IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

SUSAN GAFFNEY, in her official capacity as Inspector General, U.S. Department of Housing and Urban Development Petitioner, v. THE HAMILTON SECURITIES GROUP, INC., and HAMILTON SECURITIES ADVISORY SERVICES, INC., Respondents.	:	Misc. No. 98-92 (SS) Filed UNDER SEAL

PETITIONER'S RESPONSE IN OPPOSITION TO MOVANTS', THE HAMILTON SECURITIES GROUP, INC., AND HAMILTON SECURITIES ADVISORY SERVICES, INC., MOTION FOR LEAVE TO CONDUCT DISCOVERY

Petitioner, Susan Gaffney, in her official capacity as Inspector General, United States Department of Housing and Urban Development ("HUD"), by her undersigned counsel, hereby submits this response in opposition to Movants', The Hamilton Securities Group, Inc., and Hamilton Securities Advisory Services, Inc. (collectively "Hamilton"), Motion for Leave to Conduct Discovery.

Hamilton requests leave to conduct discovery "regarding communications between Ervin and [the Office of Inspector General ("OIG")], as well as the circumstances surrounding the issuance of overbroad and repetitious subpoenae." In support of its motion, Hamilton alleges that there is "the appearance of bad faith" surrounding the OIG's investigation of irregularities in HUD's mortgage sales program. Hamilton's motion is nothing more

than a vehicle for Hamilton to repeat unsupported accusations and allegations that it has made throughout these proceedings, and should be denied because discovery is not necessary to assist this Court to decide the merits of the case, and because the OIG has not acted in bad faith. Moreover, given the posture of this proceeding--the relevant issues have been briefed by the parties, and the case is ripe for decision--the Petitioner does not believe that discovery can possibly serve a benefit.

Background

The pertinent background is fully set forth in the OIG's pleadings filed herein, and the Declaration of Jack Rogers ("Declaration"), attached as Exhibit A. The following is a summary of the background.

On June 5, 1996, Ervin and Associates ("Ervin") filed a 253-page Bivens Complaint against the United States, HUD, the Secretary of HUD, the Small Business Administration ("SBA"), the SBA Administrator, and Helen Dunlap, the former Deputy Assistant Secretary for Operations within HUD's Office of Housing-Federal Housing in U.S. District Court for the District of Columbia. Declaration at ¶ 3. Ms. Dunlap was sued in her individual capacity. Id. Ervin alleged corruption and favoritism in the procurement of services associated with HUD's sale of defaulted mortgage notes. Id. Ervin also alleged that HUD, through Ms. Dunlap and its financial advisor, Hamilton, used Hamilton's control over the note sales process to embark on a complex scheme

to deliver huge blocks of discounted multifamily and single family HUD-owned notes to prominent Wall Street firms. Id.

On June 6, 1996, a qui tam complaint pursuant to 31 U.S.C. §§ 3729 et seq. was filed under seal in United States District Court for the District of Columbia, Civil Action No. 1:96-CV-1258 ("qui tam action"). Declaration at ¶ 4. The Hamilton Securities Group, Inc., and Hamilton Securities Advisory Services, Inc., were among the named defendants in the qui tam action.[1] In early July 1996, the Civil Division of the United States Attorney's Office contacted the HUD OIG, advised OIG of the existence of the qui tam action, and requested the OIG's assistance in investigating the allegations in the qui tam action. Declaration at ¶ 5. Thereafter, the OIG commenced an investigation of the allegations contained in both the Bivens Complaint and the qui tam action. Id.

Over the course of the last 26 months, the OIG, in coordination with the United States Attorney's Office and other law enforcement agencies, has conducted an extensive investigation in an effort to explore methodically the many, complex allegations in both the Bivens Complaint and the qui tam action, as well as many related allegations that have arisen in the course of the investigation. Declaration at ¶ 6. To further the investigation, the OIG issued administrative subpoenas duces

[1] While Hamilton has been advised of the fact that it is a defendant in the qui tam complaint, it has not been advised of the particulars of the action, which remains sealed.

tecum to Hamilton.[2] Declaration at ¶ 7.

OIG is also seeking evidence through other subpoenas issued to secondary sources. Among the secondary sources to which the OIG issued subpoenas are financial institutions with which Hamilton conducted business. Based upon information developed in the course of the investigation, OIG has also forwarded a subpoena to Morgan Guaranty Trust Company of New York for records of account number 001-36-184, and on the same date, the OIG, via CERTIFIED MAIL—RETURN RECEIPT REQUESTED addressed to the account holder, C. Austin Fitts, 1735 Fraser Court, N.W., Washington, DC 20009, also mailed a Customer Notice letter, a copy of the subpoena duces tecum, a Privacy Act of 1974 notice, a Customer's Sworn Statement form, a Customer's Motion to Challenge the Government's Access to Financial Records form, and instructions for completing the latter two forms. Declaration at ¶ 8. On or about September 4, 1998, the CERTIFIED MAIL—RETURN RECEIPT REQUESTED envelope and its contents mailed to Ms. Fitts at 1735 Fraser Court, N.W., Washington, DC 20009, were returned to the OIG. Declaration at ¶ 10. Markings on the envelope appear to indicate that it was forwarded to P.O. Box 57326, Washington, DC 20037 on July 28, 1998, that the box holder was given a second notice of its receipt on August 13, 1998, and that it went unclaimed by the box holder. Id. On September 9, 1998, the

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[2] OIG issued one copy each of three virtually identical subpoenas to The Hamilton Securities Group, Inc., and Hamilton Securities

contents of the returned envelope were copied and placed into a new envelope. This new envelope was hand-addressed to C. Austin Fitts, 1735 Fraser Court, N.W., Washington, DC 20009, and was mailed via United States first class mail. Declaration at ¶ 11.

Discussion

The Court of Appeals for the District of Columbia Circuit has advised that discovery may be permissible in subpoena enforcement proceedings "when 'the circumstances indicate that further information is necessary for the courts to discharge their duty.'" SEC v. Lavin, 111 F.3d 921, 926 (D.C. Cir. 1997) (quoting SEC v. Dresser Indus., Inc., 628 F.2d 1368, 1388 (D.C. Cir. 1980) (en banc)). However, the Court of Appeals has emphasized that discovery is an extraordinary measure, as follows:

> A court may inquire into [allegations of bad faith] if the recipient of a subpoena makes "an adequate showing that the agency is acting in bad faith or for an improper purpose, such as harassment." United States v. Aero Mayflower Transit Co., 831 F.2d 1142, 1145 (D.C. Cir. 1987). We have observed, however, that "[s]uch procedures are inappropriate in summary [subpoena] enforcement proceedings except in extraordinary circumstances." FTC v. Invention Submission Corp., 965 F.2 1086, 1091 (D.C. Cir. 1992) (internal quotation marks omitted). Indeed, in addressing a subpoena recipient's analogous request for discovery into the good faith of an agency's investigation, we have warned that "district courts must be cautious in granting such discovery rights, lest they transform subpoena enforcement proceedings into exhaustive inquisitions into the practices of the regulatory agencies." [Dresser Indus., Inc., 628 F.2d at 1388].

Advisory Services, Inc.

RTC v. Frates, 61 F.3d 962, 965 (D.C. Cir. 1995).

Here, discovery is not necessary for this Court to discharge its duty--to decide the merits of the OIG's petition for summary enforcement. The parties herein have briefed the merits, and the case is now ripe for a decision. Indeed, Hamilton filed its opposition to the OIG's petition for summary enforcement more than five months ago on April 10, 1998. In its opposition, Hamilton made most of the same unsupported allegations of "bad faith" that it makes in its Motion for Leave to Conduct Discovery, but Hamilton did not seek discovery in April. If Hamilton sincerely believed that discovery was necessary for this Court to decide the merits in this matter, then Hamilton would have sought discovery more than five months ago.

With respect to alleged incidents of bad faith, Hamilton recites that: 1) the OIG has issued "overbroad and duplicative subpoenae"; 2) the OIG has insisted that "Hamilton engage in the expense of reviewing all of its backup tapes"; 3) Hamilton believes that the OIG has not demonstrated to it a sufficient understanding of their business; 4) the OIG has denied their request for a copy of a draft of an audit report concerning HUD's mortgage sales program; and 5) Hamilton's principal received a customer notice associated with a subpoena that the OIG issued to Morgan Guaranty Trust Company of New York almost two months after the issuance of the subpoena. Each of these issues has been raised by Hamilton or its principal, Ms. Fitts, in this

proceeding or a related proceeding, and the OIG has addressed the same.

1. Subpoenas Issued by the OIG

With respect to what Hamilton characterizes as "overbroad and duplicative subpoenae," the OIG has issued three subpoenas to Hamilton. Those subpoenas are the subject of this proceeding, they are not overbroad or duplicative, and they have been thoroughly briefed.

Regarding subpoenas that OIG may issue to Hamilton in the future, OIG subpoenas are not self-enforcing; rather the Inspector General Act provides that "in the case of contumacy or refusal to obey, [the subpoena] shall be enforceable by order of any appropriate United States district court." 5 U.S.C. App. 3 § 6(a)(4). Thus, Hamilton, as it has previously done, can merely refuse to comply with any OIG subpoena issued to them, and force the OIG to file a petition for enforcement, such as the instant proceeding, when they believe that a subpoena issued to them is unauthorized or unreasonable.

With respect to subpoenas issued to third parties, Hamilton lacks standing to assert the rights of such third parties.[3] See

[3] The OIG does feel compelled to address Movant's complaints about the subpoenas issued to, or for the records of, two third parties: 1) Hamilton's principal, Ms. Fitts; and 2) Robin D. Willits, "Ms. Fitts' elderly uncle." Ms. Fitts, pursuant to the Right to Financial Privacy Act ("RFPA"), has filed two challenges against subpoenas issued to financial institutions for her personal bank records. See Fitts v. United States Department of Housing and Urban Development, Misc. No. 98-262 (SS); Fitts v. United States Department of Housing and Urban Development, Misc.

Craig v. Boren, 429 U.S. 190, 193 (1976); see also U.S. v. Theron, 116 F.R.D. 58, 62-63 (D. Kas. 1987) (RFPA does not grant third parties standing to move to quash release of bank records of other bank customers.

2. Review of the Backup Tapes

The backup tapes have been a point of controversy for almost two years, and the origin and scope of the controversy has been thoroughly briefed in the OIG's Memorandum of Points and Authorities in Support of Petition for Summary Enforcement of Subpoenas Issued Pursuant to 5 U.S.C. App. 3 § 6(a)(4). Moreover, at page three of their September 8, 1998 Third Report of Co-Special Masters Irving M. Pollack and Laurence Storch (attached as Exhibit B), the Co-Special Masters stated:

> Concerning information stored in electronic media, Hamilton has asserted that separating responsive and non-privileged data from electronic data would be burdensome, costly, and take more than a year and would produce documents that have already been delivered to the government. Hamilton proposed that the government pay an independent third party to perform the review of the electronic data. The government rejected this suggestion. The Special Masters' position is that because respondents are required to comply with the subpoenas, it is their responsibility to designate privileged and non-responsive documents. Without such designations by respondents, the data should be made

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No. 98-347 (SS). Those subpoenas are appropriately challenged in those proceedings, not this one. Further, with respect to Mr. Willits, Hamilton spuriously alleged that the "OIG needlessly subpoenaed several years of tax records" from him. This allegation is false. The subpoena issued to Mr. Willits was intended to obtain records relating to three payments for which Ms. Fitts' financial records did not include supporting information, and the subpoena expressly referenced and was limited to such payments. (Declaration at p.3 n.1 and Exhibit 1).

available to the government in its entirety.

Thus, what Hamilton cites as a bad faith action by the OIG was also recently recommended to the Court by the Co-Special Masters.

3. The OIG's Understanding of Hamilton's Business

Next, Hamilton argues that the OIG does not understand their business, stating "[d]espite having received tens of thousands of pages of documents, when officials from OIG interviewed a Hamilton [sic] at the beginning of this year, it became apparent that OIG had not taken even preliminary steps to learn about the FHA loan sales programs and Hamilton's integral role in it." Hamilton does not provide any additional details concerning this allegation, and there are no affidavits or evidence referenced in support of it, and, thus, the OIG is at somewhat of a disadvantage to respond to it. However, Hamilton did once complain that the OIG must not understand HUD's note sales program and Hamilton's business because OIG representatives had asked the same or similar questions to more than one Hamilton employee. Interviewing a witness does not signify a lack of understanding. Indeed, as Hamilton's able counsel is well aware, one has to have at least a rudimentary understanding of a matter in order to ask questions about it. Moreover, it is a well-worn investigative technique to ask two witnesses the same questions in order to guard against, identify, and follow up on discrepancies.

4. The Mortgage Sales Audit

Hamilton also alleges that the OIG "cloak[ed] . . . in claims of privilege" a draft audit report prepared by the OIG's Rocky Mountain District Office of Audit because it was favorable to Hamilton. The subject of the draft audit was not Hamilton, but rather HUD's mortgage sales program. More importantly, the audit has been integrated into the OIG's investigation and was only partially complete at the time of its integration, and the OIG properly withheld a draft report of the partially completed audit under the Freedom of Information Act ("FOIA"), 5 U.S.C. § 552.

On July 13, 1998, Hamilton's counsel, Michael J. McManus, pursuant to the FOIA, submitted a request for "a copy of the Denver audit of Hamilton." (July 13, 1998 letter to Judith Hetherton, Counsel to the Inspector General, from Michael J. McManus, is attached as Exhibit C). On July 20, 1998, the OIG responded to Mr. McManus's FOIA request, advising him that the OIG "does not possess or control 'a copy of the Denver audit of Hamilton,'" but that the OIG would construe his FOIA request to be a request for a copy of the draft audit report of the HUD's loan sales program. The OIG further advised that it was withholding the partial draft audit report under 5 U.S.C. §§ 552(b)(5) and (b)(7)(A), which protect intra-agency communications subject to the deliberative process privilege,

records subject to the law enforcement investigative files privilege, and records or information compiled for law enforcement purposes, which if released could reasonably be expected to interfere with a pending or prospective law enforcement proceeding. (July 20, 1998 letter to Michael J. McManus from Darlene Hall, Freedom of Information Act Officer, is attached as Exhibit D).

On August 20, 1998, Mr. McManus administratively appealed the July 20, 1998 initial FOIA response, and the Inspector General denied his administrative appeal because: 1) his appeal was not timely; 2) he failed to challenge the OIG's withholding of the partial draft audit report pursuant to the law enforcement investigative files privilege under 5 U.S.C. § 552(b)(5); and 3) he made inadequately supported, unpersuasive challenges to the OIG's assertion of the deliberative process privilege under 5 U.S.C. § 552(b)(5) and the OIG's assertion of FOIA exemption, 5 U.S.C. § 552(b)(5). (September 15, 1998 letter to Michael J. McManus from Susan Gaffney, Inspector General, is attached as Exhibit E). The response to Mr. McManus' administrative appeal also advised him that judicial review of the OIG's response to his FOIA request was available in the United States District Court for the District of Columbia. That is the appropriate proceeding in which Mr. McManus can challenge the denial of his FOIA request, not this one.

5. The Delay in Receipt of the Customer Notice

Hamilton next alleges that the OIG failed to mail a customer notice to Hamilton's principal, Ms. Fitts, in compliance with the RFPA, until nearly two months after the OIG issued a subpoena to Morgan Guaranty Trust Company of New York for financial records relating to account number 001-36-184. Hamilton's allegation is false.

In relevant part, section 1105(2) of the RFPA states:

> A Government authority may obtain financial records . . . pursuant to an administrative subpoena . . . if–
>
> (2) a copy of the subpena . . . has been served upon the customer or mailed to his last known address on or before the date on which the subpena . . . was served on the financial institution . . . .

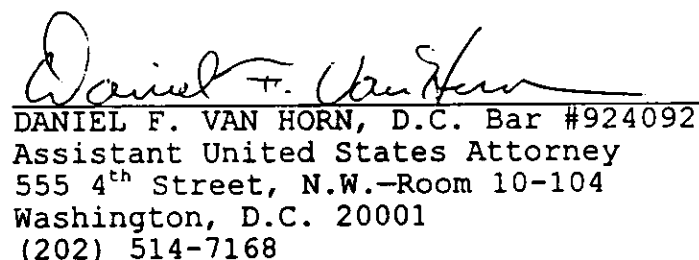
12 U.S.C. § 3405(2) (emphasis added). On July 15, 1998, the same day that the OIG forwarded its subpoena to the Morgan Guaranty Trust Company of New York for financial records relating to account number 001-36-184, the OIG also mailed the subpoena and associated documents to Ms. Fitts' last known address, 1735 Fraser Court, N.W., Washington, DC 20009, via CERTIFIED MAIL–RETURN RECEIPT REQUESTED. Declaration at ¶ 8. Later, on or about September 4, 1998, the customer notice that the OIG mailed to Ms. Fitts on July 15, 1998, was returned to the OIG. Declaration at ¶ 10. The returned CERTIFIED MAIL–RETURN RECEIPT REQUESTED envelope contained markings appearing to indicate that

it was forwarded to P.O. Box 57326, Washington, DC 20037.[4] Id. The envelope also appears to indicate that Ms. Fitts was twice advised that the envelope, which bears a pre-printed OIG return address, had been received, and, thus, should be picked up by her. Id. In any event, the OIG has not yet retrieved the records in question from the financial institution, and the subpoena in question is appropriately challenged, if at all, in Ms. Fitts' RFPA proceeding, not this one. Declaration at ¶ 12.

Conclusion

WHEREFORE, for the foregoing reasons, the Petitioner respectfully requests that this Court deny Hamilton's Motion for Leave to Conduct Discovery.

Respectfully submitted,



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[4] OIG now understands that P.O. Box 57326, Washington, DC 20037, is Ms. Fitts' new address.

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing Response in Opposition to Movant's, The Hamilton Securities Group, INC., and Hamilton Securities Advisory Services, INC., Motion for Leave to Conduct Discovery, was served on September 24, 1998, a copy thereof to Hamilton's counsel at the following address:

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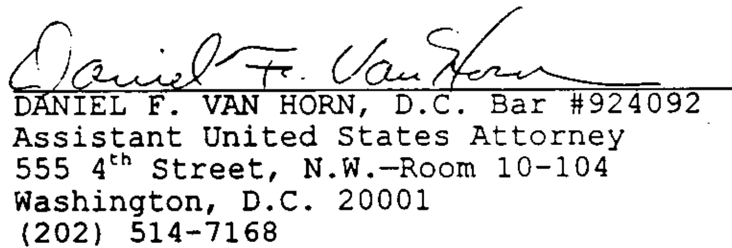

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