9, and gave Mr. Raines and Ms. Spencer until February 14 to file replies.

On January 23, OFHEO filed the instant motion with this Court. OFHEO asks that the Court (1) docket the request for recusal submitted by counsel for Mr. Raines and (2) set a schedule for submission of briefs concerning the request. OFHEO's Proposed Order at 2.

ARGUMENT

Mr. Raines's request for recusal is not subject to the jurisdiction of this Court and was properly made to the Director. Moreover, the request for recusal was not a prohibited *ex parte* communication. For these reasons, OFHEO's motion should be denied.

I. The Request for Recusal Is Outside the Court's Jurisdiction and Can be Made Only to the Director.

This Court's jurisdiction does not extend to requests that the Director of OFHEO be recused from the proceeding. Mr. Raines's request was properly made to the Director, and this Court possesses neither the authority to place such a request on its docket nor the authority to order briefing on the matter.

In *Brendsel*, OFHEO contended, and Judge Cregar agreed, that an Administrative Law Judge has *no authority* to entertain a motion to disqualify the Director. At OFHEO's urging, Judge Cregar held:

> Although the presiding officer has authority to conduct the hearing process . . . this authority does not extend to removing or

> disqualifying the OFHEO Director. . . . Disqualifying an agency director who is the official designated by statute to authorize such proceedings, to appoint the presiding officer, and to make the final agency decision in such cases, is *not a matter appropriately included in an adjudicatory proceeding*. As the Government correctly states, that would be akin to a district court judge deciding to disqualify an appellate court judge who would hear the same case on appeal.
>
> The presiding officer's authority is limited by 12 C.F.R. § 1780.5(a) specifically to conducting the hearing. . . .
>
> . . . .
>
> This motion is not properly before me for decision. For a decision on the issue of disqualifying the Director of OFHEO, the Respondent should submit a motion to the Director directly. Such a motion is outside the parameters of conducting the hearing and relates instead to the Director's authority to make a final decision.

Ex. 1 at 1-2 (emphasis added). In so ruling, Judge Cregar accepted OFHEO's own contention that "requests for recusal in administrative proceedings must be made to the 'agency,' *i.e.*, the Director himself, *not* to this Court." OFHEO's Opp. to Resp. Leland C. Brendsel's Mot. to Disqualify OFHEO Dir. Armando Falcon, Jr., *In re Brendsel*, at 1, Feb. 20, 2004 (Ex. 11); *see also id.* at 3 n.2 (arguing that whereas a respondent may "be required to file motions *regarding the hearing* with the presiding officer, he may file a request for the Director's disqualification *only* with the agency itself").

In short, it has been established that the presiding officer's jurisdiction, in a matter brought by OFHEO, does not extend to requests for recusal of the Director. The Court thus has no jurisdiction over Mr. Raines's request for recusal. It goes without saying that the Court should not docket a request over which it has no jurisdiction. The request has been properly made to the Director, who has now made clear that he will not recuse himself.

For similar reasons, the Court should not order briefing concerning the request for recusal. Since the Court cannot rule on the recusal issue, it has no authority to order briefing.

Indeed, it would be particularly inappropriate to order briefing in this case given that the request for recusal has already been rejected by the Director, and petitions for mandamus on the recusal issue are pending before the Court of Appeals, which has directed OFHEO and Director Lockhart to file responses to the petitions.

For that same reason, this Court has no authority to grant OFHEO's request for briefing on "whether sanctions should be imposed." OFHEO's Proposed Order at 2. Because this Court has no jurisdiction to consider requests for recusal, it has no jurisdiction to determine whether a request for recusal was made in violation of OFHEO's Rules of Practice and Procedure. Moreover, there has been no *ex parte* communication. As discussed below, the request for recusal did not violate the OFHEO regulation prohibiting *ex parte* communication concerning the merits, nor did it implicate the purposes of the prohibition.

II. The Request for Recusal Did Not Concern the Merits and Was Not a Prohibited *Ex Parte* Communication.

OFHEO's request for briefing on whether Mr. Raines's request was *ex parte* and whether sanctions should issue is not only beyond the jurisdiction of this Court, but also entirely unnecessary.

The relevant regulation, 12 C.F.R. § 1780.8, specifically provides that "[a] communication that does not concern the merits of an adjudicatory proceeding . . . does not constitute an ex parte communication." § 1780.8 (a)(2). Mr. Raines's request for recusal did not concern the merits of this proceeding—it addressed whether Director Lockhart should be disqualified because of bias. *See* Ex. 1 to OFHEO's Motion. Under the express terms of the regulation, the request therefore was not a prohibited *ex parte* communication.

That a request for recusal of the Director does not concern the merits of the proceeding was the very basis of Administrative Law Judge Cregar's ruling in *Brendsel*, which sustained the position advocated by OFHEO, that such a request is not "a matter appropriately included in an adjudicatory proceeding." Ex. 1 at 1; *see also id.* at 2 (holding that a request for disqualification "is outside the parameters of conducting the hearing").

Director Lockhart, who under OFHEO's regulation may not make or cause the making of an *ex parte* communication once a notice of charges is issued, *see* 12 C.F.R. § 1780.8(a)(2)(b), has already taken advantage of the fact that communications that do not concern the merits are outside the reach of the regulation. On December 18, the same day that the Notice of Charges was filed, Director Lockhart had OFHEO's General Counsel send a letter to the Office of Personnel Management ("OPM") which not only requested the services of an administrative law judge but identified what experience he or she should possess. *See* Ex. 12. The letter also singled out one statutory requirement, that the hearing be held in the District of Columbia, but ignored the very next requirement of the statute, that the hearing be held within 60 days unless the party to be served requests a later date. Respondents were not sent a copy of the letter or otherwise notified that it had been sent. Not until January 24, in response to a specific request, did Respondents obtain a copy of the letter. Moreover, the fax cover sheet forwarding Mr. Pollard's letter demonstrates that it was provided to Charlotte A. Reid, OFHEO's counsel of record in this proceeding, long before it was provided to counsel for Mr. Raines or the other Respondents.

The request for recusal also does not implicate in the slightest the purposes of the prohibition against *ex parte* communications concerning the merits. Such prohibitions are intended "to prevent the appearance of impropriety from secret communications," and to permit

a party to "respond effectively and ensure that its position is fairly considered." *Elec. Power Supply Ass'n v. FERC*, 391 F.3d 1255, 1259 (D.C. Cir. 2004) (*quoting Prof'l Air Traffic Controllers Org. v. Fed. Labor Relations Auth.*, 685 F.2d 547, 563 (D.C. Cir. 1982)). The request for recusal was anything but a "secret communication[]"—it was discussed in articles in the *Washington Post*, the *New York Times*, the *Chicago Tribune*, *USA Today*, and elsewhere the day after it was submitted. Moreover, on the very same day that the request was submitted, OFHEO's General Counsel announced to the press that Director Lockhart would not recuse himself, *see* Ex. 6 at C2—thereby eliminating any reason for OFHEO to respond to the request.

Thus, the request for recusal was not only outside the letter of OFHEO's regulation prohibiting *ex parte* communications, but also did not implicate the purposes of the prohibition. *See Paragon Cable Television Inc. v. FCC*, 822 F.2d 152, 156 (D.C. Cir. 1987) (rejecting claim of improper *ex parte* contacts because, *inter alia*, "the communications at issue are merely letters, not detailed submissions," and "all such communications were promptly placed in the public file and made known to petitioner"). For this reason as well, OFHEO's claim that counsel for Mr. Raines violated the regulation is frivolous. There is simply no reason to order further briefing on this issue.

CONCLUSION

For the foregoing reasons, OFHEO's motion should be denied. A proposed order accompanies this Response.

Respectfully submitted,

WILLIAMS & CONNOLLY LLP

Kevin M. Downey
Paul Mogin
Joseph M. Terry
Jack E. Clabby

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(202) 434-5000
(202) 434-5029 (facsimile)

Counsel for Respondent Franklin D. Raines

Dated: February 6, 2007

CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of February, 2007, I caused to be served by hand delivery true and correct copies of Respondent Franklin D. Raines's Response to OFHEO's Motion To Docket, with exhibits and a Proposed Order, on the following:

Mr. David A. Felt, Esq.
Deputy General Counsel
Office of Federal Housing Enterprise Oversight
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Counsel for OFHEO

Mr. Steven M. Salky, Esq.
Zuckerman Spaeder LLP
1800 M Street, N.W., Suite 1000
Washington, DC 20036
Counsel for Respondent J. Timothy Howard

Mr. David S. Krakoff, Esq.
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1909 K Street, N.W.
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Counsel for Respondent Leanne G. Spencer

Joseph M. Terry

EXHIBIT

1

S.S

UNITED STATES OF AMERICA
OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

In the Matter of: LELAND C. BRENDSEL, Respondent.	HUDALJ 04-056-NA Notice No. 2003-2 Judge William C. Cregar

ORDER REGARDING MOTION TO DISQUALIFY OFHEO DIRECTOR ARMANDO FALCON, JR.

On February 5, 2004, Respondent filed a Motion to Disqualify OFHEO Director Armando Falcon, Jr. The Government's opposition was served on February 20, 2004 and received by the court on February 26, 2004.

Respondent asserts that the Director should be disqualified due to having made statements indicating that he has prejudged the case against Mr. Brendsel. Respondent believes this motion is required to be filed with the presiding officer pursuant to 12 C.F.R. § 1780.25(c), which states that "Motions must be filed with the presiding officer, except that following the filing of a recommended decision, motions must be filed with the Director."

Although the presiding officer has authority to conduct the hearing process and has "all powers necessary" (12 C.F.R. § 1780.5) to conduct the hearing and assure that a record of the proceeding is made, this authority does not extend to removing or disqualifying the OFHEO director. As the Respondent points out, the presiding officer's powers include the authority to rule on motions and other procedural matters "appropriate in an adjudicatory proceeding." 12 C.F.R. § 1780.5(b)(7). Disqualifying an agency director who is the official designated by statute to authorize such proceedings, to appoint the presiding officer, and to make the final agency decision in such cases, is not a matter appropriately included in an adjudicatory proceeding. As the Government correctly states, that would be akin to a district court judge deciding to disqualify an appellate court judge who would hear the same case on appeal.

The presiding officer's authority is limited by 12 C.F.R. § 1780.5(a) specifically to conducting the hearing. The Director of OFHEO, or his designee, is the sole authority for

issuing charges, for initiating administrative and enforcement actions that he deems necessary, such as a hearing before an administrative law judge, and for issuing a final decision in the case. This authority is granted to the Director by statute, 12 U.S.C § 4513(b)(5). The presiding officer does not have authority to dispense with statutory provisions, nor would it be appropriate to do so on the basis of the arguments presented in the parties' briefs. The Director has final authority for all decisions related to carrying out his duties and, in fact, may at any time perform, direct the performance, or waive the performance, of any act the presiding officer could take. 12 C.F.R. § 1780.4.

In addition, because the presiding officer is appointed by the Director, the presiding officer would, if deciding to disqualify the Director, also remove his own authority to conduct the hearing, leaving a situation in which there would be no one to initiate a proceeding or to appoint someone to conduct it. Such an illogical result is contrary to the intent of the statute, the purpose of the hearing process, and the Director's mandate to enforce banking regulations against organizations under OFHEO's oversight. Standard cannons of statutory construction mandate against decisions leading to such vacuums as clearly contrary to Congressional intent. This is particularly true where, as here, no alternative decision-maker has been set forth in the applicable statutes or regulations. Only the Director may decide whether or not to delegate his decision-making authority to someone else.

This motion is not properly before me for decision. For a decision on the issue of disqualifying the Director of OFHEO, the Respondent should submit a motion to the Director directly. Such a motion is outside the parameters of conducting the hearing and relates instead to the Director's authority to make a final decision. Therefore, Respondent's Motion to Disqualify OFHEO Director Armando Facon, Jr. is **DENIED.**

SO ORDERED.

William C. Cregar

WILLIAM C. CREGAR
Administrative Law Judge

May 5, 2004

J://draft/OFH.Brendsel.dqdirector.05-05-04.wpd//krk

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing ORDER REGARDING MOTION TO DISQUALIFY OFHEO DIRECTOR ARMANDO FALCON, JR., issued by WILLIAM C. CREGAR, Administrative Law Judge, HUDALJ 04-056-NA, Notice No. 2003-2, were sent to the following parties on this 5th day of May, 2004, in the manner indicated:

Charlene Parmer
for Chief Docket Clerk

FACSIMILE and REGULAR MAIL

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EXHIBIT

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800
Office of General Counsel

January 9, 2007

Kevin M. Downey, Esq.
Williams & Connolly LLP
725 Twelfth Street, N.W
Washington, D.C. 20005-5901

RE: Demand Letter Related to Notice of Charges 2006-1

Dear Mr. Downey:

OFHEO is in receipt of your December 18, 2006, demand letter. In the letter, you request that the Director recuse himself from any further regulatory actions affecting Mr. Franklin Raines.

This letter could be considered an *ex parte* communication sent to the Director contrary to the provisions of Title 12 of the Code of Federal Regulations Section 1780.8(b). The provision prohibits such *ex parte* communications with the Director during an administrative enforcement proceeding. Your attention is directed to the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Title 12, United States Code, Section 4631 *et seq.*, regulations issued pursuant to that Act, Title 12, Code of Federal Regulations, Part 1780.1 *et seq.*, and the Administrative Procedure Act, Title 5, United States Code, Section 500 *et seq.* which govern the present proceeding.

Contemporaneous with this writing, we are moving to have your letter docketed in the administrative proceeding against Mr. Raines. In this way, your letter and your concerns may be addressed appropriately and on the record.

Future correspondence to OFHEO or pleadings related to Notice of Charges 2006-1 should be directed to Deputy General Counsel David A. Felt or Associate General Counsel Charlotte A. Reid until counsel for OFHEO formally have noted their appearances with the Administrative Law Judge.

With all best wishes, I am

Sincerely,

Alfred M. Pollard

cc: Steven M. Salky, Esq.

EXHIBIT

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EDWARD BENNETT WILLIAMS (1920-1988)
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January 12, 2007

VIA HAND DELIVERY

Mr. Alfred M. Pollard, Esq.
Office of the General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street N.W.
Washington, D.C. 20552

Re: In the Matter of Franklin D. Raines, et al.
Notice Number 2006-1

Dear Mr. Pollard:

I write in response to your January 9, 2007, letter. My December 18, 2006, letter requesting the Director to recuse himself is not an *ex parte* communication under 12 C.F.R. § 1780.8 because *inter alia* it is not "relevant to the merits" of the proceeding. I sent the demand letter to the Director in reliance on an instructive position that you took in a recent enforcement action and on guidance from an administrative law judge in that proceeding.[1]

In that matter, our firm filed with the presiding officer a motion for the Director's recusal. In an opposition brief that lists you as an author, OFHEO stated that "requests for recusal in administrative proceedings must be made to the 'agency,' *i.e.*, the Director himself, *not* to this Court."[2] You also took the position

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[1] *In the Matter of Leland C. Brendsel*, HUDALJ 04-056-NA, Notice No. 2003-2.

[2] OFHEO's Opposition to Respondent Leland C. Brendsel's Motion to Disqualify OFHEO Director Armando Falcon, Jr., HUDALJ 04-056-NA, Notice No. 2003-2, at 1, Feb. 20, 2004,.

that while a respondent may "be required to file motions *regarding the hearing* with the presiding officer, he may file a request for the Director's disqualification *only* with the agency itself."[3] I labor to find justification for the inconsistent position you have taken in your recent letter.

Furthermore, the ALJ agreed with you. In denying our motion, Judge Cregar held that "[f]or a decision on the issue of disqualifying the Director of OFHEO, the Respondent *should submit a motion to the Director directly*. Such a motion is outside the parameters of conducting the hearing and relates instead to the Director's authority to make a final decision."[4]

I understand based on your own public statements that the Director has decided not to recuse himself. *Ex-Fannie Mae Officers Sued; Trio Allegedly Inflated Profit to Boost Bonus*, Bloomberg News (Dec. 19, 2006) ("Lockhart doesn't intend to recuse himself from the matter, Pollard said."). But since you state in your letter that you are moving to have my December 18, 2006 letter requesting recusal "docketed in the administrative proceeding against Mr. Raines," we too are submitting the attached affidavit and accompanying exhibits regarding Director Lockhart's impermissible bias.

Very truly yours,

Kevin M. Downey

cc: (Via U.S. Mail)

Mr. Steven M. Salky, Esq.
Zuckerman Spaeder LLP
1800 M Street, N.W., Suite 1000

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[3] *Id.* at 3 n.2.

[4] Order Regarding Motion to Disqualify OFHEO Director Armando Falcon, Jr., HUDALJ 04-056-NA, Notice No. 2003-2, at 2, May 5, 2004 (WCC) (Emphasis added).

Washington, D.C. 20036
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Honorable James Lockhart
Director
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Enclosures

EXHIBIT

4

The New York Times

December 19, 2006 Tuesday
Late Edition - Final

SECTION: Section C; Column 6; Business/Financial Desk; Pg. 1

LENGTH: 1083 words

HEADLINE: Fannie Mae Ex-Officers Sued by U.S.

BYLINE: By ERIC DASH

BODY:

Fannie Mae's main regulator sued the company's former chairman and chief executive, Franklin D. Raines, and two top financial officers yesterday in an effort to extract more than $215 million in bonus payouts and fines over their involvement in a huge-scale accounting scandal.

The regulator, the Office of Federal Housing and Enterprise Oversight, is seeking about $100 million in penalties. But its effort to recoup more than $115 million in bonus payments is notable for its rarity and size.

Even in the aftermath of the Enron scandal, only a handful of company boards have aggressively tried to claw back executive bonuses or departure packages when questionable accounting or wrongdoing was later discovered. The Securities and Exchange Commission has rarely taken similar action. And previous cases have involved much smaller amounts of money.

But the regulator here, known in government shorthand as Ofheo, seems intent on sending a message to Capitol Hill, where legislation is to be debated that would give the office greater authority.

"Ofheo basically may be trying to send a signal that they are going to be really tough under their jurisdiction," said Henry T. Hu, a professor at the University of Texas Law School. "They traditionally have not had the clout compared to other regulators for banks. And by bringing this action, they may want to send the fear of God to these executives."

Ofheo filed 101 civil charges against Mr. Raines; Fannie Mae's former chief financial officer, J. Timothy Howard; and the former controller, Leanne G. Spencer.

The Ofheo director, James B. Lockhart III, said in a conference call yesterday: "We believed as an agency that these three individuals, separately and together, did serious harm to the company. There is a long list of charges that show they allowed this company to grow out of control."

Echoing many findings that the agency's 27-month investigation into Fannie Mae uncovered in May, the lawsuit contended that the three executives took part in widespread misconduct and mismanagement from 1998 to 2004. It accused them of filing misleading financial reports, improperly applying accounting principles while knowingly failing to establish sound internal controls and misleading regulators. All the while, the three were said to have been manipulating Fannie Mae earnings to maximize their bonuses.

A lawyer representing Mr. Raines, Kevin M. Downey, called the accusations false and said in a letter to Ofheo that Mr. Lockhart was a "fatally biased regulator" who was using "Mr. Raines as a prop in the interests" of his own political agenda. He called on Mr. Lockhart to remove himself immediately from any further regulatory action.

Steven M. Salky, a lawyer for Mr. Howard, called the charges "a work of unsubstantiated fiction." David S. Krakoff, a lawyer for Ms. Spencer, did not return a phone call requesting comment.

Ofheo's move yesterday will set in motion a complex legal process that could take years to resolve. Upon its filing, the suit will go to an administrative law judge who will oversee hearings and eventually make a ruling. The judge will then present his decision to the director of Ofheo, who may accept, modify or set it aside. Should a defendant disagree with the findings, he or she may appeal the decision to a federal court judge for review. Mr. Downey said yesterday that Ofheo should allow the executives to challenge the agency's findings immediately in federal court.

The administrative law process can be cumbersome. Ofheo filed a similar suit against the former chief executive and chief financial officers of another federal-linked lender, Freddie Mac, in December 2003, seeking civil penalties and the return of more than $37 million in bonuses. That case has been bogged down in intense battles for three years and is still wending its way through administrative law courts.

Ofheo said it was seeking more than $100 million in civil penalties "in light of the multibillion-dollar harm" Fannie Mae caused to investors. The company recently completed a $6.3 billion restatement to correct its financial results up to 2004, among the largest for any public company.

But Wall Street analysts expect that it will be at least a year before Fannie Mae can issue current financial statements. The company's shares slipped 11 cents yesterday, to $60.16.

In May, Fannie Mae agreed to pay $400 million in civil penalties to resolve charges with Ofheo and the S.E.C. The Justice Department and the S.E.C., while no longer investigating the company, have said that they continue to look at other former employees who were involved in the scandal.

Fannie Mae declined to comment on the Ofheo lawsuit.

Ofheo is also seeking a cease-and-desist order that would bar Mr. Raines and the other defendants from conducting business with Fannie Mae and Freddie Mac. Since Fannie Mae is bearing their legal bills, it is also asking that they pay back those fees if there is a finding of misconduct.

But perhaps Ofheo's boldest action yesterday was in seeking to recoup the bonuses. In its complaint, the regulator asked that Mr. Raines, Mr. Howard and Ms. Spencer give back a total of more than $115 million in bonus payouts from 1998 to 2004, which the agency contends represented unjust enrichment. Under this arrangement, the former executives would be allowed to retain only their salaries.

It is asking Mr. Raines to give back about $84.6 million of the $91.1 million that he collected. In the past, the agency said that roughly $52 million of that amount was directly tied to the achievement of earnings targets.

But in an interview yesterday, Ofheo's general counsel, Alfred Pollard, said that the new, higher amount reflected the regulator's interest in recovering past stock-option compensation, too.

"We are also alleging these people were engaging in misconduct and mismanagement," he said. "Options, in effect, are given for working for the company, and it was mismanaged so they didn't deserve it."

Ofheo is asking that Mr. Howard return some $27.3 million and Ms. Spencer about $5.6 million in pay. But in the complaint and news release, it made no mention of recovering pensions or other funds.

Mr. Pollard said that the regulator was still interested in recouping that money. Even though Mr. Raines was ousted over the accounting problems, he received a pension valued around $25 million, according to a Harvard study. Mr. Howard's pension was estimated at $6 million.

URL: http://www.nytimes.com

GRAPHIC: Photo: Franklin D. Raines, left, and J. Timothy Howard in 2004. The government wants to recover bonus payments to them and another officer. (Photo by Larry Downing/Reuters)(pg. C9)

LOAD-DATE: December 19, 2006

EXHIBIT

5

The Washington Post
washingtonpost.com
The Washington Post

December 19, 2006 Tuesday
Final Edition

SECTION: A Section; A01

LENGTH: 1172 words

HEADLINE: Fannie Mae Ex-Officials Are Sued for Disputed Pay

BYLINE: David S. Hilzenrath, Washington Post Staff Writer

BODY:

Federal regulators yesterday sued three former Fannie Mae executives, including former chairman and chief executive Franklin D. Raines, to recoup more than $115 million in pay they received while the company's earnings were misstated.

In an administrative complaint, regulators said Raines and the others engaged in a variety of ruses to meet profit goals and boost their compensation. For example, they delayed booking $200 million of expenses one year and used transactions with no economic purpose in other periods simply to shift income into the future, the complaint alleged.

The regulators' discovery of accounting problems in 2004 ultimately led Fannie Mae to pay a $400 million penalty and correct years of financial results, erasing $6.3 billion of previously reported profit.

Charged with Raines were J. Timothy Howard, former chief financial officer of the government-chartered mortgage finance company, and Leanne G. Spencer, former controller.

The former executives "improperly manipulated earnings to maximize their bonuses, while knowingly neglecting accounting systems and internal controls, misapplying over twenty accounting principles and misleading the regulator and the public," James B. Lockhart III, director of the Office of Federal Housing Enterprise Oversight, said in a statement.

The three "did very serious harm to this company," Lockhart said in a conference call with reporters.

Lawyers for the former executives said the allegations were false and politically motivated. OFHEO's director had been warning for weeks that he planned to take action against former Fannie Mae executives, and he has cited the company's problems in calling on Congress to pass legislation giving Fannie's regulators greater power.

Lockhart is using Raines as a prop in his legislative campaign, and his agency has distorted evidence that it has kept from public view, Kevin M. Downey, an attorney for Raines, wrote in a letter yesterday to the OFHEO director.

Lawyers for Howard and Spencer noted that the agency now bringing the charges once vouched for Fannie's soundness, adding that the company's annual financial results were certified by auditor KPMG.

OFHEO's charges are to be reviewed by an administrative law judge, who is to recommend a final decision to the agency's director. Raines's lawyer called on Lockhart to withdraw from the matter, saying he was "fatally biased" because he repeatedly accused Raines of wrongdoing before bringing charges.

The agency is seeking to recoup $84.6 million in bonuses, stock option grants and other awards from Raines alone. In addition, OFHEO is seeking penalties from the three former executives that could total more than $100 million.

Before Fannie's problems came to light, Raines was one of Washington's most prominent businessmen, widely viewed as a potential Treasury secretary. His résumé traced his rise from humble roots to the heights of government and

finance: graduate of Harvard College and Harvard Law School, Rhodes Scholar, junior aide to President Jimmy Carter, investment banker at Lazard Freres, chairman of Harvard's Board of Overseers, director of President Bill Clinton's Office of Management and Budget.

He was also a leader of the Business Roundtable, a lobbying group for chief executives of major companies, and he worked to repair corporate America's credibility after accounting scandals at Enron and other companies.

"As a CEO, one of the most offensive things about the corporate scandals that emerged recently was to hear CEOs claim that they did not know, they could not know, and they could not be expected to know about the activities that brought down their companies," Raines wrote in Fannie Mae's 2002 annual report.

In 2004, an OFHEO examination faulted Fannie's accounting and challenged its management, ultimately leading the company to settle charges of fraud and other violations with the Securities and Exchange Commission.

Fannie's accounting problems were so extensive that it took two years and cost more than $1.4 billion for thousands of workers to redo past financial reports. Fannie remains unable to issue current financial statements on a timely basis, one of the basic requirements of any public company, and in the absence of such reports, its shares continue trading on the New York Stock Exchange by special dispensation.

The charges filed yesterday are the first to target the top executives who presided over the company during the accounting debacle.

To unlock maximum executive bonuses for 1998, regulators alleged, Fannie understated expenses by almost $200 million, counted two years of low-income housing tax credits in a single year, and, through a last-minute bookkeeping entry, recorded $3.9 million of "miscellaneous income."

The complaint said Raines has testified that he had no reason to refute Spencer's statement that he signed off on the decision to defer the nearly $200 million of expenses.

Most of Fannie's flawed bookkeeping involved accounting for derivatives, financial instruments Fannie uses to hedge against movements in interest rates. Raines argued in 2004 that the derivatives accounting involved complex issues about which experts could disagree. Regulators said that the issues were black and white and that Fannie deliberately violated the requirements. Other companies have issued corrections over similar mistakes.

Relations between the company and the agency have often been antagonistic. In a May report, OFHEO alleged that Fannie lobbied to keep the agency poorly funded so that Fannie "would essentially be regulated only by itself."

Raines's successor as chief executive, Daniel H. Mudd, distanced himself from Fannie's posture under Raines, telling lawmakers this year that the days "of the arrogant, defiant my-way Fannie Mae had to end."

A Fannie spokesman declined to comment yesterday.

Unlike OFHEO, the SEC has taken no action against any Fannie Mae employee. The SEC's investigation is continuing, SEC spokesman John Nester said.

The Justice Department has said that it does not plan to prosecute Fannie Mae, though it has been investigating whether Raines and Howard committed perjury when they testified about Fannie's accounting at a 2004 congressional hearing.

Fannie, Raines and Howard, meanwhile, are defending themselves against litigation brought by shareholders.

Fannie Mae recently sued its former auditor KPMG, alleging the accounting firm's negligence caused damages of more than $2 billion. KPMG said it plans to pursue claims of its own against Fannie Mae.

A fair review of OFHEO's claims "will demonstrate the propriety in all respects of Mr. Howard's conduct," said his attorney, Steven M. Salky. Spencer's work "was nothing short of outstanding," said her attorney, David S. Krakoff.

OFHEO acted yesterday to meet a two-year statute of limitations. Its charges could take years to resolve. More than three years after an accounting scandal at Fannie's rival Freddie Mac, the agency remains in litigation to recoup pay from former Freddie executives.

LOAD-DATE: December 19, 2006

EXHIBIT

6

Chicago Tribune

December 19, 2006 Tuesday
Chicago Final Edition

SECTION: BUSINESS; ZONE C; Pg. 2

LENGTH: 529 words

HEADLINE: Ex-Fannie Mae officers sued;
Trio allegedly inflated profit to boost bonus

BYLINE: Bloomberg News

DATELINE: WASHINGTON

BODY:

Fannie Mae's regulator on Monday sued ousted Chief Executive Franklin Raines and two other former senior officers for more than $215 million because of their roles in overstating profit by $6.3 billion.

The Office of Federal Housing Enterprise Oversight filed a complaint with an administrative law judge alleging Raines, former Chief Financial Officer Timothy Howard and former Controller Leanne Spencer manipulated the company's bookkeeping to meet earnings targets and maximize bonuses.

The agency wants more than $100 million in civil penalties and the recovery of more than $115 million in bonuses, it said. The 101 charges allege the executives deliberately filed misleading financial reports and failed to establish "sound internal controls" at Fannie Mae.

"The misconduct cost the enterprise and shareholders many billions of dollars and damaged the public trust," said James Lockhart, the regulator's director.

Raines, Howard and Spencer "knowingly" neglected "accounting systems and internal controls, misapplying over 20 accounting principles and misleading the regulator and public," the complaint said.

The regulator might bring similar charges against current and former executives and directors, said Alfred Pollard, the agency's general counsel.

A Fannie Mae spokesman didn't return a phone call requesting comment.

Howard's attorney, Steven Salky, said the charges are "a work of unsubstantiated fiction."

Raines' attorney, Kevin Downey, characterized the allegations as "false" and called on Lockhart to recuse himself. Lockhart has authority to review rulings of an administrative law judge in such matters.

Lockhart is "a fatally biased regulator," using "Raines as a prop in the interests of" persuading Congress to create a tougher regulator for Fannie Mae, Downey said.

Lockhart doesn't intend to recuse himself from the matter, Pollard said. He declined to comment on Downey's allegations of bias. The agency is part of the Department of Housing and Urban Development.

David Krakoff, Spencer's attorney, said, "We look forward to disproving the politically motivated claims brought by [the oversight agency]."

The agency needed to file charges against Raines and Howard before the end of the year based on a statute that gives the regulator two years to consider the case from the time of the former executives' removal in December 2004. Spencer left the company last year.

The oversight agency seeks to have the three former executives barred from working for Fannie Mae and its smaller rival, Freddie Mac, Pollard said. It also wants Raines, Howard and Spencer to waive their rights to sue Fannie Mae and

to disclose the agency's filing when seeking employment at a bank, credit union or other regulated financial institution, he said.

Fannie Mae lost about $30 billion of market value after the oversight agency in September 2004 said Raines, Howard and other executives used improper "cookie jar" reserves and deferred expenses to manipulate earnings results and trigger bonuses. In May, the Securities and Exchange Commission and the agency fined Fannie Mae $400 million.

The company on Dec. 6 restated profit lower from 2001 through June 2004 by $6.3 billion.

LOAD-DATE: December 19, 2006

EXHIBIT

7

USA TODAY

December 19, 2006 Tuesday
FINAL EDITION

SECTION: MONEY; Pg. 1B

LENGTH: 471 words

HEADLINE: Ex-Fannie execs face civil charges;
Earnings were manipulated to boost bonuses, regulators say

BYLINE: Edward Iwata

BODY:

Federal regulators Monday filed civil charges against former Fannie Mae CEO Franklin Raines and two other former executives, accusing them of manipulating Fannie Mae's earnings to jack up their bonuses.

In a complaint with an administrative law judge, the Office of Federal Housing Enterprise Oversight detailed 101 charges from 1998 to 2004 against Raines, former chief financial officer Timothy Howard and former controller Leanne Spencer, who all resigned in 2003 as the Fannie Mae scandal worsened.

OFHEO is seeking $100 million in penalties and $115 million in return of bonuses. The regulator also seeks the return of legal fees, and to bar the former executives from any future business with Fannie Mae.

A major force in the mortgage investment market, Fannie Mae has been engulfed in political controversy and financial scandal for years. Lawmakers and regulators are seeking greater regulatory control of the government-sponsored housing finance giant.

Fannie Mae was run by Harvard University graduate Raines, former budget director in the Clinton administration and one of the first black CEOs of a major corporation.

James Lockhart, OFHEO's director, said the actions of the former executives "cost the enterprise and shareholders many billions of dollars and damaged the public trust."

OFHEO alleges that the former executives submitted "misleading and inaccurate accounting statements and inaccurate capital reports that enabled them to grow Fannie Mae in an unsafe and unsound manner."

Defense attorneys for the former executives deny the charges.

Howard's lawyer, Steven Salky of the Zuckerman Spaeder law firm, called the allegations "a work of unsubstantiated fiction" and "a politically motivated attempt to rewrite history."

Spencer's attorney, David Krakoff of Mayer Brown Rowe & Maw, said OFHEO brought the charges even after reporting to Congress that Fannie Mae surpassed financial safety requirements through 2003.

Raines' attorney, Kevin Downey of Williams & Connolly, demanded Monday that Lockhart recuse himself from the case. In a letter to Lockhart, he called the OFHEO director "a fatally biased regulator" who is using the case to advance his political agenda of enacting Fannie Mae-related legislation. Raines' lawyers hope to move the case to a federal court.

Lockhart declined to address the allegations of bias.

While the charges cover 1998 to 2004, Lockhart said other violations may have occurred in the early 1990s.

The agency continues to investigate other current and former Fannie Mae executives, he said.

Two years ago, a special examination by OFHEO found that former Fannie Mae executives ignored internal financial controls and manipulated earnings through questionable "cookie jar" reserves.

Last spring, OFHEO and Fannie Mae agreed to a $400 million fine for alleged accounting manipulation.

GRAPHIC: PHOTO, Color, AP
PHOTO, Color, Bloomberg News

LOAD-DATE: December 19, 2006

EXHIBIT

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January 18, 2007

By Hand Delivery

James B. Lockhart III
Director
Office of Federal Housing Enterprise Oversight
1700 G Street, N.W.
Fourth Floor
Washington, D.C. 20522

Re: *In re Raines et al.*, OFHEO Notice No. 2006-1

Dear Director Lockhart:

I represent J. Timothy Howard, the former Chief Financial Officer of Fannie Mae. The purpose of this letter is to request that you immediately recuse yourself from any further regulatory action affecting Mr. Howard, including any further participation in the above-referenced matter. Recusal is required by the law of this jurisdiction based on numerous statements you have made to the public, the press and Congress demonstrating that you have prejudged the claims asserted against Mr. Howard in the above-referenced notice of charges. In making this request, we adopt the arguments submitted by counsel for Franklin Raines and Leanne Spencer in letters dated December 18, 2006 and January 12, 2007, respectively. We also adopt the arguments regarding your bias made in Mr. Howard's Motion to Require the Director of OFHEO to Pursue His Notice of Charges Against Mr. Howard in the United States District Court for the District of Columbia. Copies of these letters and our district court filing are attached as Exhibits 1 - 3.

Based upon the statements of OFHEO's General Counsel, Alfred M. Pollard, to the media about Mr. Raines' request for your recusal, we understand that you do not intend to recuse yourself from this matter. To the extent that this understanding is incorrect, please let us know no later than the close of business on Wednesday, January 24, 2007. If you do not respond, we will take it as a denial of our request.

Thank you for your attention to this matter. We look forward to your prompt response.

Very truly yours,

Steven M. Salky

Enclosures

cc: Kevin M. Downey
David S. Krakoff
Alfred M. Pollard

EXHIBIT

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January 12, 2007

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James B. Lockhart III
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Office of Federal Housing Enterprise Oversight
1700 G Street N.W.
Washington, D.C. 20552

Re: *In re Raines et al.*, OFHEO Notice No. 2006-1

Dear Mr. Lockhart:

I am counsel for Leanne Spencer. As you know, she previously served as the Controller and as a Senior Vice President of Fannie Mae. I respectfully request that you recuse yourself from any further participation in *In re Raines et al.*, OFHEO Notice No. 2006-1. OFHEO's enforcement procedures appoint you, as Director of the agency, to be the final arbiter of the charges that OFHEO filed against Ms. Spencer, Franklin D. Raines, and J. Timothy Howard. 12 U.S.C. § 4633(b) ("the Director shall render the decision"); *see also* 12 C.F.R. § 1780.5(b)(7) (stating that "only the Director shall have the power to ... make a final determination of the merits of the proceeding").

It is clear from your own statements and those of your predecessors, as well as from the reports issued by OFHEO on September 17, 2004, and May 23, 2006, that you and the agency have already decided that Ms. Spencer is liable for the claims brought in this matter. As delineated below, you have articulated unbridled hostility toward the respondents. Your statements are based solely on a one-sided investigation by OFHEO whose outcome was predetermined without affording the respondents any opportunity to be heard. That is not due process. Indeed, OFHEO's conclusions are premised on a full scale distortion of the witnesses and documents. The Inspector General of the Department of Housing and Urban Development even found evidence that the OFHEO examination was "altered and made to appear much more egregious and significant." Report of the Office of the Inspector General, U.S. Dep't of Housing & Urban Dev't, Investigation No. SID-04-0034-1, at 84 (Oct. 5, 2004) (hereinafter "OIG Report") (Exhibit 1). When the respondents are permitted a fair adjudication, they will undoubtedly prevail. However, as long as you continue to serve as both prosecutor and adjudicator, it will be impossible for Ms. Spencer to receive a fair resolution of the Notice of Charges.

The Supreme Court of the United States has stated repeatedly, a "fair trial in a fair tribunal is a basic requirement of due process. This applies to administrative agencies which adjudicate as well as to courts." *Withrow v. Larkin*, 421 U.S. 35, 46 (1975) (citations and internal quotation marks omitted). An adjudicator who has formed an opinion regarding the merits of the case

before it is tried cannot provide a fair trial. *See, e.g., Cinderella Career & Finishing Schs., Inc. v. FTC*, 425 F.2d 583 (D.C. Cir. 1970); *Texaco, Inc. v. FTC*, 336 F.2d 739 (D.C. Cir. 1964), *vacated and remanded on other grounds*, 381 U.S. 754 (1965). Accordingly, whenever "a disinterested observer may conclude that (the agency) has in some measure adjudged the facts as well as the law of a particular case in advance of hearing it," the agency is disqualified from participating in the case. *Cinderella*, 425 F.2d at 591 (citation and internal quotation marks omitted).

On July 17, 2003, OFHEO commenced a Special Examination of Fannie Mae, one of only two Government Sponsored Enterprises regulated by the Agency. As you know, Ms. Spencer fully cooperated with the Special Examination, providing testimony on three separate occasions. On September 17, 2004, OFHEO issued a preliminary report on the findings of examination. Report of Findings to Date, Special Examination of Fannie Mae (Sept. 17, 2004) (Exhibit 2). The 198-page report concluded, inter alia, "that the accounting used by Fannie Mae for amortizing purchase premiums and discounts on securities and loans as well as amortizing other deferred charges is not in accordance with GAAP" (*id.* at ii); that "management intentionally developed accounting policies and selected and applied accounting methods to inappropriately reduce earnings volatility and to provide themselves with inordinate flexibility in determining the amount of income and expense recognized in any accounting period" (*id.*); and that "Fannie Mae implemented SFAS 133 in a manner that placed minimizing earnings volatility and maintaining simplicity of operations above compliance with GAAP" (*id.* at v).

OFHEO continued its examination, culminating in a final report on May 23, 2006. Report on the Special Examination of Fannie Mae (May 23, 2006) (Exhibit 3). The report accuses Fannie Mae and the three respondents of manipulating earnings "in order to generate unjustified levels of compensation for themselves and other executives" (*id.* at 4); engaging in "a wide variety of unsafe and unsound practices" (*id.*); and "failing to establish a sound internal control system" (*id.* at 9), through the violation of at least eight different accounting standards. As Acting Director of OFHEO, you announced in a press release: "As the OFHEO report shows, the image of Fannie Mae as one of the lowest-risk and 'best in class' institutions was a façade. In fact, it was just the opposite. They promoted unconstrained growth while undermining proper internal controls by under investing in systems, risk management and staff. Our examination found an environment where the ends justified the means. There was a systematic effort by senior management to manipulate accounting, reap financial rewards, and prevent the rest of the world from knowing about it." OFHEO Press Release, *OFHEO, SEC Reach Settlement With Fannie Mae; Penalty Imposed* (May 23, 2006) (Exhibit 4). In another press release issued the same day, you stated that "Fannie Mae's executives were precisely managing earnings to the one-hundredth of a penny." OFHEO Press Release, *OFHEO Report: Fannie Mae Façade* (May 23, 2006) (Exhibit 5). Their conduct, you alleged, "resulted in an estimated $10.6 billion of losses, well over a billion dollars in expenses to fix the problems, and ill-gotten bonuses in the hundreds of millions of dollars." *Id.*

On the same day the report issued, OFHEO entered into an agreement with Fannie Mae in which the entity agreed to pay $400 million to OFHEO and the Securities and Exchange Commission to

resolve the allegations. You commented: "The penalty and settlements represent a major step in correcting a dangerous course that had been followed by one of the largest financial institutions in the world. Unprincipled corporate behavior and inadequate controls will simply not be tolerated." OFHEO Press Release, *OFHEO, SEC Reach Settlement With Fannie Mae; Penalty Imposed* (May 23, 2006) (Exhibit 4). On December 18, 2006, OFHEO issued the Notice of Charges against Mr. Raines, Mr. Howard and Ms. Spencer, which includes 101 different claims and seeks significant penalties from the respondents. Notice of Charges, OFHEO Notice No. 2006-1 (Exhibit 6).

OFHEO's Rules of Practice and Procedure permit you to hand-pick an administrative law judge or "any other person" to hear evidence and make a recommendation to you on liability, restitution, and penalties of the respondents. 12 C.F.R. §§ 1780.3(h), 1780.5. Even after appointing such person, you may, "at any time during the pendency of a proceeding, perform, direct the performance of, or waive performance of any act that could be done or ordered by the presiding officer." *Id.* § 1780.4. Moreover, you retain the exclusive power "to grant any motion to dismiss the proceeding or make a final determination of the merits of the proceeding." *Id.* § 1780.5(b)(7). It is our view that a fair assessment of the evidence will demonstrate that the respondents are not liable for any of the claims in the Notice of Charges. However, under OFHEO procedure, you are free to reject a recommendation of the presiding officer in favor of the respondents. *Id.* §§ 1780.53-.55. Based upon your unqualified statements, it is clear that you would do just that.

Your statements to the press throughout the course of OFHEO's investigation of Fannie Mae and its former officers demonstrate unequivocally that you have already determined that Ms. Spencer, Mr. Raines, and Mr. Howard are liable for all claims against them. For example, even before OFHEO issued the Notice of Charges, you told the press that these individuals "grossly mismanaged" Fannie Mae, "underspent dramatically on systems, internal controls, risk management—all the basic building blocks of a good corporation," and went "beyond mismanagement to manipulating earnings." David S. Hilzenrath, *Fannie Mae Final Tally: $6.3 Billion Overstated*, Washington Post (Dec. 7, 2006) (Exhibit 7).

Moreover, you testified before Congress that "[b]y encouraging rapid growth, unconstrained by proper internal controls, risk management and other systems," these individuals "did serious harm to Fannie Mae while enriching themselves through earnings manipulation." Statement of James B. Lockhart III on OFHEO's Report on the Special Examination of Fannie Mae Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, U.S. House of Representatives (June 6, 2006) (Exhibit 8). You told Congress that the actions of these former Fannie Mae executives "were flat-out wrong, or, to use the proper regulatory phrase, they were managing Fannie Mae in an 'unsafe and unsound' manner. Senior management manipulated accounting; reaped maximum, undeserved bonuses; and prevented the rest of the world from knowing about it. They co-opted their internal auditors and other managers. They stonewalled OFHEO." *Id.*

You further stated that "[i]n 1998, management *should* have recognized significant losses from the amortization of premiums and the impairment of guaranty-fee buy-ups, but much of the actual loss was deferred so that management could meet bonus targets, as well as the expectations of analysts." *Id.* (emphasis in original). Among other things, you concluded that "senior management did not make adequate investments in accounting systems and staffing," which helped them "to hide improper actions that smoothed earnings; that they implemented FAS 115 and 133 in a manner that "did not comport with GAAP"; that they "went to extraordinary lengths to avoid recording GAAP required impairment losses"; and that they used "cookie-jar reserves, income shifting transactions and inappropriate debt repurchases." *Id.*

In a speech you delivered to the American Enterprise Institute on September 13, 2006, you announced OFHEO's intention to sue the respondents, declaring: "I think we need to send a very strong message. We sent a strong message with the $400 million fine against Fannie Mae, but I think we also need to send a message about the mismanagement and—as the SEC says it—fraud committed by the former management." Transcript of Remarks of Jim Lockhart to the American Enterprise Institute (Sept. 13, 2006) (Exhibit 9). Indeed, it appears that you anticipated overstepping the bounds of your lawful authority in your zeal to prosecute these individuals. You declared that OFHEO "will try to use our powers to the utmost," noting: "In some cases we may end up being sued by Fannie and Freddie if we try to use some powers that we think we could possibly have. But we'll try to do the best we can because that's our job." *Id.*

In a press release accompanying the Notice of Charges you filed against Ms. Spencer, Mr. Raines, and Mr. Howard, you did not mince words. On behalf of the agency, you characterized the charges not as allegations that you would fairly evaluate, but rather as facts you had already determined to be true. You stated: "The Notice of Charges details the harm to Fannie Mae resulting from the conduct of these individuals from 1998 to 2004. The 101 charges reveal how the individuals improperly manipulated the earnings to maximize their bonuses, while knowingly neglecting accounting systems and internal controls, misapplying over twenty accounting principles and misleading the regulator and the public. The Notice explains how they submitted six years of misleading and inaccurate accounting statements and inaccurate capital reports that enabled them to grow Fannie Mae in an unsafe and unsound manner. The misconduct cost the Enterprise and shareholders many billions of dollars and damaged the public trust." OFHEO Press Release, *OFHEO Files Notice of Charges Against Former Fannie Mae Executives Franklin Raines, Timothy Howard and Leanne Spencer* (Dec. 18, 2006) (Exhibit 10).

Similarly, in a subsequent press conference, you declared that OFHEO "believed as an agency that these three individuals, separately and together, did serious harm to the company. There is a long list of charges that show they allowed this company to grow out of control." *See* Eric Dash, *Fannie Mae Ex-Officers Sued By U.S.*, New York Times (Dec. 19, 2006) (Exhibit 11); *see also, e.g.*, David S. Hilzenrath, *Fannie Mae Ex-Officials Are Sued For Disputed Pay*, Washington Post (Dec. 19, 2006) (Exhibit 12). You told reporters that Mr. Raines, Mr. Howard, and Ms. Spencer "knowingly" neglected "accounting systems and internal controls, misapplying over 20 accounting principles and misleading the regulator and the public." James Tyson, *Fannie Mae Regulator Sues Raines, Former Executives*, Bloomberg.com (Dec. 18, 2006) (Exhibit 13). You

further stated: "This activity was so unsafe and unsound that we have to take this action. We have no choice, really. We have to send a message to the management ..., both present and previous, that this kind of activity cannot be allowed." Damien Paletta, *OFHEO Files Notice of Charges vs. Ex-Fannie Executives*, Dow Jones Newswires (Dec. 18, 2006) (Exhibit 14).

These comments illustrate precisely the sort of bias that compels your recusal from participation in this case. Federal law requires you to recuse yourself from "any proceeding in which [your] impartiality might reasonably be questioned." 28 U.S.C. § 455(a). Your public condemnations of Ms. Spencer, Mr. Raines, and Mr. Howard, which have been widely reported in every national newspaper, would cause any reasonable observer to question your impartiality. Indeed, the Washington Post has already noted that "after the evidence has been heard, it is the accuser who will render judgment." David S. Hilzenrath, *Players Oddly Aligned in New Fannie Mae Case*, Washington Post (Dec. 20, 2006) (Exhibit 15); *see also id.* (noting that "[t]he playing field is inhospitable"). The New York Times has observed that OFHEO "seems intent on sending a message to Capitol Hill, where legislation is to be debated that would give the office greater authority." Eric Dash, *Fannie Mae Ex-Officers Sued By U.S.*, Washington Post (Dec. 19, 2006) (Exhibit 11). As one commentator explained, "OFHEO basically may be trying to send a signal that they are going to be really tough under their jurisdiction. They traditionally have not had the clout compared to other regulators for banks. And by bringing this action, they may want to send the fear of God to these executives." *Id.* (quoting Prof. Henry T. Hu, University of Texas Law School).

Moreover, your agency's bitter and repeated criticisms of the respondents are premised on a perversion of the testimony and documents obtained in the Special Examination, where there was an institutional initiative to distort the evidence in order to marginalize Fannie Mae and damage the Respondents. Indeed, as early as April 2004, the Office of the Inspector General of the Department of Housing and Urban Development ("OIG") launched an investigation at the request of Senator Christopher S. Bond into possible criminal misconduct stemming from improper leaks of confidential information by former Director Armando Falcon, based on OFHEO's selective release to the press of "the results and partial recommendations of a confidential regulatory examination of Fannie Mae." OIG Report at 2 (Exhibit 1). While the U.S. Attorney's Office ultimately declined to prosecute Director Falcon "in favor of administrative remedies," *id.* at 92, the OIG Report well documents OFHEO's overwhelming institutional bias. For example, one member of OFHEO's examination staff reported to the OIG that OFHEO staff members were instructed "that it's our job, meaning all employees of OFHEO, to make the Director look good." *Id.* at 9. Employees were told that "the Enterprises should fear OFHEO when we come onto the premises and that our relationship is inherently acrimonious and adversarial." *Id.* According to this witness, OFHEO's Special Examination of Fannie Mae "was focused on finding a way to bring into question the propriety of Fannie Mae's approach," and thus examination results and conclusions "were then altered and made to appear much more significant and egregious." *Id.* at 84. The "ultimate objective on the part of the Director and the Deputy Director" was to force Fannie Mae "to recognize an increased level of impairment" and to "find a way to conclude that Fannie has misapplied the financial accounting standards." *Id.* at 85.

Another OFHEO employee told OIG that the agency's Special Examination was driven by the goal of "finding problems at Fannie Mae," and that employees were "rewarded for finding things versus saying that everything is okay." *Id.* at 80. OFHEO's former Chief Examiner, Scott Calhoun, testified that "the attitude prevailing at OFHEO was one in which efforts would be made to find things wrong at Fannie Mae, then take strong enforcement action; 'when we find them, we'll hammer you hard.'" *Id.* at 82. Managers who "did not conform to this new approach" were "marginalized" by senior management. *Id.* at 82-83. OFHEO's former Deputy Director, Stephen Blumenthal, acknowledged lecturing staff "about how public announcements by government officials could negatively impact the stock of Fannie Mae and could serve as a means for making the regulated entity ... 'submit to the will' of the regulator." *Id.* at 11.

Under these circumstances, your dual role as prosecutor and adjudicator casts inescapable doubt on your impartiality. As the Supreme Court has held, the Constitution does not permit a judge who has "in effect bec[ome] part of the prosecution and assumed an adversary position" to adjudicate a case. *Withrow v. Larkin*, 421 U.S. at 53; *see also, e.g., Wildberger v. Am. Fed'n of Gov't Employees*, 86 F.3d 1188, 1190, 1195 (D.C. Cir. 1996) (holding that a disciplinary procedure in which the same individual "initiated the investigation, determined probable cause, and served as the final adjudicator" violated constitutional due process). In light of OFHEO's politically motivated investigation and prosecution of Ms. Spencer, Mr. Raines, and Mr. Howard, in which you personally have played a crucial role, you must remove yourself from any further involvement in this case.

The Due Process Clause of the United States Constitution requires that "an administrative hearing 'must be attended, not only with every element of fairness but with the very appearance of complete fairness.'" *Cinderella*, 425 F.2d at 591 (quoting *Amos Treat & Co. v. SEC*, 306 F.2d 260, 267 (1962)). Your statements are prima facie evidence that you have "adjudged the facts as well as the law ... in advance of hearing [*In re Raines et al.*]." *Id.* You cannot back off your public statements now. Decision-makers are without "license to make speeches [or statements] which give the appearance that the case has been prejudged." *Id.* As long as you continue to participate in this case, Ms. Spencer will be denied her fundamental constitutional right to due process.

This letter is presented to you to permit you a fair opportunity to recuse yourself now. Because this matter will be irrevocably tainted by any further involvement from you – including appointment of a presiding officer pursuant to 12 C.F.R. § 1780.3(h) – you must act on this issue now. Your recusal cannot await completion of a hearing on the Notice of Charges. If you deny

our request or take any further action in this matter without responding, we will petition the United States Court of Appeals for the District of Columbia Circuit for a writ of mandamus removing you and OFHEO from the adjudication of this matter. *See* 28 U.S.C. § 1651(a). Whatever your action, please make this letter part of the administrative record of *In re Raines, et al.*, OFHEO Notice No. 2006-1.

Very truly yours,

David S. Krakoff

cc: Kevin M. Downey
Counsel for Franklin D. Raines

Steven M. Salky
Counsel for J. Timothy Howard

Alfred M. Pollard
General Counsel for OFHEO

EXHIBIT

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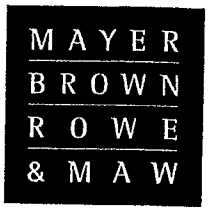

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January 24, 2007

BY HAND DELIVERY

Mr. Alfred M. Pollard, Esq.
Office of the General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street N.W.
Washington, D.C. 20552

Re: *In re Raines et al.*, Notice No. 2006-1

Dear Mr. Pollard:

On behalf of my client Leanne G. Spencer, I write to follow up on my January 12, 2007 letter to Director Lockhart asking him to recuse himself from the adjudication of *In re Raines et al.*, Notice No. 2006-1. Neither Director Lockhart nor OFHEO has responded to that letter. Moreover, you have apparently told the press that Director Lockhart has decided not to recuse himself. *See Ex-Fannie Mae Officers Sued; Trio Allegedly Inflated Profit to Boost Bonus*, Bloomberg News (Dec. 19, 2006) ("Lockhart doesn't intend to recuse himself from the matter, Pollard said."). Finally, in your January 9, 2007 letter to Kevin M. Downey, counsel for respondent Franklin D. Raines, you effectively denied Mr. Raines's request for Director Lockhart's recusal.

In light of the Director's appointment of a presiding officer without responding to my letter, and in light of your statements to the press and to Mr. Downey, we believe that further efforts to obtain Director Lockhart's voluntary recusal are futile. Nevertheless, pursuant to 5 U.S.C. § 556(b), we are submitting the attached affidavit and accompanying exhibits. Because any involvement of the Director—including the appointment of the presiding officer—will irrevocably taint this proceeding, we intend to petition the United States Court of Appeals for the District of Columbia for a writ of mandamus disqualifying Director Lockhart if the Director's recusal is not tendered by January 29, 2007.

Very truly yours,

David S. Krakoff

Enclosure

cc: Kevin M. Downey
Counsel for Franklin D. Raines
Steven M. Salky
Counsel for J. Timothy Howard

EXHIBIT

11

UNITED STATES OF AMERICA
OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

In the Matter of: LELAND C. BRENDSEL, Respondent.	HUDALJ 04-056-NA Notice No. 2003-2 Chief Judge Arthur A. Liberty

OFHEO'S OPPOSITION TO RESPONDENT LELAND C. BRENDSEL'S MOTION TO DISQUALIFY OFHEO DIRECTOR ARMANDO FALCON, JR.

Respondent Leland C. Brendsel ("Brendsel") has asked this Court to grant the extraordinary relief of "disqualify[ing]" the Director of OFHEO from fulfilling his statutory duties in connection with this enforcement action. Brendsel's request is meritless for several reasons. First, the request is misdirected. As the authority upon which Brendsel relies makes clear, requests for recusal in administrative proceedings must be made to the "agency," *i.e.*, the Director himself, *not* to this Court. Indeed, there is no authority for this Court to consider Brendsel's request. Second, even had Brendsel's request been properly directed, he has ignored mandatory procedural prerequisites for making such request – a failure that itself bars consideration of his motion. Finally, assuming the proper filing of Brendsel's request and satisfaction of the procedural requirements, Brendsel has fallen far short of meeting the heightened standard necessary to support the disqualification of the Director. Accordingly, Brendsel's motion should be denied.

I. This Court Has No Jurisdiction To Consider Brendsel's Request

Brendsel's request to disqualify the Director cannot be considered by this Court. Brendsel makes his request pursuant to 5 U.S.C. § 556(b), which provides for disqualification of presiding or participating employees based on certain procedural requirements and a sufficient showing of bias. That provision makes clear, however, that only "the agency" – which is specifically distinguished from the administrative law judge – may determine these issues. *See* 5 U.S.C. § 556(b) ("On the filing in good faith of a timely and sufficient affidavit of personal bias or other disqualification of a presiding or participating employees, *the agency* shall determine the matter as a part of the record and decision in the case") (emphasis added); *see also In the Matter of Thomas Spiegel*, Ord. No. OTS AP 92-36, 1992 OTS LEXIS 129, at *2 (Apr. 17, 1992) (APA requires the "*administrative agency*" to determine claims for bias or prejudgment; motion to disqualify Director – properly filed *with the Director himself* – denied by the Director) (attached hereto as Exhibit A).

Brendsel has not cited a single case in which an administrative law judge was presented with, or considered, a request for the disqualification of any member of a government agency.[1] Nor is OFHEO aware of any such authority. Indeed, that

[1] Indeed, Brendsel argues only that "*Courts* have disqualified agency decision-makers" for what he alleges to be "far less egregious demonstrations of bias than those voiced here by Director Falcon." Leland C. Brendsel's Motion to Disqualify OFHEO Director Armando Falcon, Jr., ("Motion to Disqualify"), p. 9 (emphasis added) (citing district and appellate court opinions). Putting aside the fallacy of Brendsel's argument on the merits, which is addressed more fully *infra*, the authority of Article III judges to consider challenges to agency action, including matters concerning disqualification, has no relevance to Brendsel's current request for an Administrative Law Judge to disqualify the head of a federal agency, let alone the head of a federal agency who is the ultimate decisionmaker in the case.

would be akin to a litigant in federal court asking a magistrate to disqualify the district court judge presiding over the case, or asking a district court judge to disqualify the appellate judge who would consider the case on appeal. Simply stated, this Court is not authorized to compel the Director, to whom it is required to submit its final recommendations, to be disqualified. For this reason alone, Brendsel's motion should be denied.[2]

II. Brendsel Has Failed To Comply With The Procedural Requirements For Seeking Disqualification

As discussed above, Brendsel's request is not properly before this Court. But even had Brendsel submitted his request to the Director – as required by law – his request still would be denied. Brendsel's failure to comply with the procedural requirements for recusal – *i.e.*, by filing a "timely and sufficient affidavit of personal bias or other disqualification" – *mandates* this result. *See* 5 U.S.C. § 556(b).

One need look no further than the case authority relied upon by Brendsel to demonstrate his fatal omission:

> The requirement of affidavits [for recusal motions] ... is not an empty formality to be cast aside unilaterally by a party to a[n administrative] proceeding.... [The] failure to

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[2] Brendsel suggests that OFHEO's regulations confer limitless authority on the presiding officer to effect any and all relief in connection with this enforcement action. *See* Motion to Disqualify at 1-2 n. 1. The regulations cited by Brendsel are not so broad. Those regulations instead *limit* the authority of the presiding officer to the conduct of the hearing itself. Indeed, while the regulations specifically confer upon the presiding officer the authority to disqualify *himself*, 12 C.F.R. § 1780.5(b)(13), nowhere do they authorize the removal of anyone else, including the Director. Thus, while Mr. Brendsel may, as he suggests, be required to file motions *regarding the hearing* with the presiding officer, he may file a request for the Director's disqualification *only* with the agency itself.

> submit affidavits is thus an *independently sufficient basis to deny [the] petitions in this respect.*

Keating v. OTS, 45 F.3d 322, 327 (9th Cir. 1995) (quoting *Gibson v. FTC*, 682 F.2d 554, 565 (5th Cir. 1982)) (emphasis added). By ignoring the "affidavit requirement" – a procedural *prerequisite* for disqualification – Brendsel has failed to satisfy the barest minimum standard for the extraordinary relief he now seeks. *See id.* ("The affidavit requirement would be gutted if this court reversed simply because, on appeal, the appellant makes allegations that would have been sufficient to require recusal if they had been properly presented to the agency."). For this reason as well, Brendsel's motion should be denied.

III. On The Merits, Brendsel Has Failed To Overcome The Presumption Of Honesty And Integrity Of Adjudicators

As OFHEO already has demonstrated, Brendsel's request is barred by this Court's lack of jurisdiction and Brendsel's failure to comply with the basic procedural requirements for disqualification. But even assuming Brendsel somehow had cleared each of these jurisdictional and procedural hurdles, he still has not made a sufficient showing to warrant disqualification of the Director.

As a preliminary matter, Brendsel's request that the Director be disqualified must be considered within the statutory framework that was established by Congress for this administrative enforcement proceeding. As acknowledged by Brendsel, the Director must have made certain determinations before he can file a Notice of Charges. Brendsel misleadingly suggests, however, that because a "reasonable cause to believe" determination is sufficient to file a Notice of Charges,

the Director's allegedly more conclusive statements are evidence that he has inappropriately prejudged this matter. *See* Motion to Disqualify at 6 n.5.

The relevant statutory language provides that a Notice of Charges can be issued:

> if in the *determination* of the Director, the enterprise, executive officer, or director is engaging or *has engaged,* or the Director has reasonable cause to believe that the enterprise, executive officer, or director is *about to* engage in [certain prohibited conduct].

12 U.S.C. § 4631(a) (emphasis added). The framework established by Congress thus expressly contemplates that the Director can initiate administrative enforcement proceedings upon a determination that an executive officer or director has engaged in certain prohibited conduct. *Id.* The fact that a Director so believes and expresses that view in describing the Notice of Charges cannot, therefore, be a basis for disqualifying the Director. *See Withrow v. Larkin*, 421 U.S. 35, 50 n.16 (1975) (quoting *Pangburn v. CAB,* 311 F.2d 349, 358 (1st Cir. 1962)) ("We cannot say that the mere fact that a tribunal has had contact with a particular factual complex in a prior hearing, *or indeed has taken a public position on the facts*, is enough to place that tribunal under a constitutional inhibition to pass upon the facts in a subsequent hearing. We believe that more is required. Particularly is this so in the instant case where the Board's prior contact with the *case resulted from its following the Congressional mandate to investigate and report the probable cause of all civil air accidents.*") (emphasis added).

Moreover, there is no evidence, and Brendsel has not alleged, that the Director is incapable of fairly considering all the evidence presented in the administrative enforcement proceeding, including the recommendation of the administrative law judge, before making his final decision in this matter. The Supreme Court has held that government adjudicators – like the Director – "are assumed to be men of conscience and intellectual discipline, capable of judging a particular controversy fairly on the basis of its own circumstances." *Withrow*, 421 U.S. at 54 (quoting *United States v. Morgan*, 313 U.S. 409, 421 (1941)).[3] To overcome this presumption, a party seeking disqualification "must come forward with substantial evidence of actual or potential bias, such as evidence of a pecuniary interest in the proceeding, personal animosity toward [that party], or actual prejudgment of the [party's] case." *Head*, 225 F.3d at 804; *see also Schweiker*, 456 U.S. at 196 ("the burden of establishing a disqualifying interest rests on the party making the assertion").[4]

Here, Brendsel argues that the Director "has prejudged Mr. Brendsel and the issues in this case." Motion to Disqualify at 1. To make this showing, it is

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[3] *Accord Head v. Chicago Sch. Reform Bd. of Trustees*, 225 F.3d 794, 804 (7th Cir. 2000) ("[t]hose serving as adjudicators are presumed to act in good faith, honestly, and with integrity"); *see also Schweiker v. McClure*, 456 U.S. 188, 195 (1982) (disqualification analysis must begin with the presumption that the adjudicators are unbiased); *Marathon Oil Co. v. EPA*, 564 F.2d 1253, 1265 (9th Cir. 1977) (presumption of objectivity applies to adjudicator despite procedures which "bear some functional resemblance to initial and appellate adjudication").

[4] To demonstrate prejudgment, the requesting party "must point to specific statements *clearly showing prejudgment of both the facts and the law of a given case*," the statements "must be viewed in the context of the entire case," and "the statements must be analyzed from the perspective of a disinterested observer." *In the Matter of Fox Television Stations, Inc.*, DA 94-1014, 1994 WL 513703 (FCC Sept. 21, 1994) (attached hereto as Exhibit B); accord *In the Matter of Commercial Realty St. Pete, Inc.*, FCC 99-211, 1999 WL 623825 (FCC Aug. 18, 1999) (attached hereto as Exhibit C).

insufficient for Brendsel – as he has done here – merely to allege that the Director "formed or even expressed opinions about those issues before the hearing." *See In re Marine Shale Processors, Inc.*, Dkt. No. 06900009, 1995 WL 135572 (EPA Mar. 17, 1995), *aff'd*, 81 F. 3d 1371 (5th Cir. 1996) (attached hereto as Exhibit D). Instead, to meet his "heavy burden of overcoming the presumption of honesty and integrity attaching to the actions of government decisionmakers," Brendsel must demonstrate that the Director was "so psychologically wedded" to those opinions that he "would consciously or unconsciously avoid the appearance of having erred or changed position, and that such opinions 'as a practical or legal matter foreclosed fair and effective consideration' of the evidence presented" at the hearing. *See id.* (quoting *Withrow*, 421 U.S. at 57-58). Stated otherwise, Brendsel must establish that the Director had "demonstrably made up his mind about important and specific factual questions and [is] impervious to contrary evidence," *i.e.*, that his mind is "irrevocably closed on the adjudicative factual issues" in this case. *Metropolitan Council of NAACP Branches v. FCC*, 46 F.3d 1154, 1165 (D.C. Cir. 1995); *FTC v. Cement Inst.*, 333 U.S. 683, 701 (1948).

There is nothing in Brendsel's motion approaching this standard.[5] Specifically, his entire argument of bias rests on the following sources:

- OFHEO press releases;

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[5] Brendsel's primary complaint appears to be with the Director's combined involvement in the filing of the Notice of Charges, the disclosure to Congress of certain findings arising from OFHEO's ongoing Special Examination, and the ultimate disposition of Brendsel's case, which is set to occur following the recommendation of this Court at the close of this proceeding. But the mere combination of investigation and adjudication reflected in the Director's statutory duties does not represent grounds for recusal. *See, e.g., United States v. Batson*, 782 F.2d 1307, 1313-14 (5th Cir. 1986).

- A public statement by Director Falcon that "accounting improprieties and management misconduct" require "remediation and enforcement actions;"
- Statements by Director Falcon to Congress summarizing the results of OFHEO's Report of its ongoing Special Examination;
- The Notice of Charges; and
- A "Letter to the Editor" by Director Falcon to the Wall Street Journal.

None of these are sufficient to support the extraordinary relief of recusal.

First, press releases *by OFHEO* cannot support an allegation of personal bias *by the Director.*[6] *See Simpson v. OTS*, 29 F.3d 1418, 1424 (9th Cir. 1994) (statements reflecting the agency's position insufficient to establish personal opinion on behalf of Director). Nor do statements regarding unidentified "management misconduct" that is the subject of an "ongoing investigation" remotely suggest any "prejudgment" of the case, much less prejudgment of Brendsel, *who is not even mentioned. See Batson*, 782 F.2d at 1314 (statement regarding "those people" insufficient to support request for recusal).

Similarly, statements by the Director to Congress summarizing the results of the Special Examination not only fail to reflect any "irrevocable" personal position by the Director, but represent the execution of the Director's duty to inform

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6 Brendsel points out that one OFHEO press release quotes the Director as saying: "If you engage in improper conduct, you will be terminated for cause." Motion to Disqualify at 8. This qualified statement, by its terms, does not approach the entrenched position on Brendsel's guilt or innocence that would be required to support disqualification. In any event, the mere expression of a position on law or policy does not warrant disqualification. *See, e.g., American Cyanamid v.* FTC, 363 F. 2d 757 (6th Cir. 1966) ("It has been held that it was not necessarily 'a violation of procedural due process for a judge to sit in a case after he had expressed an opinion as to whether certain types of conduct were prohibited by law.' A judicial officer is not disqualified because he 'may have an

Congress and the public of the agency's performance of its activities, which may include the Director's "own views" (Motion to Disqualify at 4) of the matters under review. *See, e.g.*, *Morgan*, 313 U.S. at 421 (expression of "strong views" on matters at issue in proceeding insufficient to disqualify Secretary of Agriculture from exercising his adjudicative duties); *Marine Shale Processors*, 1995 WL 135572 (rejecting argument for disqualification where "at most, [petitioner] has shown that [the adjudicators] formed preliminary opinions about the [facts of the case] *as they were required to do in the course of fulfilling their statutory and regulatory obligations*") (emphasis added). The Notice of Charges itself, including *statutory language* regarding the determinations *of the Director*, 12 U.S.C. § 4631, also cannot support a claim of bias under these circumstances. *See Simpson*, 29 F.3d at 1424. Finally, the representation in a "Letter to the Editor" that OFHEO "initiated a process that *resulted* in the discharge [of Brendsel] for cause" before the proceeding even had commenced, at worst, cannot be read as anything other than the mere identification of the relief sought in the Notice of Charges. The suggestion that the

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underlying philosophy in approaching a specific case.' A 'strong conviction' or a 'crystallized point of view' on questions of law and policy are not grounds for disqualification") (internal citations omitted).

[8] In *Morgan*, the Secretary of Agriculture wrote a letter to the New York Times "vigorously criticiz[ing]" an earlier decision in that case. 313 U.S. at 421. The Supreme Court held that this did not disqualify the Director from participating in future proceedings: "That he not merely held *but expressed strong views* on matters believed by him to have been in issue, did not unfit him for exercising his duty in subsequent proceedings ordered by this Court.... Cabinet officers charged by Congress with adjudicatory functions are not assumed to be flabby creatures any more than judges are. Both may have an underlying philosophy in approaching a specific case. But both are assumed to be men of conscience and intellectual discipline, capable of judging a particular controversy fairly on the basis of its own circumstances." *Id.*; *see also In the Matter of Fox Television Stations*, 1994 WL 513703 ("[e]ven if isolated press reports were relevant to the recusal request, the demand must be evaluated from the perspective of 'a realistic observer ... who troubles to equip himself with all the facts bearing on the circumstances" of the case) (citations omitted) (alteration in original).

use of the past tense in the Director's letter –and nothing more– demonstrates some irreversible bias against Brendsel (Motion to Disqualify at 5) is wholly untenable.[8]

A nearly identical situation was presented in *In the Matter of Thomas Spiegel*, 1992 OTS LEXIS 129. In *Spiegel*, respondent filed a motion – as required, with the Director of OTS – asking the Director to disqualify himself from participating in certain aspects of his enforcement case. *Id.* at *1. Respondent – like Brendsel – based his request on certain public statements made by the Director surrounding the filing of the Notice of Charges. The Director noted that "the procedure established by Congress specifically requires the Director to make a preliminary judgment about factual allegations before instituting action," following which the Director could issue a Notice of Charges if, "in *[his]* opinion," respondent has engaged in an unsafe or unsound practice or has violated any law, rule or regulation, or written agreement with the agency. *Id.* at *3; *cf.* 12 U.S.C. § 4631(a). Given this role, and given the "important responsibility of the agency" to inform the public about banking agency enforcement activities, the Director determined that statements reflecting the nature of the Notice of Charges and noting the agency's intent to pursue those charges were insufficient to state a claim for bias:

> The APA recognizes and endorses the participation of the agency head in the initiation of enforcement proceedings and in the final agency review of the ALJ's decision in those proceedings. *See* 5 U.S.C. Section 554(d)(C) (members of body comprising the agency not subject to separation of functions strictures). Here, the statements made by the Director do no more than explain the nature of the charges brought against Respondent and state forcefully the agency's commitment to pursuing them. "[T]here is no incompatibility between an agency filing a

> complaint based on probable cause and a subsequent decision, when all the evidence is in, that there has been no violation of the statute. *Withrow v. Larkin*, 421 U.S. 35, 57 (1975).

Spiegel, 1992 OTS Lexis 129, at *4-5. Thus, where – as here – "nothing in [the Director's] statements suggest he will be unable to decide fairly" the merits of the enforcement action, disqualification of the Director "on the basis of statements that do no more than restate the contents of the Notice of Charges ... would frustrate the statutory scheme." *Id.* at *5-6.[9]

In short, the most that can be said about the Director's public statements in this case is that they reflect, on the one hand, appropriate communication with Congress and the public regarding the ongoing activities of the agency, and, on the other, the preliminary determination by the Director that there was sufficient evidence to suggest that Brendsel engaged in conduct which violated certain laws and regulations. There is nothing in any of these statements to suggest that the Director has prejudged Brendsel's case, much less that his mind has been "irrevocably closed" on any issues or that he is "impervious to contrary evidence." *Metropolitan Council*, 46 F.3d at 1164-65 (rejecting as "unfortunate" appellants attack on FCC decision on grounds that Chairman and others "created a public

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[9] The same result was reached in *Simpson.* 29 F.3d 1418. There, the Ninth Circuit also rejected a claim that statements by the OTS Director in connection with the filing of a Notice of Charges alleging unsafe and unsound practices (and willful violations of applicable laws) were sufficient to warrant disqualification. *Id.* at 1424. The Court specifically noted that the Director's involvement at the Notice of Charges stage was minimal and, though he is required to sign the Notice, "the Director does not investigate or prosecute the case" (which was conducted before an ALJ that was *not* alleged to be biased). *Id.* Given respondent's entitlement to a hearing before an impartial ALJ, and ultimate Article III review in federal court, no due process violation was established. *Id.*

impression" that the agency had predetermined appellants case "before it was even filed").[10] Brendsel's suggestion that sufficient grounds for disqualification have been offered is, therefore, without merit. Instead, any comments made by the Director reflect nothing more than the proper execution of his statutory role in connection with administrative enforcement proceedings, or inactionable statements summarizing OFHEO's examination findings and/or the nature of its pending enforcement actions.

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[10] *See also Batson*, 782 F.2d at 1314 (finding no violation of due process even where hearing officers had "decided beforehand that the facts constituted a prohibited scheme or device"); *Marathon Oil*, 564 F.2d at 1265 ("we see no more reason to assume that a Regional Administrator [who makes an initial decision and then, after further hearings before an ALJ, reviews the matter] cannot objectively review his earlier decision in light of additional hearings than to assume that a federal judge cannot retry or review a case after its remand following the initial trial or review").

CONCLUSION

For the foregoing reasons, Brendsel's Motion to Disqualify OFHEO Director Armando Falcon, Jr. should be denied.

Respectfully submitted,

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February 20, 2004

CERTIFICATE OF SERVICE

I hereby certify that on this 20th day of February 2004, I caused a copy of the foregoing to be served by United States mail on the person identified below:

Brendan V. Sullivan, Jr., Esq.
Kevin M. Downey, Esq.
David Zinn, Esq.
Williams & Connolly LLP
725 12th Street, N.W.
Washington, D.C. 20005

Andy Liu

EXHIBIT

12

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
1700 G STREET, NW WASHINGTON DC 20552 (202) 414-3877
Office of General Counsel

VIA FACSIMILE
HIGH PRIORITY

December 18, 2006

Ms. Linda M. Springer
Office of the Director
Special Initiatives
Office of Personnel Management
1900 E Street N.W.
Washington, D.C. 20415

Re: Request for Services of Administrative Law Judge to Preside in
In the Matter of Franklin D. Raines, et al.; Notice Number 2006-01

Dear Ms. Springer:

Pursuant to 12 U.S.C. 4633 and 5 U.S.C. 553, the Office of Federal Enterprise Oversight (OFHEO) requests of the Office of Personnel Management (OPM) the services of an administrative law judge (ALJ) to hear charges in the above matter, which is required to be held in the District of Columbia pursuant to 12 U.S.C. 4633. The Notice of Charges names Messrs. Franklin D. Raines, J. Timothy Howard and Leanne G. Spencer and alleges that the named former executive officers or directors of the Federal National Mortgage Association (Fannie Mae) engaged in conduct that violated the Federal Housing Enterprises Financial Safety and Soundness of Act of 1992 (Safety and Soundness Act of 1992), 12 U.S.C. §§ 4501 *et seq.*, the Federal National Mortgage Association Charter Act, 12 U.S.C. 1716 *et seq.*, and OFHEO's orders, rules, regulations, or guidances, as is to be alleged with more particularity in the Notice of Charges. OFHEO has determined and the facts will show that Messrs. Raines and Howard and Ms. Spencer engaged in violations or conduct that caused or is likely to cause a loss to Fannie Mae; and that such violations or conduct: violations and conduct (a) resulted from a pattern of malfeasance, misfeasance, and nonfeasance; (b) involved recklessness; (c) were knowing; and (d) resulted in unjust enrichment.

OFHEO requests relief in the form of civil money penalties and other monetary sanctions. The Director may impose a civil money penalty in accordance with 12 U.S.C. § 4636. As the matters described above involve violations of financial safety and soundness standards for the financial institutions regulated by OFHEO, OFHEO requests the services of an ALJ with experience in adjudicating financial regulatory matters.

OFHEO anticipates imminent issuance of the Notice of Charges and service upon the parties named above, and therefore requires the assignment of an appropriate ALJ as soon as possible. OFHEO is making this request of OPM as OFHEO does not employ ALJs.

Please contact David A. Felt, Deputy General Counsel, at 202-414-3750, if you have any questions or need any additional information regarding this matter. Your consideration of this time sensitive request is very much appreciated.

Sincerely,

Alfred M. Pollard
General Counsel

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*** FAX TX REPORT ***
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TRANSMISSION OK

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RESULT	OK

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
OFHEO
1993

1700 G STREET, NW, WASHINGTON, DC 20552
(202) 414-3800 FAX: (202) 414-6506

FAX TRANSMITTAL

To:
Ms. Linda M. Springer, OPM

Date: **December 18, 2006**

Time:

Facsimile Number: **202-606-2573**

From: **Charlotte A. Reid**
Assistant General Counsel
Office of General Counsel

Telephone No.: **(202) 414-3810**

Page 1 of 3

Notes/Comments: Request for Assignment of Administrative Law Judge

UNITED STATES OF AMERICA
OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

In the Matter of: **FRANKLIN D. RAINES,** **J. TIMOTHY HOWARD, and** **LEANNE G. SPENCER,** **Respondents.**	**Notice Number 2006-1** **Judge William B. Moran**

PROPOSED ORDER

Upon consideration of OFHEO's Motion to Docket Ex Parte Letter from Respondent Raines and Respondent Raines's Response thereto, it is **ORDERED**, this _____ day of February, 2007, that the Motion is **DENIED**.

_____
Honorable William B. Moran
U.S. Administrative Law Judge