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Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

Decision

Matter of: Office of Federal Housing Enterprise Oversight—Settlement Agreement with Freddie Mac

File: B-306860

Date: February 28, 2006

DIGEST

The terms of a settlement agreement entered into between the Office of Federal Housing Enterprise Oversight (OFHEO) and the Federal Home Loan Mortgage Corporation (Freddie Mac), in which Freddie Mac agreed to pay a vendor to electronically format certain documents for OFHEO, will not augment OFHEO's appropriations. Under the settlement agreement, OFHEO agreed to dismiss all administrative charges it had brought against Freddie Mac. In exchange, Freddie Mac agreed, among other things, to pay a vendor picked by OFHEO up to $1 million to electronically format and code certain documents belonging to Freddie Mac for OFHEO's use. No augmentation of OFHEO's appropriations will occur as the settlement agreement satisfies a prosecutorial objective, and no contractual relationship between OFHEO and the vendor exists with respect to the formatting of Freddie Mac's documents.

DECISION

The Office of Federal Housing Enterprise Oversight (OFHEO) has requested a decision under 31 U.S.C. § 3529 on whether the Federal Home Loan Mortgage Corporation's (Freddie Mac) payment to a vendor to electronically format and code documents as specified by OFHEO will augment OFHEO's appropriation. OFHEO and Freddie Mac entered into a settlement agreement to resolve an administrative proceeding brought by OFHEO against Freddie Mac pursuant to OFHEO's regulatory oversight authority. As part of this settlement, Freddie Mac agreed to pay the vendor up to $1 million. After reviewing the information provided by OFHEO, we conclude that no augmentation of OFHEO's appropriations will occur.

BACKGROUND

OFHEO has oversight responsibility for the Federal National Mortgage Association (Fannie Mae) and for Freddie Mac.[1] Both Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs)[2] that OFHEO must ensure are financially secure and adequately capitalized. 12 U.S.C. § 4513(a); 12 C.F.R. § 1720.1 (2005). The Director of OFHEO may pursue administrative proceedings against a GSE if he determines that it is engaging in any conduct that threatens to deplete its core capital, will violate an applicable law, order or regulation, or will violate a written agreement entered into by the GSE with OFHEO. 12 U.S.C. § 4631; 12 C.F.R. § 1780.1.

On December 17, 2003, OFHEO filed a notice of charges against Freddie Mac. Office of Federal Housing Enterprise Oversight, *In the Matter of: Federal Home Loan Mortgage Corporation,* Notice of Charges 2003-1, Dec. 17, 2003. On September 9, 2005, OFHEO and Freddie Mac agreed to settle all charges pursuant to conditions set forth in a consent order. Office of Federal Housing Enterprise Oversight, *In the Matter of: Federal Home Loan Mortgage Corporation,* Consent Order No. 2005-1, Sept. 9, 2005 (hereinafter Consent Order); Office of Federal Housing Enterprise Oversight, Office of General Counsel Memorandum for Gail S. Palestine, Deputy Chief Financial Officer, *Settlement with Freddie Mac,* Nov. 3, 2005. Paragraph 11 of the Consent Order requires Freddie Mac to provide OFHEO with compact discs (CDs) containing certain documents in a manner agreeable to both parties.

With respect to paragraph 11 of the Consent Order, OFHEO and Freddie Mac entered into a production agreement on September 9, 2005, that specifies how the documents will be formatted. OFHEO, Production Agreement, Sept. 9, 2005 (hereinafter Production Agreement). Under the Production Agreement, the parties agree that "Freddie Mac shall pay a vendor (or vendors) hired by OFHEO" (1) to convert the documents to be produced to OFHEO to any different format required by OFHEO, and (2) to electronically code the documents with document fields chosen by OFHEO. *Id.* In no event is Freddie Mac to pay the vendor hired by OFHEO in excess of $1 million.[3] *Id.*

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[1] Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Pub. L. No. 102-550, title XIII, § 1302, 106 Stat. 3672, 3941–42 (Oct. 28, 1992) (*codified at* 12 U.S.C. § 4501); *see* B-302825, Dec. 22, 2004 (describing OFHEO's oversight responsibility). OFHEO is an office within the Department of Housing and Urban Development. 12 U.S.C. § 4511.

[2] Government-Sponsored Enterprises (GSEs) are privately owned and operated federally chartered financial institutions that facilitate the flow of investment funds to specific economic sectors. GAO, *A Glossary of Terms Used in the Federal Budget Process,* GAO-05-734SP (Washington, D.C.: September 2005), at 59.

[3] OFHEO officials have advised us that the Production Agreement settled a dispute between Freddie Mac and OFHEO with respect to the adequacy of Freddie Mac's

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To carry out its responsibility under the Production Agreement, OFHEO sent Pitney Bowes Government Solutions, Inc. (Pitney) a letter of understanding establishing that Pitney will begin the formatting of Freddie Mac's documents when Freddie Mac begins to wire up to $1 million in installments to the account of Pitney. Letter from David A. Felt, Acting General Counsel, Office of Federal Housing Enterprise Oversight, to Jon Love, President, Pitney Bowes Government Solutions, Inc., *Re: Letter of Understanding,* January 17, 2006 (hereinafter Pitney Letter). The letter states that Pitney will not seek payment from OFHEO for services performed, but will only look to the moneys wired to it by Freddie Mac. *Id.* To conform with the $1 million limitation that OFHEO and Freddie Mac agreed to, OFHEO informed Pitney that it should not incur costs exceeding the amount of the installment paid by Freddie Mac, nor should Pitney incur expenses in excess of $1 million unless OFHEO instructs Pitney to incur those costs at OFHEO's expense. *Id.*

Before finalizing its Production Agreement with Freddie Mac, OFHEO sought a decision from our Office asking whether payment by Freddie Mac to Pitney for the formatting would augment OFHEO's appropriations. Letter from Gail A. Palestine, Deputy Chief Financial Officer, Office of Federal Housing Enterprise Oversight, to Thomas H. Armstrong, Assistant General Counsel for Appropriations and Budgeting, Government Accountability Office, *Re: Request for Expedited Opinion on Appropriations,* November 4, 2005. While OFHEO continues to assert authority to require Freddie Mac to submit documents in a specified format, OFHEO, in settlement of its dispute with Freddie Mac, agreed to accept unformatted documents that Freddie Mac would pay up to $1 million to format. It is the language of the Production Agreement ("Freddie Mac shall pay a vendor (or vendors) hired by OFHEO") and the possibility that OFHEO, itself, using its own appropriations, may decide to format additional Freddie Mac documents that give rise to an augmentation question. If (1) OFHEO hires the vendor, and (2) OFHEO, eventually, decides to format some of Freddie Mac's documents, the appearance, at least, is that the formatting costs are OFHEO's responsibility, and that Freddie Mac, individually, is paying to defray OFHEO's costs.

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discovery production. During the discovery phase of the litigation, Freddie Mac had objected to OFHEO's request that Freddie Mac submit documents in a certain format. Telephone Conversation with David A. Felt, Acting General Counsel, Office of General Counsel, Office of Federal Housing Enterprise Oversight, with Thomas H. Armstrong, Assistant General Counsel for Appropriations and Budgeting, Government Accountability Office, January 4, 2006 (hereinafter Felt Conversation). In settlement of that dispute, OFHEO and Freddie Mac agreed in the Production Agreement that Freddie Mac would incur up to $1 million in formatting costs. *Id.*

DISCUSSION

When Congress makes an appropriation to an agency, it directs that the agency may not operate beyond the level it can finance from its appropriation. B-300248, Jan. 15, 2004. An augmentation occurs when an agency supplements its appropriation from some other source. *Id.* A *"de facto"* augmentation occurs when an agency arranges for an outside source to defray an obligation of the agency. *Id.* At issue is whether Freddie Mac's $1 million payment to Pitney constitutes a *de facto* augmentation of OFHEO's appropriations. In the absence of specific statutory authority, an agency may not circumvent the financial limitations imposed upon it by Congress by augmenting, or supplementing, its appropriation from outside sources. *Id.*

Congress charged OFHEO with oversight of Freddie Mac. 12 U.S.C. § 4501. Congress prohibits current and former Freddie Mac executives officers from receiving excess compensation, 12 U.S.C. §§ 4518, 4637, and delegated authority to OFHEO to take enforcement action against Freddie Mac or the executive officers as necessary. *Id.* at §§ 4631-4641. OFHEO may enforce its authority through an adjudicatory proceeding. *Id.* at 4631. Regulations governing adjudicatory proceedings provide the procedures for settlement during such proceedings. *See* 12 C.F.R. § 1780.14.

Regulatory agencies, such as OFHEO, have authority to settle charges consistent with statutorily authorized prosecutorial objectives—correction or termination of a condition or practice, punishment, and deterrence. *See* 70 Comp. Gen. 17 (1990); B-210210, Sept. 14, 1983. In this case, OFHEO brought administrative charges against Freddie Mac and the former executive officers for the undue compensation of those officers. Consent Order; *see* 12 U.S.C. §§ 4518, 4631, 4637. In the course of discovery, OFHEO requested that Freddie Mac submit certain electronically formatted documents. Felt Conversation. Freddie Mac objected to the formatting requirement, but wanted "to avoid the expense and distraction of further litigation with OFHEO." Consent Order. In settlement of all the charges against it, Freddie Mac offered to submit electronically formatted documents if OFHEO agreed that Freddie Mac would have to pay no more than $1 million in formatting costs. Production Agreement. OFHEO agreed in order to pursue the prosecution of the more important matter—undue compensation of former executive officers. *Id.*

Our case law has addressed settlement agreements in the past. In both cases, the Commodity Futures Trading Commission (CFTC) and the Nuclear Regulatory Commission (NRC) sought to accept a charged entity's donation to an educational or research institution in settlement of the charges. 70 Comp. Gen. 17 (1990); B-210210, Sept. 14, 1983. While both CFTC and NRC had settlement authority, the charged entities' donations were not related to the entity's offense and therefore exceeded the agencies' prosecutorial discretion. *Id.* The agreements resulted in *de facto* augmentations of the agencies' appropriations as the donations would financially assist the agencies' in achieving their statutory requirements to support the development of educational materials and research. *Id.*

Unlike the above cases, we view OFHEO's actions as consistent with its prosecutorial discretion to correct an improper practice. *See* 12 U.S.C. § 4631; 12 C.F.R. § 1780.14. The settlement agreement is related to the administrative charges, as the formatted documents will enable OFHEO to continue pursuing charges against Freddie Mac's former executive officers. *See* 12 U.S.C. §§ 4518, 4637. As a result of the settlement agreement, the costs of formatting are Freddie Mac's costs, not OFHEO's costs, and Freddie Mac's payment to Pitney, therefore, does not constitute a *de facto* augmentation of OFHEO's appropriation. Freddie Mac is dealing directly with Pitney to produce the formatted documents and paying Pitney directly. *See* Pitney Letter. Thus, unlike in the cases described above, Freddie Mac is not defraying an obligation of OFHEO, but is fulfilling Freddie Mac's obligation as agreed to in settling the charges brought against it by OFHEO. Although the Production Agreement states that "Freddie Mac shall pay a vendor (or vendors) hired by OFHEO," OFHEO has made clear to Pitney and Freddie Mac that there is no legal relationship between OFHEO and Pitney with respect to the formatting of, and the costs of formatting, the documents. *See* Pitney Letter.

To the extent that some documents remain unformatted when Freddie Mac's costs reach $1 million, OFHEO will have to decide whether to format those documents. *Id.* The fact that OFHEO could decide to pay for this formatting does not alter the character of the first $1 million of formatting costs, which remains an obligation of Freddie Mac, not OFHEO. Freddie Mac agreed to pay up to $1 million as a limit on how many documents it would format for OFHEO. Felt Conversation.

CONCLUSION

Under the terms of the settlement agreement, Freddie Mac's payment of formatting costs does not constitute a *de facto* augmentation of OFHEO's appropriation. The settlement agreement represents a legitimate exercise of OFHEO's prosecutorial discretion. Despite the language of the settlement agreement ("Freddie Mac shall pay a vendor (or vendors) hired by OFHEO"), the costs of formatting, up to $1 million, are Freddie Mac's costs, not OFHEO's costs.

/signed/

Anthony H. Gamboa
General Counsel