IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

UNITED STATES OF AMERICA :
and OFFICE OF FEDERAL
HOUSING ENTERPRISE OVERSIGHT :

v. : Civil Action No. DKC 2003-3440

:

VAUGHN CLARKE

:

MEMORANDUM OPINION

Petitioners, United States of America and Office of Federal Housing Enterprise Oversight (OFHEO), seek an order compelling Respondent Vaughn Clarke to comply with a subpoena to provide testimony and produce documents relating to a purported "special examination" being conducted by OFHEO into the safety and soundness of the Federal Home Loan Mortgage Corporation (Freddie Mac). For the reasons that follow, the petition will be granted.

Background

Respondent was employed by Freddie Mac from August 1998 until June 9, 2003, as Executive Vice President and Chief Financial Officer. On December 3, 2003, Petitioners filed a Petition for Summary Enforcement of Administrative Subpoena Duces Tecum and a Motion for Order to Show Cause. Respondent filed an Opposition, Petitioners replied. Just before the scheduled hearing, Respondent filed a letter with attachments,

to which Petitioners again replied. A show cause hearing was held on January 23, 2004.[1]

Two declarations have been submitted from David Roderer, Deputy General Counsel of OFHEO. In the first, he states that OFHEO is conducting an examination into conduct of Freddie Mac. The examination arose out of the announced delay in publication of Freddie Mac's financial statement for 2002, and the restatements for 2000 and 2001. He avers that: "The uncertainty that surrounds Freddie Mac's ability to produce timely and accurate financial statements threatens investor confidence and could, unless promptly and decisively corrected, greatly increase Freddie Mac's cost of funds, impairing its safe and sound operation." Paper 1, Ex. 3 at ¶ 4. Furthermore, this uncertainty was said to interfere with OFHEO's own ability to monitor the safety and soundness of Freddie Mac. Roderer states that OFHEO's director ordered a "special examination" on June 7, 2003. *Id.* at ¶ 6.

[1] A related case is pending in the Eastern District of Virginia and, after the hearing in this case, Judge Brinkema issued an opinion and Petitioners supplied the court with a copy. Respondent submitted a letter discussing the opinion, which Petitioners have moved to strike. The court has considered the decision as well as Respondent's comments. Inasmuch as the court will enforce the subpoena, the motion to strike will be denied as moot.

In a letter dated June 7, 2003, to the Board of Directors of Freddie Mac, Armando Falcon, Jr., Director of OFHEO, informed the Board of OFHEO's special examination and requested Freddie Mac's cooperation. Falcon wrote of the initiation of the special examination:[2]

> OFHEO is deploying a special team to investigate all aspects of the issues surrounding the review of the re-audit that revealed deficiencies in accounting practices and controls and the matter of employee misconduct discovered on June 4, 2003.

Paper 4, Ex. C at 1.

On June 9, 2003, Director Falcon, Jr., released a statement announcing that he had "tasked a special investigative team to assume the review of accounting practices relevant to the restatement process at Freddie Mac and, in addition, management's progress in implementing the action plan that OFHEO has directed the Board to provide. The team will also undertake an investigation of employee misconduct." Paper 1, Ex. B. The news release nevertheless concluded that "Freddie Mac's business fundamentals, asset quality, capital positions and other safety and soundness measures remain strong." *Id.*

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[2] Respondent makes much of the failure to use the term "examination" in contemporaneous documents, using instead the term "investigation."

OFHEO has sought Respondent's appearance since July 18, 2003, when contact was first made with counsel seeking his appearance during the week of August 11. Counsel said that no examination could occur that week because of counsel's medical conflict, but the law firm would accept service of a subpoena for examination during the week of August 25. OFHEO issued a subpoena for testimony on August 26. On August 18, counsel stated that Respondent would not appear on August 26. OFHEO did not pursue enforcement at that time. Another effort was made for testimony during the week of September 15. Because of ongoing settlement discussions, Respondent, through counsel, said he would not appear. On October 7, OFHEO issued a subpoena for testimony on October 14. Respondent objected to the subpoena, and OFHEO again declined to pursue enforcement. Finally, on October 10, a subpoena was issued for October 28. On October 24, counsel submitted a petition to revoke the subpoena, and Respondent did not appear.

On December 9, 2003, a few days after instituting the current enforcement proceeding, OFHEO entered into a Stipulation and Consent to the Issuance of a Consent Order with Freddie Mac. Article IV of the Stipulation, entitled "Other Action," provides:

> The Enterprise agrees that the provisions of this Stipulation and Consent shall not

> inhibit, estop, bar, or otherwise prevent the Director from taking any other action affecting the Enterprise in connection with OFHEO's ongoing regulatory oversight of the Enterprise with respect to matters occurring subsequent to the date of the Order or with respect to matters relating to third parties not affiliated with the Enterprise (including separated senior officers of the Enterprise) if, at any time, the Director deems it appropriate to do so to fulfill the responsibilities placed upon him by the several laws of the United States of America.

Paper 8, Ex. 1.

On December 12, 2003, OFHEO issued a Report of the Special Examination of Freddie Mac, presenting its "conclusions and recommendations." Paper 7, Ex. 2 at 3. In his second declaration, Roderer explained that the OFHEO Report documented the agency's findings and conclusions "to date" and that the examination is continuing, particularly as it relates to the "role of various parties in causing the transactions, accounting misstatements and corporate governance failures that are detailed in the Report." Paper 7, Ex. 1 at ¶¶ 4-5.

Standard of Review

Under 12 U.S.C. § 4517 (b), the Director "may conduct an examination under this section whenever the Director determines that an examination is necessary to determine the condition of an enterprise for the purpose of ensuring its financial safety and soundness." OFHEO issued the subpoena pursuant to 12 U.S.C.

§ 4517 (f), which provides: "In connection with examinations under this section, the Director shall have the authority provided under section 4641 of this title." Section 4641, in turn, authorizes the Director "to issue subpoenas and subpoenas duces tecum." 12 U.S.C. § 4641.

Enforcement of an administrative subpoena is ordinarily a straightforward exercise, as "a district court's role in enforcing administrative subpoenas is 'sharply limited.'" *EEOC v. Lockheed Martin Corp., Aero & Naval Systems*, 116 F.3d 110, 113 (4th Cir. 1997) (quoting *EEOC v. City of Norfolk Police Dep't*, 45 F.3d 80, 82 (4th Cir. 1995) (internal quotations omitted)). To enforce an administrative subpoena, the administrative agency must show that:

"(1) it is authorized to make such investigation; (2) it has complied with statutory requirements of due process; and (3) the materials requested are relevant." *Lockheed Martin Corp.*, 116 F.3d at 113 (internal quotations omitted). Once the government has established its prima facie case, the burden shifts to the party challenging the subpoena to demonstrate "an abuse of process" by showing "bad faith" on the part of the administrative agency in its issuance of the subpoena. *United States v. Am. Target Adver., Inc.*, 257 F.3d 348, 354-55 (4th Cir. 2001) ("The burden of demonstrating an abuse of process is on

the party challenging the investigation") (citing *United States v. Powell*, 379 U.S. 48, 58 (1964)).

Analysis

Respondent contends that the subpoena is improper because (1) OFHEO has completed its "special examination;" (2) the "special examination" was, in any event, merely a pretext to gather evidence to use in the administrative enforcement proceeding against former Freddie Mac officers, including Respondent, and (3) now that OFHEO has filed a Notice of Charges against Respondent, the use of the subpoena in a separate examination would circumvent limitations on discovery. As will be discussed, while the record may raise some suspicions, none of the asserted defects in the subpoena or its timing is sufficient to undermine the authority of OFHEO to conduct the examination as it sees fit.

1. Completed or Ongoing Examination

Respondent points to several facts to underscore his argument that completion of the "special examination" renders the subpoena invalid, *inter alia*: the issuance of the OFHEO report, with its language of finality; the testimony of Director Falcon, Jr., to Congress attesting to the findings that Freddie Mac is "safe and sound;" and the consent decree with Freddie Mac that appears to foreclose any further regulatory action against

the Enterprise itself. Petitioners counter that the language in the report and testimony does not negate the fact that the examination is ongoing, and the consent decree explicitly states that inquiries are ongoing concerning third parties, including former officers such as Respondent. *See* Paper 8, Ex. 2 at ¶¶ 1-2. Inasmuch as OFHEO only reaches these potential third parties through the Enterprise, of necessity the safety and soundness examination of Freddie Mac is ongoing.

Given the summary nature of this enforcement proceeding, the government's burden of demonstrating, prima facie, the right to enforce the subpoena is "fairly slight." *Alphin v. United States*, 809 F.2d 236, 238 (4th Cir. 1987). In the taxpayer dispute in *Alphin*, the court held that:

> Once the government has made its prima facie case, the burden shifts to the party challenging the summons to show that enforcement would be an abuse of the court's process. The party challenging the summons bears the heavy burden of disproving the actual existence of a valid civil tax determination or collection purpose.

Id. at 238 (citing *United States v. LaSalle Nat'l Bank*, 437 U.S. 298, 316 (1978)).

The declarations submitted by OFHEO, while somewhat conclusory, are sufficient to show that an examination is being conducted pursuant to statutory authority and that the subpoena

is a legitimate part of that ongoing examination. *See Id.* ("The government may establish its prima facie case by an affidavit of an agent involved in the investigation averring the *Powell* good faith elements"). It undoubtedly is true that OFHEO has completed a large portion of the examination and has decided on some of the actions to take as a result. Nevertheless, it is not Respondent's place to determine when the examination is "complete." *See Am. Target Adver., Inc.*, 257 F.3d at 354 (issuance of subpoena proper "[s]o long as the agency's assertion of authority is not obviously apocryphal" (internal quotation omitted)). Petitioners therefore have satisfied the prima facie case for issuance of the subpoena.

2. Pretext

In an alternative argument, and to rebut Petitioners' prima face case, Respondent contends that OFHEO was never, in fact, conducting a safety and soundness examination, for which the subpoena power exists, but rather always has been conducting a special investigation into accounting practices and employee misconduct. Again, Respondent relies on the terminology used by Director Falcon, Jr., in letters and public statements, in contrast to the declarations filed in this proceeding.[3] Second,

[3] One such letter, dated June 4, 2003, was submitted at the (continued...)

Respondent points to the timing of events and the institution of the special investigation long after the restatement, after letters were written attesting to findings of safety and soundness, and only after the three Freddie Mac executives were forced out.[4] Further, Respondent contends that the hiring of an outside private law firm to conduct the examination takes the project out of the examination category.[5] Finally, the subjects listed on the document portion of the subpoena are the same as those identified in the Notice of Charges.

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[3](...continued)
hearing and is subject to a motion to seal. Although the motion was only filed February 2, the issue was mentioned at the hearing open to the public, and the court has not received any objection. Accordingly, the motion to seal, which is based on a confidentiality agreement that admits of no alternative to sealing, will be granted.

[4] As noted, *supra*, OFHEO has sought Respondent's appearance and testimony since as early as July 18, 2003. It is a dubious tactic for Respondent, who himself created the delays preventing his appearance, now to argue that the OFHEO's continued pursuit of the subpoena is pretextual.

[5] Respondent argues in its opposition brief and at the show cause hearing that OFHEO's retention of a private law firm to conduct the "special examination" is evidence of pretext. In particular, Respondent erroneously contends that "OFHEO's ability to retain outsiders to conduct examinations is limited by statute." Paper 4 at 9. To the contrary, the unambiguous language of that statute, 12 U.S.C. § 4517(c), indicates that the matter is purely discretionary: "The Director *may* contract with the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, or the Director of the office of Thrift Supervision for the services of examiners" (emphasis added). 12 U.S.C. § 4517(c).

The level of scrutiny that Respondent suggests appropriate is, again, too sweeping, and the definition of "safety and soundness" too narrow. The court accepts the representation of OFHEO that a complete examination of the safety and soundness of Freddie Mac includes inquiry into the conduct of third parties and former executives and that the examination may uncover lapses within Freddie Mac, in the past or presently, that bear further examination. Indeed, the Fourth Circuit has made clear that the court should "defer to an agency's own appraisal of what is relevant so long as it is not obviously wrong." *Lockheed Martin Corp.*, 116 F.3d at 113 (internal quotation omitted). Such deference is appropriate here. Even though OFHEO and Freddie Mac have entered into a Stipulation and Consent Order, reflecting the significant findings thus far, OFHEO has explicitly reserved the right to continue the examination as it relates to third parties and to take regulatory or enforcement action based on what it finds. *See* Paper 8, Ex. 2 at ¶¶ 1-2. Counsel stated that OFHEO must reach these third parties only through Freddie Mac.

Respondent relies on a First Circuit decision, *United States v. Gertner*, 65 F.3d 963 (1st Cir. 1995), for the proposition that (1) the government must make a prima facie showing that a subpoena is appropriate; (2) a respondent then must come forward

with sufficient evidence to show that there is something amiss; (3) and the petitioner bears the ultimate burden to prove that the subpoena is not a pretext for some improper purpose. In *Gertner*, the court refused to enforce the IRS summons because it was purely pretextual, concluding that the district court "reasonably could have found that a preponderance of the evidence favored the respondents' claim of pretext." *Id.* at 970. The court reached this conclusion, in part, because "the respondents fashioned a sufficient evidentiary infrastructure to support an inference" of pretext. *Id.* In the instant case, unlike *Gertner*, Respondent has not produced evidence sufficient to rebut the good-faith presumption that attached to Petitioners' prima facie case.[6] Therefore, this court need not reach or examine the purported third tier regarding the ultimate burden.[7]

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[6] Even the *Gertner* court made clear that the challenging party must "shoulder a significant burden of production: in order to advance past the first tier, the taxpayer must articulate specific allegations of bad faith and, if necessary, produce reasonably particularized evidence in support of those allegations." *Id.* at 967.

[7] Similarly, the court in *Gertner* deferred a decision on the third tier issue. Respondent has not acquiesced in shouldering the burden of persuasion here and, indeed, asserts that the burden is on the government. If, however, the burden is on him, and the court should find that he has not met that burden on the present record, Respondent alternatively seeks discovery from (continued...)

3. Pendency of Notice of Charges

The third argument pressed by Respondent is that, now that OFHEO has issued a Notice of Charges against him, it should not be permitted to secure evidence from him pursuant to a subpoena issued for another function.

The pendency or initiation of another proceeding does not, by itself, invalidate a subpoena. There must be something inconsistent in the two roles of the agency before a court will intervene. For example, because the EEOC is only empowered to investigate with an eye to attempting conciliation before initiating litigation, the issuance of a right to sue letter does herald the end of investigation and hence the end to the proper use of a subpoena. *See EEOC v. Fed. Home Loan Mortgage*

(...continued)
the Director which he claims will support his position. Discovery, like the review process itself, is closely circumscribed here:

> The general rule, however, is that such discovery is prohibited in these types of summary enforcement proceedings absent "extraordinary circumstances." To obtain discovery, the target of the subpoena or other process must "distinguish himself from the class of the ordinary respondent, by citing special circumstances that raise doubts about the agency's good faith."

Am. Target Adver., Inc., 257 F.3d at 355 (internal quotations omitted). Respondent has not met the burden to justify discovery.

Corp., 37 F.Supp. 2d 769, 774 (E.D.Va. 1999). On the other hand, when continuing investigation is not inconsistent with action in another forum, as here, courts permit the parallel proceedings to continue.

The United States Court of Appeals for the District of Columbia Circuit has held, regarding the Resolution Trust Corporation, that "the initiation of civil proceedings will not moot an administrative subpoena," because the ongoing investigation "might reveal information to underpin further charges." *RTC v. Walde*, 18 F.3d 943, 950 (D.C. Cir. 1994) (citing *Linde Thomson Langworthy Kohn & Van Dyke, P.C. v. Resolution Trust Corp.*, 5 F.3d 1508, 1518 (D.C. Cir. 1993)).[8] Similarly, the pendency of a civil suit does not limit the authority of the Environmental Protection Agency to continue to use investigative techniques under the Solid Waste Disposal Act. *See In re Stanley Plating, Co., Inc.*, 637 F.Supp. 71 (D.Conn. 1986).

Nor need this court be overly concerned that OFHEO may collect evidence for use in connection with the Notice of Charges against Respondent. The D.C. Circuit also has held:

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[8] On the other hand, issuing a subpoena to determine whether litigation would be cost effective is an improper motive and invalidates a subpoena. *See Resolution Trust Corp. v. Thornton*, 41 F.3d 1539, 1546 (D.C. Cir. 1994).

> If information is wrongly obtained through an administrative subpoena and used in a subsequent civil or criminal proceeding, the subpoenaed party remains free to challenge the use of the information in the appeal from *that* proceeding.

Walde, 18 F.3d at 190 (quoting *Office of Thrift Supervision v. Dobbs*, 931 F.2d 956, 959 (D.C. Cir. 1991) (emphasis in original)). Thus, if such an occasion arises, it is for another tribunal to determine whether any use of evidence obtained as a result of this subpoena would be improper.

Conclusion

For the foregoing reasons, the petition to enforce the subpoena will be granted.

/s/
DEBORAH K. CHASANOW
United States District Judge

February 6, 2004