



National Credit Union Administration

February 6, 2013

Office of Inspector General

The Honorable Darrell E. Issa
Chairman
Committee on Oversight and Government Reform
U.S. House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Chairman Issa:

This responds to your letter to me dated October 16, 2012, wherein you inquired about the National Credit Union Administration's (NCUA) use of contingency fee arrangements with outside counsel hired to handle certain financial securities-related litigation. You asked the Office of Inspector General (OIG) to review NCUA's use of such arrangements "in light of the potential negative impact of contingency fee arrangements on the interests of member credit unions."

Your letter went on to reference several lawsuits that NCUA has already settled as well as ongoing lawsuits expected to result in additional recoveries from financial institutions that misled credit unions about the quality of mortgage-backed securities (MBS). With regard to the settlements NCUA has already reached, you expressed concern about the amounts which flowed into the estates of the failed credit unions after 25% of the money recovered was paid to the two outside law firms representing NCUA in its conservatorship capacity. Consequently, you stated, the contingency fee arrangement reduced the amount of money in the Stabilization Fund, thereby "placing a greater burden on NCUA's members in terms of fees and assessments."

You also inquired whether NCUA followed Executive Order (E.O.) 13433, "Protecting American Taxpayers From Payment of Contingency Fees," signed by President George W. Bush on May 16, 2007. E.O. 13433 prohibits the use of contingency fee arrangements by Executive Branch agencies in order to "ensure the integrity and effective supervision of the legal and expert witness services provided to or on behalf of the United States."¹

Consequently, you asked the OIG to consider the following questions:

1. Were the contingency fee arrangements utilized by NCUA in the above-referenced litigation the best possible alternative given the circumstances? Please consider the potential costs of such arrangements to the agency and the possible effects for member credit unions and taxpayers of paying unnecessarily high legal fees.
2. Does E.O. 13433 cover the NCUA?

We address each of your questions separately below.

¹ Ex. Order No. 13,433, 72 Fed. Reg. 28441 (May 18, 2007).

Contingency Fee Arrangement

The objective of our review was to determine whether the United States can be assured that the potential costs of and possible effects of the contingency fee arrangement for credit unions and taxpayers were fair and reasonable and whether the contingency fee arrangement was the best possible alternative given the circumstances.

Our interviews of and discussions with NCUA officials initially brought to light the determination of the agency's former General Counsel that NCUA's conservatorship of U.S. Central Federal Credit Union (USC) and Western Corporate Federal Credit Union (WesCorp) in March 2009 created a fiduciary duty on the part of the NCUA, as Conservator, to investigate possible causes of action for wrongdoing that related to the sale of MBS to both USC and WesCorp. This included a determination as to whether the issuers, underwriters, and rating agencies made any misstatements or omissions of fact that induced USC or WesCorp to purchase the MBS in question.

Moreover, the NCUA Office of General Counsel (OGC) informed the OIG that NCUA, first as Conservator and then as Liquidating Agent, had the responsibility to minimize additional losses or costs and to take reasonable steps to try to recover as much of the \$16 billion loss sustained by the failed corporates as possible. We determined that OGC considered a significant number of critical factors in making its recommendation to the NCUA Board to move forward with the securities-related litigation. With regard to the decision to retain the firms on a contingency fee basis, we gave weight to the NCUA's determination that it would be facing extremely complex litigation against some of the biggest banks and brokerage firms in the world, which it fully expected would engage in protracted costly litigation rather than settle.

We found OGC exercised extreme caution in considering whether to proceed with the litigation in the first instance. Specifically, we found that OGC considered there would be an enormous amount of upfront time and cost involved in analyzing hundreds of securities containing thousands of mortgage loans, issuing numerous administrative subpoenas, taking testimony of hundreds of witnesses, reviewing tens of thousands of pages of documents, drafting complaints, and developing and relying on a rather unique theory related to each security, *viz.*, a theory based on statistical projections with little data on the individual loans contained within each security. Additionally, we determined OGC officials knew they would face many legal barriers such as statute of limitations and statutes of repose which had the potential to defeat many of the claims it intended to bring.

We also learned during our review that OGC anticipated a protracted, complex litigation with considerable risk that there would be little or no recoveries. In addition, the litigation occurred at a time when the National Credit Union Share Insurance Fund (NCUSIF) was under enormous pressure due to the then five² failed corporates, and was left with little or no money to fund any type of recovery litigation. Consequently, OGC made the business decision to move forward with the litigation using a contingency fee arrangement because (1) it did not have the monies up front to compensate the firms on a

² By June 2011, NCUA, in its capacity as Conservator of USC and WesCorp, modified the original September 1, 2009, Legal Services Agreement (LSA) it had entered into with the firms of Kellogg, Huber, Hansen, Todd, Evans & Figel, PLLC, and Korein Tillery LLC (the firms) through a second addendum to the contract. This second addendum acknowledged that three other corporate credit unions were in liquidation, that NCUA was the Liquidating Agent, and that both parties desired that the firms continue to represent the NCUA in its capacity as Conservator and Liquidating Agent for all five corporate credit unions.

billable hours basis; (2) it was the most cost effective and efficient way to proceed; and, most importantly, (3) it believed NCUA as Conservator had the legal authority to proceed in that manner.³

As to the potential cost of the contingency fee arrangement and the possible effects for member credit unions and taxpayers of paying unnecessarily high legal fees, we concluded that the amounts paid to outside counsel as of October 31, 2011, appear reasonable and are not “unnecessarily” high. My office came to this conclusion based on an independent review of the costs as outlined below.

Specifically, we determined that the LSA which the NCUA entered into with the firms provided that if NCUA, as Conservator, unilaterally terminated the engagement, it would have to pay accrued hourly rates in lieu of contingency fees. The firms provided OGC with estimates of their attorney fees for the first three (of four⁴) phases on a billable hours basis. The firms calculated that their estimates and the billable hours for the preliminary investigative phase alone would have amounted to \$2–\$2.5 million.⁵ Their total estimate for the first three phases ranged from \$5.25 to \$9.5 million.⁶ The firms did not estimate the trial phase because at the time they believed it to be too speculative.

We found supportable OGC’s conclusion that the firms’ estimated billable hours were reasonable—relative to the \$16 billion loss under investigation—had the Conservator decided to terminate litigation. Given that the Conservator did not terminate the litigation and therefore did not have to pay on a billable basis, the point is moot from a realized cost standpoint. However, we believe the firms’ estimates provide valuable insight into how legal costs mounted once the legal work was actually underway.

In considering the potential costs to the agency, we limited our review to the costs associated with the preliminary investigative phase,⁷ because this offered the best comparison between actual amounts the Conservator paid under the contingency fees arrangement and what the accrued billable hour amounts would have been under a billable hours arrangement. As you are aware from previous disclosures made by NCUA officials regarding the contingency fee arrangement, the Conservator paid the firms approximately \$41.1 million from the first two settlement recoveries of \$165.5 million.

To determine the firms’ total number of billable hours and the associated rates charged in connection with the preliminary investigative phase, we obtained from the firms a complete listing of every hour accrued, the business purpose, the attorney, and the attorney’s associated hourly rate. We analyzed the number of billable hours and their associated hourly rate(s) for each firm for the period covering March 2009, to October 31, 2011,⁸ and determined that combined, the two firms accrued a total of 40,997 hours in the investigative phase alone. We then calculated the associated hourly rates for each billable hour and determined that the firms accrued over \$14.9 million in attorney fees. As previously noted, the firms’

³ Our analysis of the legality of NCUA entering into the contingency fee based LSA follows this discussion.

⁴ OGC identified four distinct phases: the investigative phase, the complaint and dispositive motions phase, the summary judgment phase, and the trial phase.

⁵ OGC officials acknowledged that the estimates could climb significantly higher depending on various factors such as the number of targets subpoenaed and the number of depositions taken.

⁶ These estimates do not include experts’ fees, which are paid by NCUA, or out of pocket expenses which are advanced by the firms and reimbursed by NCUA from any net proceeds.

⁷ The first two settlements, Deutsche Bank and Citigroup, occurred at the conclusion of the preliminary investigative phase.

⁸ The Conservator used October 31, 2011, as the cut-off date when calculating the firms’ share of the settlement fees, net of expenses, because the settlements occurred at the conclusion of the preliminary investigative phase, which made for a clean cut-off date.

initial estimate for the investigative phase was approximately \$2–2.5 million, which we believe demonstrates how quickly billable hours could mount, making it difficult to predict how the fully litigated case might have proceeded.

While an initial comparison of the two amounts, \$41.1 million (contingency fees) versus \$14.9 million (billable hours), suggests that the Conservator might have paid higher attorney fees than was necessary, we believe closer analysis shows there are other significant factors to consider in arriving at our conclusion that the \$41.1 million in fees the Conservator paid the firms from the settlement recovery was reasonable.

First, it is inarguable that NCUA would have incurred attorneys' fees, whether on a billable or contingency fee basis. Consequently, we questioned whether a billable hours arrangement would have resulted in a lower cost to the Conservator, given that the firms' total estimated termination costs were between \$5.25 – \$9.5 million, which covered only three of the four litigation phases. As evidenced by an August 9, 2009, OGC memorandum to the NCUA Board regarding the estimated cost of the engagement, the Conservator and the firms were preparing for protracted litigation. Indeed, the OGC memo stated that "the accrued hourly rates would mount quite significantly as the engagement proceeded to the filing of a complaint and through the dispositive motions phase."

OGC's comment to the NCUA Board indicated that OGC anticipated the estimated amounts provided by the firms would continue to mount as the litigation proceeded. In addition, OGC's comment about mounting fees made no mention of one of the remaining phases included in the firms' original estimate of attorney's fees—the summary judgment phase. Therefore, we believe it is reasonable to conclude that had the Conservator entered into a billable hour arrangement with the firms, the accrued hourly rates would have continued to mount. We asked OGC officials to consider, as a percentage, where the litigation stood on a continuum in terms of completed phases at the time they were concluding the preliminary investigative phase and the date a settlement with Deutsche Bank and Citigroup was reached in October 2011. OGC officials stated that because the parties reached a settlement at the end of the preliminary investigative phase and before the complaint and dispositive motions phase, they could only provide an approximate range from a low of 25 percent to no more than 50 percent completed.

Based on OGC's estimated range of completion percentages, we determined that had the litigation gone to trial and had the Conservator contracted with the firms on an hourly basis, the NCUA could have encountered attorneys' fees ranging from a low of approximately \$30 million to a high of approximately \$60 million. Based on the range of fees the Conservator might have paid under an hourly arrangement, we find the contingent reimbursement fees paid at the conclusion of the preliminary investigative phase, of \$41.1 million, to be comparatively reasonable, especially since we determined that under a billable hours arrangement, the firms would have billed the Conservator for over \$14.9 million in attorneys' fees after completing only the first of four phases of litigation.

As for the effect on member credit unions and taxpayers paying unnecessarily high legal fees due to NCUA's decision to enter into a contingency fee arrangement, we found this an inaccurate assertion. Specifically, as noted above, our analysis of the actual attorneys' fees paid under the contingency fee arrangement found the firms' settlement allocation reasonable compared to what the Conservator could have potentially paid on an hourly basis had the litigation proceeded to the trial phase. Moreover, we believe it is critical to acknowledge at the outset that fees in some significant amount were a foregone

necessity, once the NCUA decided to pursue litigation. Finally, as discussed in fn. 10, *infra*, no taxpayer funds were at stake in the agency's litigation.

Additionally, the NCUA told the OIG it would not have pursued litigation in the first instance if a billable hours arrangement was the agency's only option, because the risk of paying millions up front in attorney's fees, with no guarantee of recovery, far outweighed the risk of taking no action and potentially costing the credit union industry and its members millions. We agree with this conclusion and believe member credit unions have benefited by the litigation for the first two settlements because the Conservator recovered \$124 million that would otherwise not have been collected.

E.O. 13433

Summary of Findings⁹

E.O. 13433 prohibits federal agencies from entering into contingency fee contracts for legal or expert witness services provided to or on behalf of the United States. However, as explained below, we have concluded that E.O. 13433 does not prohibit the NCUA from entering into contingency fee arrangements when it is serving in its capacity as Conservator or as Liquidating Agent of a federally insured credit union. In brief, the NCUA as Conservator succeeds by operation of law to all the rights, powers, and duties of the credit union. To be more specific, NCUA as Conservator "steps into the shoes" of the credit union and is no longer functioning as a government agency. *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 86 (1994). The Conservator, therefore, has the same authority to hire outside counsel on a contingency fee basis that the credit union possessed before the NCUA was appointed Conservator. Moreover, when the Conservator contracts for legal services, such services are not provided "to or on behalf of the United States" within the meaning of the executive order. Executive Order 13433 § 1. Finally, the Executive Order states that it must be "implemented consistent with applicable law" and that it "shall not be

⁹ In mid-October 2012, the OIG Counsel initiated her legal research into the question of whether the E.O. applied to NCUA when acting as Conservator or Liquidating Agent. On November 16, 2012, the NCUA Office of the General Counsel (OGC) sent the OIG Counsel an email entitled: "Legal Opinion on Applicability of E.O. 13433." In that email, the OGC stated that "[w]e recently requested the attached opinion. I am forwarding [it] to you as it might be of interest in connection with your investigation." The attached legal opinion, dated November 15, 2012, was a 13 page legal analysis of the E.O., prepared by the law firm of Cooper & Kirk (the Cooper opinion). The OGC subsequently advised the OIG Counsel that in late October, OGC contacted three law firms about providing a legal opinion on the E.O.'s applicability to NCUA, and ultimately decided to retain Cooper & Kirk. While OGC had previously researched this issue at length in-house, it sought a third party opinion on the E.O.'s applicability to NCUA when acting as Conservator or Liquidating Agent.

The Cooper opinion concurred with the OGC's opinion that the E.O. did not prohibit the NCUA, in its capacity as Conservator or Liquidating Agent, from entering into contingency fee legal services. Based on the legal research the OIG Counsel had conducted prior to receiving the Cooper opinion, she had already preliminarily concluded that the E.O. did not apply to NCUA as Conservator. However, because the Cooper opinion presented a far greater depth of legal research and analysis than the OIG Counsel had conducted up to that point, she proceeded to peruse the opinion, including locating and reading the case law—which represented a more exhaustive list than her own research had uncovered to date—referenced therein.

The OIG Counsel concluded that the Cooper opinion significantly bolstered and amplified her own legal research and conclusions. Consequently, in the spirit of full disclosure and attribution, we note that the OIG Counsel's legal analysis and findings (set forth herein) concerning the applicability of the E.O. to NCUA when acting as Conservator or Liquidating Agent derive in part from the Cooper opinion. On January 2, 2013, representatives from my office met with your office to discuss the Cooper opinion and the circumstances surrounding the OIG Counsel's receipt of it. We provided your office with a copy of the opinion at that meeting. We are also attaching a copy of the Cooper opinion with this response as **Attachment A**.

construed to impair or otherwise affect authority granted by law to an agency.” *Id.* §§ 4(a), 4(b). We interpret these provisions to mean that the executive order is subordinate to the express language of the Federal Credit Union Act (FCUA) which sets forth the NCUA’s powers and authorities as Conservator.¹⁰

Discussion

Section 1 of E.O. 13433 states that it is intended to address the provision of legal services “to or on behalf of the United States.” *Id.* § 1. Further, sections 4(a) and (b) provide, respectively, that the E.O. must be “implemented consistent with applicable law” and that it shall not be construed “to impair or otherwise affect . . . authority granted by law to an agency or the head thereof.” *Id.* §§ 4(a), 4(b). We believe that (1) when NCUA entered into contracts for legal services in its capacity as Conservator of USC and WesCorp, the legal services rendered were not “to or on behalf of the United States;” and (2) the Executive Order, by its own terms, is subordinate to NCUA’s existing powers and authorities under the FCUA.

A. The NCUA as Conservator or Liquidating Agent

When a credit union fails or encounters financial distress, the FCUA permits the NCUA to act as Conservator or Liquidating Agent of the failed institution. The Board, as Conservator or Liquidating Agent, takes over the day-to-day operations and, by operation of law, succeeds “[t]o . . . all rights, titles, powers, and privileges of the credit union, and of any member, accountholder, officer, or director of such credit union with respect to the credit union and the assets of the credit union.” 12 U.S.C.

§ 1787(b)(2)(A)(i). The purpose of the Conservator or Liquidating Agent is to restore the credit union to fiscal feasibility or to liquidate and distribute its assets, respectively. The statute goes on to enumerate the Board’s broad powers as Conservator or Liquidating Agent, including the authority to “make contracts.” 12 U.S.C. § 1789(a)(1). Overall, the FCUA makes clear that when the NCUA Board takes over a credit union as Conservator or Liquidating Agent, it obtains the rights and powers of the credit union; it may take over the assets and operation of the insured institution to conduct all of its business; and, in effect, it assumes the legal status of the entity.

Likewise, when the FDIC takes over as conservator or receiver for a failed bank, it obtains the rights and powers of the bank’s shareholders, officers, and directors. See 12 U.S.C. § 1821(d)(2)(A). Indeed, the Supreme Court has held that the FDIC, in its role as conservator or receiver is placed “in the shoes of the insolvent” entity. *O’Melveny*, 512 U.S. at 86-87 (examining 12 U.S.C. § 1821(d)(A) & (B)). Other courts have also held, for example, that a claim against FDIC as receiver is “a claim against the depository institution for which the FDIC is receiver.” *Am. Nat’l Ins. Co. v. FDIC*, 642 F.3d 1137, 1144 (D.C. Cir. 2011). Further, when acting as receiver, FDIC does not pursue the interests of the Government. *Atherton v. FDIC*, 519 U.S. 213, 225 (1997). Courts have similarly held that FDIC as

¹⁰ Additionally, we are aware that the NCUA has also taken the position that the E.O. does not apply to NCUA because the agency does not receive appropriated funds for its insurance or regulatory functions. The NCUA bases its position on the apparent intent of the E.O. which, as its title eponymously asserts, is to protect American *taxpayers* from *appropriated agencies’* payment of contingency fees. (Emphasis added.) We agree with this position. That is, the stated purpose of the contingency fee ban is to protect “taxpayers,” but the insurance fund that the NCUA administers, and into which any recoveries from the NCUA’s litigation would be placed, receives no taxpayer funds. Rather, it is financed by the credit unions themselves. Nevertheless, we believe that the more relevant discussion here focuses on the fact that the E.O. does not apply to NCUA when acting as Conservator or Liquidating Agent because: (1) the NCUA entered into the contingency agreements at issue in its capacity as Conservator of several failed credit unions; and (2) the E.O., by its own terms, is subordinate to the FCUA.

conservator was not acting for the United States. *See, e.g., Ameristar Fin. Servicing Co. LLC v. United States*, 75 Fed. Cl. 807, 811 (2007). Moreover, one court recently compared the Federal Housing Finance Agency (FHFA) to the FDIC, holding that when the FHFA serves as a conservator of Fannie Mae, it “step[s] into the shoes of the private corporation.” *Herron v. Fannie Mae*, 857 F.Supp.2d 87, 94 (D.D.C. 2012).

In *O’Melveny*, the Supreme Court interpreted the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), 12 U.S.C. §§ 1461 *et seq.*, the statute applicable to FDIC. There, the Court held that the language of 12 U.S.C. § 1821(d)(2)(A)(i), stating that the FDIC as receiver shall “succeed to all rights, titles, powers, and privileges of the insured depository institution” . . . appears to indicate that the FDIC as receiver ‘steps into the shoes’ of the failed S&L, obtaining the rights ‘of the insured depository institution’ that existed prior to receivership.” 512 U.S. at 86 (citations omitted; emphasis in original). The statutory language of the FCUA, regarding the powers and rights of the NCUA Board acting as Conservator or Liquidating Agent, is virtually identical to the FDIC’s. Under its own statute, when the NCUA steps in as Conservator or Liquidating Agent, it immediately succeeds to all rights, powers, and privileges of the insured credit union to conduct all of the entity’s business. 12 U.S.C. § 1787(b)(2). Thus, like the FDIC when it serves as a conservator or receiver of a private entity, the NCUA as Conservator or Liquidating Agent “step[s] into the shoes” of the distressed or failed credit union. In such circumstances, the NCUA is no longer a government actor but, rather, assumes the identity of the credit union, a private entity. *See also, Herron* at 857 F.Supp.2d at 94 (citing, among other cases, *United States v. Beszborn*, 21 F.3d 62 (5th Cir. 1994).

Consequently, we conclude that when NCUA serves as Conservator or Liquidating Agent it is no longer acting as a Federal agency but rather, as a private entity. Thus, in its conservatorship or liquidator capacity, the NCUA is not subject to a variety of rules normally applicable to government agencies. We view this conclusion as, in turn, leading to the conclusion that when NCUA is operating a credit union as Conservator, it can contract for outside counsel in any way that the credit union can. We considered further whether there are any limitations on the rights and powers of federally insured credit unions to retain outside counsel under contingency fee contracts and found no such limitations.

B. The FCUA

As discussed above, the FCUA accords the NCUA Board broad powers and authorities when it is acting as Conservator or Liquidating Agent of a failed credit union. Specifically, as mentioned above, the statute provides that “[t]he Board shall, as conservator or liquidating agent, and by operation of law, succeed to . . . all rights, titles, powers, and privileges of the credit union, and of any member, accountholder, officer, or director, of such credit union with respect to the credit union and the assets of the credit union.” *Id.* § 1787(b)(2) (A)(i). Among the other powers the FCUA accords the NCUA when it is acting as Conservator or Liquidating Agent are the authority to (1) operate the credit union with all the powers of the members or shareholders; (2) collect all obligations and money due the credit union; (3) perform all functions of the credit union in the name of the credit union; and (4) preserve and conserve the assets and property of the credit union. *Id.* § 1787(b)(2)(B). Significantly, under 12 U.S.C. § 1789(a)(1), the NCUA Board is also authorized, in carrying out its rights and duties as Conservator and Liquidating Agent, to “make contracts.”

The E.O. expressly provides that it shall not be interpreted “to impair or otherwise affect authority granted by law to an agency.” E.O. at § 4(b). Thus, the order, by its own terms, acknowledges that it is ultimately

subordinate to any applicable statutes. We interpret this to mean that the E.O. is subordinate to the Conservator's statutory authority to contract for outside counsel—on a contingency fee basis or otherwise. Consequently, while Congress may act by statute to impose a contingency fee ban on NCUA when it is acting as a Conservator or Liquidating Agent, we do not believe that the E.O., in light of its stated intent not to impair any authority granted by law to an agency, modifies or supersedes the NCUA's existing authority under section 1787 of the FCUA.

Policy Considerations

While we concluded that the NCUA Board as Conservator of USC and WesCorp lawfully entered into the contingency fee-based legal contracts at issue, this is not to say that traditional contingency fee arrangements are in all such instances the preferred arrangement of contracting for outside legal services. Therefore, after extrapolating what costs the firms would have incurred to date had the arrangement been on a billable basis, *see, supra*, and concluding that the NCUA's decision to proceed with a contingency fee arrangement was reasonable, we also considered, from a policy perspective, whether: (1) the NCUA adhered to agency internal practices and procedures for retaining the firms it did for the recovery litigation; and (2) the NCUA considered standards of neutrality in selecting the firms to handle the litigation. Moreover, we inquired whether the FHFA and the FDIC believe, respectively, that the E.O. applies to them and what their current position is with regard to contingency fee arrangements.

NCUA

A. Contingency Fee Deliberations

As discussed above, the NCUA informed us that in determining what type of fee arrangement made the most sense for the litigation, it considered specifically that (1) the liquidation estates (*i.e.*, the Corporates) held no money, so there was no money "up front" to finance the litigation; (2) the complex litigation and/or settlement efforts would be massive in scale, expensive, and would continue for years; (3) it was considering complex litigation against some of the biggest banks and brokerage firms in the world, which had deep pockets and would likely engage in costly and protracted litigation rather than settle; (4) the agency would be proceeding on a rather unique theory relying on statistical projections without much data on the loans contained in each security; and (5) even though there was no money available up front, the Conservator had to act quickly because of the statute of limitations and statutes of repose which had the potential to defeat many of the claims it intended to bring. The agency reported that it also considered the resources—particularly staffing resources—it would need to monitor the firms on a billable vs. a contingent fee basis for litigation of such an enormous scale, and concluded that it did not have such resources available for the former.¹¹

Moreover, we considered whether the terms of the LSA and the contingency fee arrangement gave the Conservator sufficient control over the litigation. We found that the LSA contained no provisions which might have directly or indirectly constrained the Conservator's authority over the cases litigated. Overall, we found that the LSA gave the Conservator sufficient control over the litigation and that the Conservator has, in fact, exercised and maintained that control. Moreover, the Conservator's and outside counsels'

¹¹ We considered this rationale in light of the FHFA's arrangement for monitoring outside counsel in similar litigation, on a billable basis, discussed *infra*.

conduct during the litigation to date demonstrates that the Conservator, not the law firms, is driving the strategy and the resolution of each case.

Finally, based on our interviews of and discussions with Chairman Matz, Board Member Fryzel, the General Counsel, and the Associate General Counsel, we believe that the NCUA, as Conservator, fully and reasonably considered the decision—especially in light of the uniqueness of this particular litigation—to retain the outside firms on a contingency fee basis. Given the particulars of the litigation, we found that the Conservator’s decision that the contingency fee arrangement was the most—indeed, perhaps the only—practical means for the agency to finance, obtain, and monitor the services of competent and experienced legal counsel to pursue the Conservator’s claims, was supportable as a matter of law and policy.

B. Procedures for Hiring Outside Counsel

With regard to the selection of the law firms to handle the litigation, we found that the OGC properly exercised its delegated authority to retain outside counsel. However, with regard to its formal “Procedures for Hiring Outside Counsel” (Procedures), we found that while the NCUA complied substantively with the Procedures, it did not adhere completely to them in selecting the two firms. NCUA Delegation of Authority LIQ 6, first adopted in 1979, delegated to NCUA’s General Counsel the “[a]uthority to select private attorneys or law firms to provide legal services in connection with the Board’s activities as Liquidating Agent and in conservatorships . . .” Pursuant to this delegation, OGC adopted the Procedures, last published on July 31, 1991.

The Procedures listed four objectives: “(1) insuring [sic] a high caliber of professional representation, (2) minimizing cost to the credit union and the [NCUSIF], (3) avoiding any appearance of conflict or favoritism, and (4) avoiding unreasonable delay.” The Procedures stated that “[w]here time permits, at least three attorneys or firms should be contacted to assure [sic] that the best counsel and terms are secured” and personal interviews should be conducted for cases where more than \$150,000 is in dispute. If “[f]ewer than three attorneys are contacted, a memorandum will be prepared and placed in the case files explaining the reasons.” Although the Procedures provided guidance on billing practices, they did not opine on or limit the type of fee arrangement. We also found that the Procedures were not entirely relatable to the contingency fee structure set forth in the LSA at issue herein. For example, the Procedures contemplated a two-year commitment, discounted rate structures, and prevented billing for educational training costs, terms usually associated with hourly fee arrangements.

With respect to the Procedures’ express objectives, we found that the OGC accomplished items (1) and (4). With regard to item (1), we found that, based on the documented experience and expertise of the firm partners in charge of the litigation, the firms selected were of unquestionably high legal caliber. With respect to item (4), avoiding unreasonable delay, we found supportable the agency’s explanation that, once OGC determined that the Board may have had viable claims, it needed to engage counsel as quickly as possible to preserve claims through tolling agreements.

With respect to item (2), minimizing the expense to the liquidation estates and the NCUSIF, we discussed this objective in detail above.

With regard to item (3), we discuss this element in subparagraph C., below.

However, we found that the agency did not comply with the Procedures' requirement that, where time permits, it should contact three firms before engaging representation. While multiple negotiations and interviews occurred, the OGC reportedly only interviewed the two firms ultimately selected for representation. While the General Counsel at that time has since retired, other agency counsel with knowledge of the negotiations reported that they do not believe the General Counsel contacted or interviewed any additional firms. There was no memorandum in the case file documenting the reasons for this; nor did any other agency counsel have more specific information. While we recognize that the Procedures acknowledge that some circumstances warrant fewer interviews, the failure to document the reason for contacting fewer firms was a departure from required protocol. Nevertheless, we accord some merit to the agency's collective memory that the negotiations with the two firms were likely some of the most intense OGC had ever engaged in for legal services. For example, OGC explained that in evaluating whether the Board had any viable claims, OGC had to provide the securities database to outside counsel for its consideration before signing any engagement. Further, assessing the risks of litigation involved gauging, the agency stated, (1) whether NCUA's extender statute would revive some of the Board's most valuable claims; and (2) how the Board's other liquidation strategies, to the extent known, would affect potential claims.

The OGC has advised us that, recognizing its procedures for selecting outside counsel were quite old, it is close to finalizing an updated and strengthened version of the Procedures. The OGC stated that its goal in updating the Procedures is to improve consistency in how it selects counsel, enhance recordkeeping in this area, and assure that women and minority-owned firms receive a fair opportunity to compete for the agency's business. Among other changes, the revised Procedures will also address the various fee arrangements available to the NCUA and to the Board as Conservator or Liquidating Agent. OGC indicated that it is using FDIC's established practices as a guide as it completes the process.

C. Standards of Neutrality

The OIG considered further the issue, raised by critics of contingency contracts in general, of whether the firms handling the litigation met the high standards of impartiality and neutrality required of lawyers prosecuting cases on behalf of the Government. In particular, we considered an allegation raised by a member of the press that the firms were retained based on their political affiliations, because partners and employees from both firms are on record as predominantly Democratic donors. Based on the following, we determined that the political affiliations of the law firms had no bearing on the Conservator's decision to retain them.

In the months preceding the execution of the LSA on September 1, 2009, during which time the OGC was considering the selection of law firms to handle the litigation and advising the NCUA Board concerning its deliberations, the NCUA Chairman was Michael E. Fryzel, a Republican. Mr. Fryzel served as the Chairman from July 29, 2008, until August 24, 2009. Debbie Matz, the current NCUA Chairman and a Democrat, was only sworn in as NCUA Chairman on August 24, 2009, one week prior to the execution of the LSA. Board Member Fryzel stated unequivocally to the OIG that while he was not aware of the firms' political donorship at the time the agency was considering retaining outside counsel, it did not factor into the OGC's recommendation to engage the two firms. He stated his belief that both firms were selected based exclusively on their having the requisite experience and expertise in handling litigation of the type and complexity contemplated. We note further that an OGC memorandum to the NCUA Board setting forth, *inter alia*, the General Counsel's final recommendation regarding the choice of law firms was dated August 20, 2009, four days prior to Matz' assumption of the Chairmanship. Chairman Matz

informed us that while the former General Counsel executed the LSA on September 1, 2009—one week after she assumed the Chairmanship—she was neither involved in nor otherwise privy to the prior briefings by agency counsel regarding either the retention of the two firms to litigate the cases or the decision to do so on a contingency fee basis.

FHFA

Like NCUA, the FHFA concluded that it [the FHFA] is not bound by the E.O. because it is a conservator. Nevertheless, it acknowledged the prevailing government policy under the E.O. that outside counsel should be retained on an hourly basis. Indeed, the FHFA informed us that when it was looking to engage outside law firms for its own MBS lawsuits,¹² public concern about contingency fees was on the FHFA's radar screen, as a result of the recent mass settlement between BNY Mellon and Bank of America, led by Kathy Patrick of the Houston-based law firm, Gibbs & Bruns.¹³ The FHFA explained further that its decision to retain outside counsel on an hourly basis for the MBS lawsuits relied in large part on the agency's ability to monitor the law firms retained. In particular, the FHFA was able to assemble a fee review group comprised of a contingent of attorneys from the FHFA, Fannie Mae, and Freddie Mac. The reviewers routinely scrutinize—and, as necessary, challenge—fees charged. Indeed, the FHFA indicated that it relies upon attorneys from Fannie and Freddie to conduct the lion's share of the fee review work. It emphasized that, but for the Fannie and Freddie attorney reviewers, and an outside fee-oversight firm it has retained, the FHFA would not have had the necessary legal resources to monitor a fee based arrangement to the extent necessary for such enormous and complex litigation. The FHFA also indicated that at the time it entered into the legal agreements with outside counsel, it was in a strong bargaining position to negotiate lower billable hour rates. Overall, the FHFA stated, based on the size of the recoveries at stake, its ability to negotiate fixed and/or lower rates, as well as the ability of the fee review panel to control litigation costs (*i.e.*, monitor the law firms retained), the FHFA determined that it was well situated to enter into a fee based arrangement.

FDIC

The FDIC explained to us that in June 2007 its Legal Opinions Unit looked at whether the E.O. applied to the FDIC and concluded that it did not. While it declined to share a copy of that legal opinion with us, an FDIC attorney paraphrased the opinion, explaining that the FDIC has independent litigation authority and the E.O., by interfering with the way FDIC can litigate under its own statute, would in effect impair that authority. He went on to state that the E.O., by its own terms, provides that it “shall not be construed to impair or otherwise affect authority granted to an agency.” The attorney we spoke with further declined to confirm or deny that it was the FDIC's current policy to avoid contingency fee arrangements.

Summary

To summarize, we believe that the contingency fee arrangement the Conservator entered into with the firms was a cost effective arrangement, was reasonable in light of the uniqueness of the litigation, and did not result in member credit unions paying, in effect, unnecessarily high legal fees. Moreover, we believe

¹² The FHFA, in its capacity as Conservator of Fannie Mae and Freddie Mac, has filed claims against 18 of the largest issuers of MBS in the United States.


¹³ Under the terms of the legal services (contingent fee based) agreement, Bank of America paid \$85 million in legal fees to Gibbs & Bruns.

The Honorable Darrell E. Issa
Chairman Committee on Oversight and Government Reform
U.S. House of Representatives
2157 Rayburn House Office Building
Washington, D.C. 20515-6143
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that NCUA, when it entered into the LSA with the firms, sufficiently considered the relevant public policy objectives in light of the potential negative impact of contingency fee arrangements on the interests of member credit unions. Finally, we found that the E.O. does not cover the NCUA when, in its capacity as Conservator or Liquidating Agent, it enters into a contract for outside legal services on a contingency fee basis.

Please let me know if we can provide further assistance. We welcome the opportunity to work with the Committee and Congress in identifying waste, fraud and abuse in government operations.

Sincerely,

A handwritten signature in black ink, appearing to read "William A. DeSarno", with a long, sweeping horizontal stroke extending to the right.

William A. DeSarno
Inspector General

Attachment

Cc: The Honorable Elijah Cummings, Ranking Member