

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

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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.

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Misc. No. 98-92 (SS)

Filed UNDER SEAL

**PETITIONER'S STATUS REPORT**

This is a summary proceeding upon a Petition filed on March 3, 1998, by the Inspector General of the United States Department of Housing and Urban Development ("HUD"), pursuant to section 6(a)(4) of the Inspector General Act of 1978, 5 U.S.C. App. 3 § 6(a)(4). The Petitioner seeks the enforcement of three distinct administrative subpoenas duces tecum issued to each of Respondents on August 6 and 22, 1996, and October 24, 1997. The subpoenas, attached as Exhibits 1 through 6 to the Declaration of James M. Martin, which is annexed to the original Petition, require the Respondents, Hamilton Securities Group, Inc., and Hamilton Securities Advisory Services, Inc. (collectively, "Hamilton"), to provide HUD's Office of Inspector General ("OIG") with various records relating to Hamilton's involvement in HUD's mortgage sales program, and to possible conflicts of interest in

connection with Hamilton's role as a financial advisor to HUD.<sup>1</sup> Since Petitioner had learned of Respondents' plan to sell much of their computer equipment at auction on March 10, 1998, Petitioner also moved for a temporary restraining order and preliminary injunction requiring Respondents to deposit with the Court the materials sought by Petitioner's subpoenas duces tecum pending a final decision on the Petition for Summary Enforcement of the subpoenas.

I. The Court's Orders of March 6 and 10, 1998, and the Special Masters' Efforts to Take Possession of the Responsive Records

On March 6, 1998, this Court entered an Order (Exhibit 1 hereto) which, among other things,

1. Appointed Irving Pollack and Laurence Storch as co-Special Masters in this case;
2. Directed Respondents to deposit with the Special Masters the items responsive to the subpoenas, and the backup tapes of Respondents' electronic and computer records systems that contain information responsive to the subpoenas;
3. Directed that Respondents submit to the Court a certification of compliance that all records required to be produced by the order had been delivered intact to the Special Masters;

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<sup>1</sup> The Petition is related to a sealed qui tam action before this Court, Case No. 1:96-CV-1258 (SS), and to The Hamilton Securities Group, Inc., et al. v. United States Department of Housing and Urban Development, et al., Civil Action No. 98-36 (SS), in which Hamilton, in its Complaint for Declaratory, Injunctive, Mandamus, and Other Relief, sought a declaration that the issuance of the October 24, 1997 OIG subpoenas was a violation of the Administrative Procedure Act and the Fourth and Fifth Amendments to the Constitution, to quash the October 24, 1997 subpoenas, and to enjoin OIG from enforcing compliance with its subpoenas.

4. Directed Respondents not to dispose of any of Respondents' or their affiliated entities' business paper records without prior approval of the Special Masters; and
5. Directed Respondents not to sell, destroy, discard or otherwise dispose of any computer or electronic equipment containing any of Respondents' electronic or computer records without prior approval of the Court, unless Respondents first delivered an exact copy of all information contained in such records to the Special Masters.

Immediately after entry of the Order of March 6, the Special Masters proceeded to take steps to acquire possession of the relevant records, both paper files and electronic. With the assistance of members of the FBI Computer Analysis and Response Team, the process of backing up the computer equipment Respondents desired to sell at auction on March 10, 1998 was begun under the supervision of the Special Masters, and the backup tapes were provided to the Special Masters. Because the computer equipment could not all be downloaded prior to the auction on March 10, 1998, this Court entered a subsequent Order of March 10, 1998 (Exhibit 2 hereto), to accommodate Respondents' desire nevertheless to proceed with the sale, making the sale of any equipment contingent upon final confirmation of the Court, providing for delivery of any sold equipment up to 30 days after the sale, and directing Respondents not to sell any computer storage devices unless the information contained therein had been downloaded and provided to the Special Masters.

The backing up of the computer equipment at Respondents' offices was completed under the supervision of the Special Masters in late March, 1998. Additional computer equipment not

intended for sale was produced by Respondents to the Special Masters, for backing up at a later date.

Pursuant to an agreement entered into between the Special Masters and counsel for Respondents on March 8, 1998, and at the direction of the Special Masters, representatives of the OIG on March 9-10, 1998, reviewed materials at Respondents' offices designated by Respondents as "trash," which Respondents wished to discard, and identified materials which the OIG believed should be retained by the Special Masters. Those materials were immediately turned over to the Special Masters' representatives.

In addition, certain paper files of Respondents--those that Respondents identified as records to which they needed immediate access--were turned over immediately to the Special Masters. Further, a number of other paper files of Respondents (75 boxes, later reboxed to 82 boxes) were moved to storage at the direction of the Special Masters. Subsequently, in June 1998, the Special Masters leased storage space in the office building in which the Special Masters maintain offices, and the 82 boxes of records were moved to that storage space. The Special Masters also obtained from Respondents' former counsel approximately 120 boxes of paper files, about 100 of which had previously been disclosed to Petitioner. Several hundred additional boxes of paper records of Respondents remain in storage, the OIG having determined from a review of the inventory of these records that it wishes to defer their retrieval until issues relating to the OIG's access to the other records have been resolved.

In addition to the paper records, the Special Masters also have in their possession numerous computer records, including backup tapes made by Respondents before the Special Masters were appointed, most of which were obtained from Respondents' former counsel, and backup tapes made by the FBI under the supervision of the Special Masters.

The Special Masters have gathered most of the relevant materials in accordance with the Court's Orders of March 6 and 10, 1998. Petitioner has not, however, gained access to many of the most significant records. Despite Petitioner's attempts to achieve resolution of these issues by negotiation with Respondents' counsel and through the good efforts of the Special Masters, the parties have been unable to resolve these issues. Accordingly, the time is now ripe for judicial resolution of these issues.

We summarize the principal pending issues below. We request that the Court rule immediately on Respondents' claim for protection of so-called "proprietary business secrets" contained in responsive records, rejecting it. With respect to the other issues, which have been previously briefed by the parties to some extent, Petitioner requests that the Court either rule immediately or direct whatever additional briefing the Court deems appropriate before ruling.

## **II. Principal Pending Issues**

### **A. Respondents' Claim that Proprietary Information Must Be Protected**

Respondents' counsel have reviewed the paper files in the

possession of the Special Masters to determine which records, in their opinion, are both responsive and not privileged. Following that determination by Respondents' counsel, Petitioner was permitted to review the responsive, non-privileged records. That process stopped in August 1998, however, when the Special Masters requested that each representative of Petitioner who was to view the records sign a non-disclosure agreement (Exhibit 3 hereto) certifying that he/she would not disclose any proprietary information of Respondents contained in the records to non-government personnel.

The Special Masters proposed this non-disclosure agreement pursuant to the Court's Order of April 29, 1998, filed on April 30, 1998 (attached to Exhibit 3), which directed government personnel not to disclose Respondents' proprietary information to non-government personnel, and to execute a non-disclosure agreement acceptable to the Special Masters restricting disclosure of Respondents' proprietary information to non-government personnel. That Order was entered at the Special Masters' suggestion, as set forth in their Second Report to the Court filed on April 27, 1998. Unfortunately, the parties did not receive the Special Masters' Second Report and proposed order until after the Court had already entered it (Petitioner received its copy on April 30, 1998; the Court had already signed the Order on April 29, 1998). Thus, Petitioner did not have an opportunity to address any concerns to the Court prior to the entry of the Order.

When Petitioner received the Special Masters' Second Report and the Court's Order of April 29, 1998, Petitioner advised the Special Masters of its objections, by letters of May 7 and June 19, 1998, and proposed a particular non-disclosure Stipulation and Agreement (Exhibit 4) to be employed in the event Petitioner was permitted access to records of Respondents prior to any review by Respondents' counsel for relevancy and privilege.

The Special Masters did not adopt Petitioner's proposed Stipulation and Agreement. Instead, in August 1998, when certain representatives of Petitioner went to the Special Masters' offices to review Respondents' records, they were asked by representatives of the Special Masters to sign a non-disclosure agreement (Exhibit 3), and did so without consulting with counsel. They proceeded to review only the exterior of certain boxes of records. When counsel learned of the proposed non-disclosure agreement, counsel advised the Special Masters' representatives that Petitioner's representatives could not sign the proposed non-disclosure agreement for the reasons previously described to the Special Masters, which are principally three.

First, in Petitioner's view, there is no reason for such an agreement at this time. The reason the Special Masters proposed a non-disclosure agreement in their Second Report to the Court of April 27, 1998, was that the Special Masters anticipated at that time that Petitioner would be reviewing all of Respondents' records in the Special Masters' custody, not just those deemed responsive and non-privileged by Respondents' counsel.

Respondents' counsel subsequently made clear, however, that it was their intention to review all the records for responsiveness and privilege and permit Petitioner access only to those deemed both responsive and non-privileged.

Second, alleged proprietary business materials responsive to an Inspector General administrative subpoena, like those responsive to a grand jury subpoena, are not entitled to protection under a non-disclosure order unless they are legally privileged. See In re: Grand Jury Subpoenas to Midland Asphalt Corp., 616 F.Supp. 223 (W.D.N.Y. 1985).<sup>2</sup>

Third, the proposed non-disclosure agreement does not require Respondents to identify the claimed "proprietary business secrets" unrelated to their performance as a HUD contractor that should be protected from disclosure, yet would forbid Petitioner to discuss the unidentified materials with anyone outside the government. Thus, Petitioner has no way of knowing what materials are claimed to be proprietary. Further, Petitioner believes that at least some of what Respondents may consider "proprietary business secrets" may already be known to Petitioner, either as the result of information developed by the

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<sup>2</sup> An administrative agency's investigative powers are analogous to those of the grand jury, and thus case law interpreting the grand jury subpoena authority is frequently applied to administrative subpoenas. See, e.g., United States v. Coopers & Lybrand, 550 F.2d 615, 619 (10th Cir. 1977) (broad investigative powers given by statute to administrative agency "are not derived from the judicial function and are 'more analogous to the Grand Jury'"). See also cases cited at pages 19-22 of the Memorandum of Points and Authorities in Support of Petition for Summary Enforcement.



Petitioner in the course of its investigation, independently of Respondents, or through information previously provided by Respondents, not subject to any non-disclosure agreement. Petitioner does not want to be in the position of having to defend against endless allegations that it has somehow violated a non-disclosure agreement any time Petitioner attempts to question a witness about matters related to the non-HUD business ventures of Respondents, or other matters Respondents consider "proprietary business secrets," which may well evidence conflicts of interest, when the questions and information derive from sources other than the records yet to be reviewed or received by Petitioner. Petitioner must be able to use the information responsive to its subpoenas in conducting its legitimate investigatory efforts, including witness interviews of non-government personnel and the issuance of subpoenas to third parties for additional information.

Accordingly, Petitioner has declined to sign the non-disclosure agreement and has reviewed no records since it was requested to sign the agreement, except for the exteriors of certain boxes and records of certain bank accounts. Petitioner requests that the Court vacate its order of April 29, 1998, insofar as it directs government personnel not to disclose Respondents' proprietary information to non-government personnel and to execute a non-disclosure agreement acceptable to the Special Masters which restricts disclosure of Respondents' proprietary information to non-government personnel.

B. Respondents' Objection to Production to Petitioner of the Backup Tapes and Other Electronic Records, and Their Refusal to Review the Backup Tapes and Electronic Records for Responsive Records

Although Respondents prided themselves on being to a large extent a "paperless office," and Respondents have acknowledged that no search of electronic records was conducted for materials responsive to the October 24, 1997 subpoenas, Respondents have nevertheless declined to review the backup tapes and certain other electronic records for responsive, non-privileged material. Respondents claim that such a review would be too burdensome, costly, and not likely to result in the production of substantial information not already produced in some other form. Further, Respondents object to Petitioner reviewing the backup tapes and other electronic media obtained by the Special Masters --both those obtained from Respondents and their prior counsel, and those produced by the FBI under the supervision of the Special Masters--on the grounds that they contain non-responsive and privileged material.

For the reasons set forth in detail in the original Memorandum of Points and Authorities in Support of Petition for Summary Enforcement at pages 26-31, and the accompanying Declaration of James M. Martin and attachments thereto, Petitioner believes that the backup tapes and other electronic media contain considerable responsive information not duplicated elsewhere in the materials produced by Respondents. Petitioner has offered to review the electronic records itself, after having attorney-client privileged communications redacted by a technical

expert based on Respondents' identification of its attorneys, and subject to an appropriate non-disclosure agreement for non-responsive records that may contain identified "proprietary business secrets." Efforts to obtain Respondents' agreement to this procedure have been unavailing. Respondents suggest instead that Petitioner pay to have a neutral third party review the electronic records and produce only the responsive, non-privileged records. Petitioner has rejected this proposal as too costly, and because it is Respondents' obligation to produce the records.

In their Third Report to the Court (filed September 8, 1998), the Special Masters state that it is their position "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 [computer/electronic] data should be made available to the government in its entirety." Petitioner agrees, and requests that the Court order the production of the computer/electronic records to Petitioner.

C. Respondents' Objection to Production to Petitioner of the Electronic Financial Records

The Special Masters have possession of certain electronic records of Respondents' accounting system--the "Solomon IV" system. Respondents have objected to Petitioner obtaining access to these electronic records on the grounds that they have produced a hard copy printout of the records relating to one of the Hamilton entities, and ought not to be required to produce

the electronic records of affiliates and related entities. Petitioner maintains that, under the terms of the subpoenas (see Item No. 19 of the subpoenas of October 24, 1997, attachments 5 and 6 to the Declaration of James M. Martin filed with the Petition for Summary Enforcement) and the definition of "Hamilton" contained in the subpoenas,<sup>3</sup> Respondents are required to produce the responsive financial records of all of Respondents' affiliates or subsidiaries, and thus the electronic accounting records should be provided to Petitioner in their entirety.

D. The Inadequacy of Respondents' Initial Certificate of Compliance

The Court's order of March 6, 1998, provides that Respondents are to submit a certification of compliance, as follows:

IT IS FURTHER ORDERED that a representative(s) of Respondents with personal knowledge of the matter and of the searches that have been conducted for records responsive to the subpoenas of August 6 and 22, 1996, as modified, and of October 24, 1997, shall submit to the Court and to Petitioner a certification of compliance, made under penalty of perjury, that all records described above have been delivered intact, without deletion or alteration, to the Special Master; provided, however, that if the Special Master determines that such certification is not feasible, then Respondents shall provide a certification regarding compliance as shall be satisfactory to the Special Master . . . .

Order of March 6, 1998, at page 3.

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<sup>3</sup> "Hamilton" is defined in the subpoenas as referring to "'Hamilton Securities Advisory Services, Inc.," 'The Hamilton Securities Group, Inc.," and/or any affiliate or subsidiary of these entities."

On May 27, 1998, Respondents submitted an "Initial Certification of Compliance," which they apparently filed directly with the Court, containing a certification from C. Austin Fitts, President of The Hamilton Securities Group, Inc. and Hamilton Securities Advisory Services, Inc.; letters from two of Hamilton's former attorneys; and an affidavit of Raul Ludert, the "residential manager" for 7 Dupont Circle, N.W., where Respondents' offices were located.

The certification of Ms. Fitts does not satisfy the Court's order, in that it is not based on Ms. Fitts' "personal knowledge of the matter and of the searches that have been conducted for records responsive to the subpoenas of August 6 and 22, 1996, as modified, and of October 24, 1997 . . . ." Ms. Fitts concedes that her certification is based only on "some personal knowledge" and is otherwise dependent upon "reports from others, including counsel, with more direct responsibility for the retention, collection and production of documents pursuant to the three administrative subpoenas (as modified) and the March 6 Order." The "others" are not specifically identified. We know, however, that for at least eighteen months, from August 1996 until January 1998, the person in charge of production in response to the OIG subpoenas was Kevin McMahan, initially a Hamilton employee and then a consultant both to Hamilton and to each of the law firms who handled the document production, Morrison & Foerster and Jenner & Block. Moreover, we have reason to believe he was working on this project with other Hamilton employees and

consultants. No reason for failing to produce his sworn certification or that of the "others" has been offered.

Since Ms. Fitts' certification is mostly based not upon personal knowledge, under the Court's order of March 6, 1998, the Special Masters were to determine whether certifications based upon personal knowledge were feasible. If so, such certifications were to be provided. If the Special Masters determined that such certifications were not feasible, then Respondents were required to provide such certifications as the Special Masters determined were satisfactory. Petitioner requested that the Special Masters make these determinations, but the Special Masters advised that Petitioner should address its request instead to the Court.

There are numerous other deficiencies in Ms. Fitts' certification, or reasons to question the adequacy of the certification, including the following:

1. Ms. Fitts certifies that "[a]ny responsive materials in Hamilton's possession of March 6, 1998 were produced." The subpoenas, however, were issued on August 6, 1996, August 22, 1996, and October 24, 1997. The question is whether all responsive materials in Hamilton's possession on those dates were produced.

2. There is evidence suggesting that Hamilton may have destroyed records responsive to the subpoenas, including the following:

(a) Hamilton has never produced the earliest acknowledged full backup tape of its electronic records systems, dated June 16-17, 1996. This backup tape was acknowledged to exist both by Hamilton's former lawyer, Steven Rosenthal, and by Kevin McMahan, who was in charge of the document production. Nor has Hamilton ever offered any explanation for the disappearance of this backup tape. This tape is particularly significant, given evidence that Hamilton employees were instructed to delete files around the time that Hamilton became aware of the allegations concerning contracting corruption at HUD, and relevant communications may have been deleted from the system before later backup tapes were made;

(b) During the securing of records at Hamilton on March 9-10, 1998, the OIG discovered original Hamilton financial records responsive to the subpoenas in the red dumpster in the basement, marked for destruction;

(c) As the Special Masters reported to the Court in the Second Report, dated April 27, 1998, several Hamilton employees and consultants entered the Hamilton premises on March 6 and 7, 1998, after the Special Masters ordered the premises sealed. At least one of these individuals, Hamilton's computer consultant Elliot Cook, did so in defiance of the Special Masters' order, and admittedly permitted another person to remove a computer from the premises. Further, the Special Masters concluded that Mr.

Cook statement concerning his whereabouts at a certain time on March 6, 1998, was contradicted by other evidence;

3. Ms. Fitts attempts to suggest through her own certification and the affidavit of Raul Ludert that any deficiencies that might exist in Hamilton's production have been caused by "FBI agents" who "moved some materials in and out of Hamilton's office suite." In fact, representatives of the Special Masters oversaw the process, and FBI agents were not moving any records in and out of the premises. The moving of records that was done was (a) by Hamilton's auctioneer to a storage facility and to the Special Masters' offices at Storch & Brenner, with the oversight of the Special Masters, and (b) by OIG representatives, who retrieved records from the trash outside of Hamilton's offices, with the approval and oversight of the Special Masters' representatives, and turned over the records directly to the Special Masters' representatives. The OIG representatives did not move any records out of Hamilton's offices, and Petitioner is prepared to submit declarations to that effect, if required. Thus, any deficiencies in Hamilton's production are not attributable to the government;

4. Ms. Fitts limits her certification to any materials that "possibly could be responsive to the March 6 Order and that had not previously been produced to the Office of Inspector General," suggesting that some unexplained discrimination was made in what was produced;



5. The certification does not specifically state that it is made "under penalty of perjury," as required by the Court's order.

Petitioner requests that, as directed by the Court's order, Respondents be required to submit sworn certifications from persons "with personal knowledge of the matter and of the searches that have been conducted for records responsive to the subpoenas of August 6 and 22, 1996, as modified, and of October 24, 1997 . . . ." Alternatively, if Respondents claim they cannot provide such certifications based upon personal knowledge, we request that Respondents be directed to provide a sworn, written statement providing details as to why they cannot provide such certifications, so that the Court can determine whether such certifications are "not feasible," as required by the Order of March 6, 1998. Petitioner requests an opportunity to address any such submissions before the Court makes any determination whether they are satisfactory.

**E. Respondents' Claims of Privilege**

On August 31, 1998, Respondents submitted a privilege log of paper records in the possession of the Special Masters which Respondents deem both responsive and privileged. Petitioner is reviewing the log, and may request that the Special Masters or the Court review certain of the records to determine whether they have been appropriately designated.

CONCLUSION

WHEREFORE, Petitioner requests that the Court direct whatever additional briefing on the Petition for Summary Enforcement the Court deems appropriate, and resolve the principal pending issues.


Respectfully submitted,

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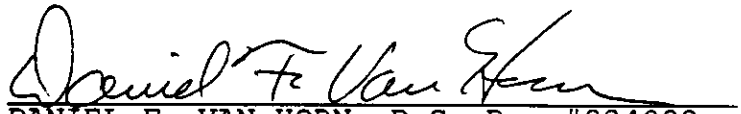
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CERTIFICATE OF SERVICE

I hereby certify that the foregoing Petitioner's Status Report, was served on September 24, 1998, by hand delivering a copy thereof to Respondent's counsel at the following address:

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