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April 21, 1999

HAND-DELIVERED

The Honorable Fred Thompson
Chairman, Government Affairs Committee
Room SD-523
Dirksen Senate Office Building
Washington, D.C. 20510-6250

Re: Hamilton Securities Group, Inc., and Hamilton Securities Advisory Services

Dear Senator Thompson:

We represent Hamilton Securities Group, Inc. and Hamilton Securities Advisory Services, collectively referred to as "Hamilton". Hamilton is an investment banking firm that for a number of years was an outside contractor to the Department of Housing and Urban Development. In the mid 90s, Hamilton served in an instrumental capacity as HUD's financial advisor developing and implementing a number of sales of HUD's mortgage loan portfolio which saved the U.S. taxpayers in excess of \$2.1 billion in credit subsidy savings. In June of 1996, another HUD contractor, Ervin & Associates, filed suit against HUD, the Small Business Administration, then-Secretary of HUD Henry Cisneros, and other government officials, more fully described below (as the "Bivens lawsuit"), and a sealed *qui tam* lawsuit against a number of undisclosed parties. Hamilton was not named as a defendant in the *Bivens* action, but while we do not know the allegations or the identity of the other defendants, we do know that Hamilton was named as a defendant in the *qui tam* action. As a result of these two lawsuits, Susan Gaffney, the HUD Inspector General, launched an investigation of Hamilton purportedly based on the allegations raised in the two lawsuits. In August of 1996, the HUD Office of Inspector General served two subpoenae on Hamilton, requesting the production of hundreds of thousands of pages of Hamilton's documents. Hamilton immediately began to work with the OIG to produce the requested documents.

In mid-November of 1996, Hamilton discovered the possibility of an error in the computer optimization program used to determine the winning bids in one of the mortgage loan sales. Hamilton immediately investigated the matter, including meetings with the subcontractor who developed the program, Lucent Technologies. Hamilton reported this matter in early December of 1996 to HUD, and followed-up with a written report to HUD of its investigation results. Hamilton believed that any

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potential error had been corrected, and that the matter was closed. Hamilton heard nothing more on this matter, and in fact, continued to work on the development and implementation of future mortgage loan sales. Then on October 17, 1997, HUD suddenly and without warning terminated Hamilton's contracts. Even though at that time HUD apparently had not investigated the matter further, it cited the computer optimization model as the basis for Hamilton's termination. HUD refused to pay Hamilton for work that Hamilton had already completed at the time of the termination (approximately \$2 million), and that dispute is now in the Federal Court of Claims.

One week later, on October 24, 1997, the HUD OIG served a third subpoena on Hamilton, which Hamilton immediately began to respond to. All tolled, Hamilton has spent in excess of \$2 million responding to the OIG subpoenae. While the HUD OIG has repeatedly claimed that it is investigating both civil and criminal matters purportedly involving Hamilton, after nearly three years of this "investigation" the OIG has taken no formal action, although it does continue to burden Hamilton with requests for yet additional document production.

We represent Hamilton in all matters relating to the actions of the HUD OIG. Over the course of our working on it, there have been many aspects of this case which have been very puzzling to us, things and procedures which, in our experience, were unexplainable within the context of how cases are normally and reasonably handled. For example, other than oblique references to the sealed *qui tam* complaint and the 253-page *Bivens* filing, the government has repeatedly alluded to serious criminal and serious wrongdoing on the part of our clients, yet refuses to provide any meaningful specifics of what it contends our clients did wrong. This investigation has taken entirely too long based upon its purported genesis. The subpoenae issued by the HUD Inspector General Susan Gaffney are unusually broad for this type of investigation, and have gone well beyond the bounds of anything necessary to obtain relevant information. And most curious, this investigation is not being done consistent with procedures and practices normally seen in similar types of investigations, either by the FBI or Offices of Inspector General, in other words, it is not consistent with normal investigatory procedures. This is highlighted by Judith Hetherington's heavy involvement in this matter, which far exceeds any statutory authority she may have as Counsel to the IG, and which has included an extraordinary injection of factually incorrect yet sensationalist and prejudiced inquiries of a very personal nature into the lives of certain parties to this matter. Investigations are usually run by investigators, not the OIG's counsel. Yet that is clearly what is happening here. This indicates an unusual interest by the IG herself, who we now believe has a personal agenda inconsistent with the authority and mandate of her official position.

Since our introduction to this case nearly one year ago, we have repeatedly asked the government, through several different inquiries and on many separate occa-

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sions, just precisely what is the nature, focus, intent and purpose of what to us now appears to be a politically motivated, never-ending and pointless investigation of Hamilton and some of its former employees. To date, the information we have obtained leads us to believe that this matter is being driven by questionable motives, for which the HUD OIG is directly responsible and accountable.

As a matter of first course, it would seem to be a simple enough proposition to at least be able to find out who is actually leading this investigation. Apparently no one is, or at least no one has been willing to accept or acknowledge that responsibility. Both Dan Van Horn (the Assistant United States Attorney representing the HUD OIG in court proceedings in this matter) and Ms. Hetherton have repeatedly advised us that neither one of them is running the investigation, and we have been directed to AUSAs Tony Alexis (civil) and Dick Chapman (criminal) as those in charge. We have met with both Mr. Alexis and Mr. Chapman, who impressed us as being professional, reasonable and straightforward in their discussions with us. They both advised us that they too were not running the investigation, but they believed that Ms. Hetherton was. We believe that she is, at least on a day-to-day basis. Given that Mr. Van Horn and Ms. Hetherton have repeatedly suggested both civil and criminal implications from whatever "it" is, I believe we are at the very least entitled to know who is running the show.

Equally mysterious is just what is being investigated? We have repeatedly asked that question, and after nearly three years of an investigation I am amazed at the government's inability to articulate any meaningful response to that question. I have worked opposite the U.S. Attorney's Office in both civil and criminal cases before, and while I do not expect the government to give away their strategy or the inner workings of their case, I have never had anyone so unwilling or unable to tell me simply and precisely what they were investigating. Yet Mr. Van Horn and Ms. Hetherton have felt free to suggest in court proceedings that significant wrongdoing has taken place, perhaps even fraud, and have apparently provided the Court (Judge Stanley Sporkin, United States District Court for the District of Columbia) with some indication of what they are investigating for its *in camera* review. Yet for some unknown and unexplained reason they are afraid to address that issue with us. Initially, we concluded that whatever it is that has been given the Court in secret must indicate that the investigation is focused in reality on some other party, and not on Hamilton, for we could think of no other legitimate reason why that basic information was not shared with us. We also believe that whatever it is the OIG has told the Court must be so irrefutably disproven by the facts that disclosing that information to us would give us cause to have the investigation terminated immediately, and those responsible for it punished. But it appears that the truth is even more ominous than that; this is not simply just a case of an investigation yielding no results, but rather an investigation aimed from its inception at destruction rather than illumination.

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Ms. Hetherton has told us that the HUD OIG began its investigation in July of 1996, at the request of the U.S. Attorney's Office. The HUD OIG was to investigate the allegations contained in Mr. Ervin's *qui tam* suit, filed in June of 1996. That suit was filed and remains under seal, and Hamilton has not been made aware of any of the allegations contained in that lawsuit. Therefore, for her to tell us that Hamilton is being investigated for the allegations raised in the *qui tam* is to tell us nothing at all. Yet Mr. Van Horn and Ms. Hetherton have obviously seen those allegations, as they were the premise for Mr. Van Horn's *in camera* submissions to the Court. By now, as a result of the past two and a half years of production of documents, Mr. Van Horn has had access to virtually all of Hamilton's documents. How is that neither Mr. Van Horn nor the OIG can tell us the specifics? It is fundamentally unfair that Hamilton has been subjected to numerous leaks to the press, conjectures and statements about potential civil and criminal wrongdoing for three years without being able to respond to these secret allegations.

The HUD OIG also asserts that Hamilton is being investigated as a result of the allegations in Mr. Ervin's *Bivens* action, but that too tells us absolutely nothing. Our question has always been rather pointed and direct: Precisely what is it that Hamilton or any of its employees did wrong? The *Bivens* action sheds no meaningful light on that. First, Hamilton is not even a defendant. Second, while Hamilton is mentioned in the complaint, the best that can be gleaned from those references is that those defendants who are alleged to have done something wrong used Hamilton to do so. What are the accusations that Hamilton did wrong?

The *Bivens* action, 253 pages long, with 851 numbered paragraphs, was filed against Helen Dunlap, former Assistant Secretary of HUD; Henry Cisneros, former Secretary of HUD; Philip Lader, former Administrator of the Small Business Administration; HUD itself; the Small Business Administration; and the United States. The complaint describes itself in ¶ 12, which states:

reduced to its essence, this complaint is about power, money and Dunlap's close relationships with HUD's contractors and subcontractors. The thrust of this Complaint is that Dunlap has usurped control and exercised unlawful influence over HUD's contract procurement process to confer huge procurements on her favored handpicked contractors and personal friends and companions, and to prevent Ervin from winning new contracts or have its existing contracts renewed or extended. Her efforts, and those of individuals at HUD under her control, are orchestrated to bypass the normal procurement processes which are intended to prevent the very abuses to which Dunlap has subjected and is subjecting Ervin and others.

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Much of the complaint deals with Ervin's allegations that Ms. Dunlap abused her power to discriminate against him and other white males, specifically alleging that Ms. Dunlap had turned HUD into "white boy's hell", yet ironically alleging at the same time that the beneficiaries of Ms. Dunlap's actions were prominent Wall Street big money firms - firms predominantly populated, directed and run by white men. Hamilton is not directly accused of any wrongdoing, but is mentioned in the complaint as a woman-owned company which did obtain HUD contracts, and whose contracts were extended. Hamilton did act as HUD's financial advisor for HUD's loan sales, and Ervin does assert that the optimization model employed by Hamilton used in selecting the successful bidders was "intentionally complex", giving "advantages" to only the biggest bidders, a curious allegation given that the complaint also acknowledges that in the first loan sale, small investors were in fact successful. But these flimsy assertions can and should have been readily and quickly investigated, and are hardly justification for the OIG's oppressive actions.

There are additional factors which demonstrate that the OIG's assertion that the investigation is based on the *qui tam* and *Bivens* complaints simply makes no sense. For example, the *Bivens* matter makes complaints about Williams Adley (another HUD contractor) and suggests improper conduct relating to the contracts between Williams Adley and HUD and Williams Adley and Hamilton. Yet, in an audit report issued by the OIG more than three months after the *Bivens* action was filed, and a month after the OIG issued its first subpoenae to Hamilton, some Williams Adley contracts were noted as having been audited. It is inconceivable to us that if the OIG was truly concerned about the *Ervin* allegations, it would not have looked further at Williams Adley than it did in that audit. And, despite sharing information with Ervin at various times during the course of his three-year pursuit of the *Bivens* case, no evidence has surfaced in any way implicating Hamilton in wrongdoing. Thus, the justification that the investigation was spurred by the *Bivens* action rings hollow.

We also know that John Ervin made about \$7 million a year servicing mortgages for HUD, and he has admitted that he loses out if those loans are sold to private-sector companies. Prior to the commencement of the loan sales, Ervin was a consistent beneficiary of HUD contracts. Between 1989 and 1994, he won more than \$25 million in HUD contracts. His firm, Ervin & Associates, grew from a staff of five to more than 40 people, although the head count has fallen back significantly since the loan sales began. Yet, this is the man on whose word this investigation has begun, and on whose allegation the investigation is based? While Mr. Ervin has ugly motives for destroying Hamilton, and may be acting in collusion with the OIG, we believe that the OIG has its own motives for destroying Hamilton.

The question arises then, is the OIG conducting this investigation in an attempt to collect information and evidence relating to the allegations made in the *qui*

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tam action? If that is the case, we believe that is patently illegal, and we are entitled at this point to know exactly who authorized this investigation, and under what authority. In addition, we ask why is it taking so long and why is the government allowing it to take so long?

It impossible to believe, based on the meager statements in a complaint directed entirely at other parties, that justification exists for a two and a half year investigation, which has cost Hamilton millions of dollars in actual costs and tens of millions of dollars in lost shareholders' equity and opportunity costs. Hundreds of thousands of documents have been produced, many witnesses have been questioned by the OIG and the FBI, yet no conclusions or recommendations, or even basic information, has been turned over to the U.S. Attorneys' Office. While initially we didn't understand why the OIG so singularly pursued Hamilton with such a vengeance, we now believe that we do.

We have serious reason to suspect that the HUD IG, Susan Gaffney, is directing a personal vendetta, the goal of which is to destroy Hamilton and the reputations and economic well being of its former employees. The best evidence of this is her handling of an OIG audit which we reference as the "Denver audit". In the regular course of conducting the loan sales, an OIG audit of the sales was to be conducted. Because of the close association of the Washington OIG office with the loan sales, the Denver field office was asked to do the audit, to avoid the potential of a "friendly" audit being conducted. We believe, however, that Susan Gaffney was personally responsible for having the Denver audit buried, precisely because the audit was very favorable to Hamilton, a conclusion that Susan Gaffney did not want to hear. We have reason to believe that Ms. Hetheron, and the investigators assigned to work with her on this particular matter, closely monitored the development of the Denver audit, even though the whole purpose of having the audit done out of the Denver office was to avoid coloration by the D.C. office. We have reason to believe that, at the personal direction of Susan Gaffney, the Denver audit was shut down for purely political purposes, over the objection of the team conducting the audit, and has been suppressed even though Ms. Gaffney personally promised Catherine Austin Fitts (Hamilton's President and CEO) that the Denver audit would not be withheld, because to do so "would be unethical".

We also think we know why Ms. Gaffney has followed this contemptible course. Hamilton and its successor, with the information and knowledge they developed, stand in the way of both Ervin and the OIG in their quest for money. Hamilton was instrumental in the development, management and oversight of the HUD loan sale programs, which involved over \$9 billion worth of sales at a known savings of over \$2 billion to the U.S. taxpayers, and Ms. Fitts was the driving force behind the disclosure and performance-based policies that favored taxpayers and communities, but were

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offensive to traditional "players" working for HUD. Thus what was at stake here, to both Ervin and the OIG, was to make sure that no more loan sales take place. Ervin managed HUD properties, that's where he made most of his money. If HUD sells off its properties, there's nothing for Ervin to manage and he doesn't make any money. With the advent of these lawsuits and the OIG's investigation, the HUD loan sale process essentially came to a halt. As funds were transferred away from loan sales, almost identical corresponding funds were provided to the OIG to expand its power and to beef-up its enforcement proceedings. Obviously, if HUD has no properties, then the HUD OIG has no authority for its enforcement efforts at what are now privately-held properties. The OIG needs the government to maintain control over the housing to enable it to obtain bigger budgets and more power.

In our view, this explains why the OIG would so viciously pursue Hamilton. We respectfully request that you immediately investigate these concerns. We ask that you consider the following matters as well.

The OIG has had, for years now, hundreds of thousands of pages of documents relating to the loan sales, produced by Hamilton, HUD, and other parties. Well over a year ago, the OIG interviewed several people who were involved with or had knowledge of Hamilton's work with HUD. Throughout the course of Hamilton's document production, the OIG had the benefit of meeting with former Hamilton employees, who described exactly the nature of Hamilton's document keeping and what was being produced to the government. The OIG has had the benefit of both the document production and deposition discovery taken by Ervin's lawyers in the *Bivens* case. The OIG has had access to Hamilton's financial records, and has subpoenaed Ms. Fitts' personal bank accounts, even those which did not come into existence until long after Hamilton's work with HUD had been terminated. The OIG has even harassed elderly members of Ms. Fitts' family, causing agents to show up at their doors with subpoenae for records of a family-owned farmhouse that does not even have complete indoor plumbing.

We would like to know just what governmental purpose was served by these actions, or for that matter any of this unending and seemingly unfocused investigation? What benefits are being provided to the taxpayers for an investigation that is no closer to reaching any conclusions than it was nearly three years ago when the investigation began, and which has taken nearly three times as long as it took to investigate, litigate (through several trips to the Court of Appeals and Supreme Court), impeach and try the President of the United States? I suggest to you that the OIG has reached no conclusions for two reasons: first, because there's only one that can be reached, but one that is very embarrassing to the OIG, *i.e.*, nothing wrong or illegal took place, certainly as regards to Hamilton or any of its employees. Second, there

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was never any intent to reach any useful conclusions, but only to destroy Hamilton for purely self-serving reasons.

We are also mindful of the fact that the OIG is investigating the optimization issue relating to certain loan sales in which Hamilton served as an advisor to HUD. We understand that the OIG has reviewed documents from Lucent Technologies, the creator of the optimization program, and has spoken with employees of Lucent Technologies. If the OIG has taken the time to understand and master the optimization issue, and has looked at the information relating to its use in the loan sales, the OIG must now know that there was no wrongdoing or illegality involved on the part of Hamilton or any of its employees. The entire optimization issue was brought to the attention of HUD **by Hamilton!** It is astounding that by bringing forth an issue that would never have been discovered except by its own due diligence, and which at most indicates a potential error that at most could have resulted in an economic correction representing a tiny fraction of the overall value of the loan sales, Hamilton has been driven out of business and its former employees have been denied access to the marketplace, at great cost. All this because the OIG cannot competently and honestly conclude what should have been a rather straightforward investigation. This is highlighted by the fact that Ms. Gaffney refuses to provide Hamilton access to the Denver audit, which she knows speaks favorably of Hamilton's actions regarding the loan sales. The OIG's behavior is nothing short of outrageous, and we believe this is but further proof of the true intent of its "investigation".

Ironically, the loan sales themselves were initiated in response to an OIG audit report which claimed that HUD's holding of the mortgages at issue was a "material weakness in its operations". It was this report that provided the basis for the OIG's headquarters' close involvement in all aspects of the loan sales as they were taking place, and that close involvement was the reason why the audit function was shipped to Denver. As part of the audit, members of the Denver OIG audit team actually sat in on one sale, and concluded that there was no way that bid rigging could have taken place, and that in a sealed bid auction (as were the loan sales), you can't favor any one bidder, particularly with the use of the optimization model and where there is open access to all loan information to all interested and qualified bidders. Surely the government should have been able to confirm these findings by now, yet the investigation continues. Hamilton is entitled to know why.

We are also very concerned about the tie-in between the withholding of Hamilton's nearly \$2 million plus fees owed by HUD, and the investigation. Hamilton was assured some time ago that the \$1.5 million withheld from it was not tied to the investigation. We don't believe that. For one thing, the justification advanced by HUD for withholding Hamilton's money is that it is a set-off for a purported \$3.8 mil-

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lion loss resulting from the optimization issue, the same optimization issue which is the subject of the investigation.

In yet another irony, in their answers to Ervin's requests for admissions filed in the *Bivens* action, the HUD defendants deny those of Ervin's assertions that attempt to involve Hamilton in any wrongdoing. Indeed, the government appears to be taking positions in that case that contradict the positions it is taking regarding the investigation of Hamilton.

In addition, the timing of the OIG's third subpoena (issued in October of 1997), which specifically sought information relating to the loan sales and the optimization issue, is extraordinarily suspicious, as it was served only one week after HUD determined to terminate Hamilton's contracts, refused to pay the monies owed to Hamilton, and made a claim for \$3.8 million against Hamilton. Our suspicion is heightened by the fact that Hamilton had reported the optimization issue to HUD nearly **one year** previously, in December of 1996, and by the fact that the existence of the subpoena had to have been leaked to the press, since it was reported in the newspaper before it was served on Hamilton.

This ties-in with our concern about the length of time it is taking for the government to take any action on the *qui tam* case. By statute, once a *qui tam* has been filed by a private party, the government has 60 days within which to either accept the case for handling by the government or allow the private party to proceed on its own. The fact that the government has continued to roll over the 60-day decision-making period for nearly three years now, gives rise to our suspicion that the OIG is either working closely with Ervin's lawyers in the development of information through the *Bivens* case, or that the government, lacking any supporting evidence on which to base the handling of the *qui tam* action, is unjustly prolonging its decision-making process in the hopes that, finally, something will develop as a result of the Ervin/OIG investigation. Who is guiding the decision to continually roll over the *qui tam*? Surely after nearly three years the government knows something.

To date, the OIG's investigation has achieved the following dismal results:

- Many of the experienced and highly-dedicated professionals in the Office of Housing/FHA have left HUD in frustration, and several have been forced to retain legal counsel personally to fend off unjustified charges of contracting abuse, mismanagement and other illegal activities.
- HUD's loan sales program, which had saved the U.S. taxpayers in excess of \$2.1 billion in credit subsidy savings, has been sus-

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pended indefinitely, leaving a large inventory of loans secured by rent subsidized properties to be worked out by state housing finance authorities, depriving the taxpayers of hundreds of millions of dollars more in credit subsidy savings.

- The financial advisors in the Office of Housing that had a grasp of the complex FHA portfolio problems and how they could be resolved consistent with HUD's mission to serve communities, residents and taxpayers have had their contracts with HUD terminated. One of them, Hamilton Securities, once a thriving, cutting-edge business employing 40 extremely talented professionals, has essentially been put out of business, as a result of a two and a half year campaign of leaks of false information to the press and Congressional staff, the wrongful withholding of nearly \$2 million of funds from Hamilton, and the nearly \$2 million expended by Hamilton to respond to the unfocused and repetitive demands of the OIG in pursuing its subpoenae, all of which have destroyed the full value of shareholders' equity. As a result, Hamilton has lost tens of millions of dollars of shareholders' equity and opportunity costs in lost business revenue.
- As a result of the OIG's unjustified destruction of Hamilton and the false allegations made against it, Hamilton's former employees have been deprived access to the marketplace for many of the ideas and concepts they had developed while at Hamilton, at a loss of millions and millions of dollars, and personal financial security for their families.
- Legislative support for introducing competition into management servicing and ownership of HUD supported properties and FHA insured loans has been thwarted, and the unworkable "demonstration program", which favors the owners and managers of assisted-housing projects and state HFAs, has been extended.

This is hardly an enviable achievement, although I'm sure the OIG takes solace in the fact that its own budget, through enforcement roundups in public housing developments and asset forfeitures to be used as cash acquisitions for the OIG, has been increased. Surely this is not a result that those who believe in honest government would be proud of, and it cannot be said that the millions of dollars spent on this investigation by the government have been worthwhile.

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The government's actions have been so inappropriate that, as I noted earlier, we have even considered whether or not Hamilton is the true target of any investigation, for surely within nearly three years' time someone of competence and integrity, with the taxpayers best interests in mind, heading such an investigation would have reached some type of conclusion. Certainly, the fact that Mr. Van Horn insists on hiding behind "*in camera*" justifications demonstrates this possibility, as well as indicates that the government has no case, no evidence, and no justification for its continued actions. Good investigators and prosecutors who know they have a case do not fear sharing that with targets. We can only conclude that any allegations Mr. Van Horn has contrived to the Court are without merit, at least as far as Hamilton is concerned. If there is another target, there's no justification for the continued harassment of Hamilton. It is neither moral nor legal to destroy Hamilton just to get to another party.

Finally, what consideration has been given, and by whom, of the effects that the government's action has had on Hamilton and its former employees? Surely at some point in this Orwellian nightmare someone has said that the fairness to the citizens involved must be considered, that the needless toll taken by this investigation must be ended, and even compensated. We are aware of the statutory provisions that allow for compensation from those responsible for the type of harm that has befallen Hamilton and its former employees, and we are now investigating the means to pursue those remedies.

Hamilton and its former employees, over whom the government has held the threat of both civil and criminal prosecution for nearly three years, are entitled to know the status of this investigation. They are entitled to know why the government won't release information favorable to them, and they are entitled to know who is responsible for prolonging their difficulties and causing them such great financial loss.

Again, we ask that you initiate an immediate inquiry into this most serious matter. We stand ready to render whatever assistance is needed and will gladly answer any questions you may have.

Very truly yours,



Michael J. McManus

MJM/gw

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cc: Mr. Thomas J. Pickard
Assistant Director
Federal Bureau of Investigation

Ms. Sylvia Matthews
Acting Deputy Director for Management
Office of Management & Budget

The Honorable June Gibbs Brown
Inspector General - PCIE
Department of Health & Human Services

The Honorable Robert H. Hast
Acting Assistant Comptroller General
General Accounting Office

The Honorable Dan Burton
Chairman, Government Reform Committee
United States Congress