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Thankless Task

Catherine Austin Fitts and her company saved taxpayers billions of dollars by creating a program to help HUD sell its defaulted loans. Her reward? After four years of government probes that found nothing, she's ruined and still hounded by HUD's OIG.

By Paul M. Rodriguez

Her name is Catherine Austin Fitts, and she's nearly broke. Though battered and down on her luck, she's still upbeat, smiling and optimistic. The truth, she says, will set her free. At least she hopes so. But for more than four years those hopes have gone aglitter as she has sought to return to her career in the arcane world of federal defaulted-mortgages, where she specialized in asset sales.

The Fitts story, and the ways in which it has touched dozens of her former employees and colleagues, is as strange a tale as A Clockwork Orange, in which up is down, white is black and the world has gone to hell in a handbasket. Once more we hear echoes of former Labor secretary Ray Donovan's question to the press as he left a federal court after being exonerated on corruption charges: "Where do I go to get back my reputation?"

Once more that question has gone unanswered as Fitts has waged a one-woman struggle to set the record straight and get at the truth about the battering she has taken at the hands of the Department of Housing and Urban Development (HUD). For Fitts is a savvy businesswoman who once worked at and then with HUD to clean up corruption and make programs work better.

Then there's John Ervin. He was a successful contractor for HUD, servicing defaulted government-backed loans. He was prosperous and on top of the world until setting out on a crusade against alleged corruption involving his competitor — a highly touted and seemingly successful loan-sales program run for HUD by Fitts' company, Hamilton Securities Group. Then, he believes, politics kicked in, and a conspiracy took over to hide the truth.

Both players in this five-year struggle to get to the facts as they see them are convinced they have stepped on some big toes and threatened some very powerful, if yet unseen, forces. But there's one thing both agree on: The most successful sales program of defaulted loans undertaken by HUD was suspended for three years, and American taxpayers have, as a result, lost billions of dollars on bad loans.

Fitts, a one-time multimillionaire, has had to liquidate her company, sell virtually all her assets and now is uncertain about her financial future. Born and raised in Philadelphia, she was graduated from the University of Pennsylvania in 1974 and the Wharton School in 1978. She then joined Dillon, Read & Co. Inc., ultimately becoming a managing director of the powerful Wall Street investment bank. She resigned to join the Bush administration in 1989 as an assistant secretary at HUD and as federal housing commissioner.

In 1990, Fitts left HUD, declining an offer from the White House to become a member of the Federal Reserve Board. Instead she started Hamilton, a Washington-based investment bank focusing on financial software and database development. Money to start the company came from her 401(k) retirement plan and savings account, the sale of her house and investments by employees.

By 1993, Hamilton had been awarded an open-bid contract to serve as a financial adviser for HUD to market billions of dollars in federally held defaulted mortgages on single-family and multifamily properties. Improving on models developed by the Resolution Trust Corp. in the aftermath of the savings-and-loan debacle, Hamilton and HUD came up with a program tailor-made to sell HUD's defaulted loans on the open market. Between 1995 and 1997, HUD sold nearly $10 billion in such loans and increased its recovery rate from 35 cents on the dollar to between 70 and 90 cents. The Office of Management and Budget (OMB) and the General Accounting Office (GAO) estimated the government's administrative savings alone exceeded $2 billion.

Vice President Al Gore's reinventing-government group was so impressed that it gave the program the Hammer Award for excellence in beating back waste. Barron's featured an article on the HUD loan-sales program developed by Hamilton and run by senior HUD officials, headlining the story: "Believe It or Not, HUD Finally Does Something Right for Taxpayers."

Then it happened: A federal qui tam lawsuit was filed in federal district court under the False Claims Act although nobody knew it because such lawsuits are secret to all but the filers and the government — in this case the details were sealed for nearly four years. But Fitts and company soon saw their world crashing around them as they sought to comply with a blizzard of subpoenas and an extremely costly probe about which they had scant details. A qui tam is a private lawsuit brought on behalf of the government with the expectation that a portion — perhaps 25 percent or more — of any proceeds won would go to the original filer.

At the same time, in the summer of 1996, a Bivens case — one claiming violation of civil rights by a government official — was also filed in federal court alleging fraud and conspiracy (among many claims) against HUD, the Small Business Administration (SBA), HUD's then-secretary Henry Cisneros and other HUD officials. The Bivens case did not name Hamilton as a defendant but outlined a broad-based conspiracy...
Still fighting: Fitts, center, and her attorney McManus, left, discuss HUD's probe with her legal team.

involving the HUD mortgage-sales program in which Fitts' company was involved. HUD was accused of engaging in contract favoritism, insider trading and bid-rigging activities on behalf of certain "Wall Street" insiders.

The lawsuit was amended in August 1996 to include new charges against Helen Dunlap and others for engaging in a conspiracy to further the plot. Dunlap was then deputy assistant secretary at HUD in charge of the home-loans sales program.

As with the qui tam, the Bivens case was filed by Ervin, the president of Ervin & Associates, a Bethesda, Md-based mortgage-services provider to HUD and a business rival of Hamilton. Based on hundreds of documents filed with the courts and at HUD's Office of the Inspector General (OIG), Ervin believed — and charges still — that sales of HUD-held home mortgages were corrupt and intended to line the featherbeds of a select few, including Goldman Sachs.

Given the history of HUD, such charges could not be dismissed as fanciful — even if coming from the head of a company that stood to lose millions of dollars in contracts servicing the types of loans that now were being sold off through a rival. "HUD's been a cesspool of corruption for years, and it wasn't a stretch of anyone's imagination that the Ervin allegations might be true," says one of the lawyers involved for several years in the ongoing cases. "It doesn't take a rocket scientist to figure out why Susan Gaffney [the HUD inspector general (IG)] would jump on these charges," confirms another lawyer who once worked at OIG.

But were the charges true? To help answer such questions the Justice Department's Civil, Criminal and Antitrust divisions were called in along with the FBI and the U.S. Attorney's office in Washington. After investigations costing tens of millions of dollars during a four-year span, all government investigators — except for Gaffney's OIG — determined nothing was there, even at the civil level, which requires a far lower standard of proof.

It was a disappointment to Ervin and his team. They were certain that evidence they presented secretly to the government supporting their public claims would win the day and that prosecution of Hamilton would lead to a nest of corrupt public officials at HUD tied to then-HUD secretary Andrew Cuomo and Wall Street that allegedly conspired to defraud the taxpayers.

During this time, between 1996 and 1999, Hamilton sought to stem damaging leaks appearing in the press concerning the secret multipronged investigation that it said was falsely accusing Fitts and her company of wrongdoing. Hamilton even filed ethics charges against Gaffney and OIG for spreading the rumors, charges ultimately dismissed for failure to prove a direct link.

In the midst of the early investigation and accusations, Hamilton received what it thought was good news: A HUD audit team from OIG that had examined the initial sales, which it helped monitor, had drafted a report that found everything up to snuff. But it was withdrawn because its methodology was called into question by Gaffney's office in Washington. The result was, Fitts says, that the credibility of the program and Hamilton suffered, as did her reputation.

Nevertheless, the waves made by all this legal brouhaha appeared to get the attention of the politically ambitious Cuomo, and he cancelled the program. He also withheld payment of about $2 million to Hamilton, citing a glitch in the system that may have cost HUD an...
additional $3.8 million in potential profits. But Fitts says her company and subcontractor, Lucent Technologies, had discovered the glitch on their own in 1996, fixed it and reported fully to HUD.

Ervin claims this was part of a cover-up of massive proportions involving skimming of maybe hundreds of millions of dollars by Hamilton, select contractors and a handful of senior HUD officials. Again, he cites secret proofs.

Keeping Ervin going was an out-of-court settlement by HUD on the Bivens case he had filed. Although no one is talking, sources close to Ervin say the settlement package was in the neighborhood of $2 million and that it would not have been authorized by Cuomo if there were nothing to the original charges. "We were a very successful HUD contractor until we blew the whistle and lost it all. And that was the basis of the Bivens case which we settled positively with HUD," Ervin claims, declining to elaborate under the deal.

In fact, in his amended qui tam filed late last year, Ervin added yet more allegations that Hamilton was and remained at the center of a massive fraud scheme — again, lots of smoke but no corroborating evidence. Also, one of the original defendants named in the first qui tam, Goldman Sachs, was dropped from the amended suit — the same Goldman Sachs that allegedly stood to gain the most from purchase of hundreds of millions of dollars in HUD loans at the heart of the conspiracy and corruption allegations.

For Fitts this was the last straw. After all, despite Ervin's public accusations and alleged proofs secretly given to government investigators, the FBI and the Justice Department spent four years and found nothing to prosecute. "If they can show us something concrete that they believe we did wrong I'm confident we'd be able to refute it," she tells Insight. It feels, she says, "as though I'm fighting a smear campaign that started years earlier. And now, like people getting on and off a train, the probe just keeps going on its own steam without anyone in control."

Complaints about the length of the ongoing qui tam case often are cast aside by Gaffney's office and Ervin's team as the fault of Hamilton for resisting subpoenas. Never mind that tens of thousands of documents were turned over, plus computers and backup tapes, Fitts argues, or that her company is kaput and she's broke. "It's never enough!" she exclaims. But HUD officials and Ervin's associates interviewed by Insight, who asked not to be named, say they are confident they'll find the stained blue dress — specifically, secret computer tapes and contemporaneous notes they believe still exist.

Michael McManus of Drinker Biddle & Reath LLP, who is Fitts's attorney, says this is wishful thinking. "Everything has been turned over and over and over again at tremendous cost to Hamilton," he says. "Nothing has been withheld, and we can prove it."

Fitts says she doesn't know why HUD's IG continues to investigate, other than that the program she put together "was offending a lot of important people who stood to lose hundreds of millions of dollars if the program continued," including Ervin, whose business made money by servicing such loans for HUD. "I don't know why this is going on, but I'm not going to give up," Fitts says from the small house in rural Tennessee, where she now lives.

She says she's ready, willing and able to testify under oath if people are willing to look into this case in an honest and open fashion. "I've got nothing to lose and I'm not afraid to tell the truth — we did nothing wrong and, after [five] years of digging, they've got nothing to show for it. I want them to tell me what it is they have so I can prove they are wrong."

Ervin claims to believe he can make his conspiracy case. And while acknowledging that much of the purported evidence behind his public claims has been secretly reviewed by the highest levels at the Justice Department and the FBI (as well as the OIG) without any action being taken, he thinks the government is playing possum. "Clearly, there was a cover-up someplace, and I want to get to the bottom of it," he says.

Fitts agrees on that first point and, while fighting mad, she remains charitable toward her tormentors, including Gaffney, because she believes the government has a right to probe serious allegations of wrongdoing. At some point, however, when nothing turns up, it's time to say it's over — in this case, even to apologize.

"Government isn't supposed to work this way," McManus says. "Instead of gracefully dropping these matters after so many years of finding nothing, they just continue to hound my client. This is wrong." At some point, they should "either put up or shut up."

A growing number of people inside HUD are saying the same thing. And many think it's time for Congress to investigate this use of the law to destroy an able businesswoman who found ways to save taxpayers billions of dollars. They say, convict or exonerate!

As one HUD official put it: "Given the scope of the Justice probes and decisions at the highest levels that there was nothing to prosecute, you'd think that to maintain her neutrality [Gaffney] would begin to look at the accuser.

Calls to Gaffney's office went unanswered. Ervin's attorney, Wayne Travell, declined to speak on the record. 

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